

Research Report
**Protection for Sale, Chinese Style: Political
Economy of China's Trade Liberalization**

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1 Purpose of Research

With the remarkable increase in the volume of trade China has with her East Asian neighbors and other advanced industrial economies, understanding how China makes her trade policy has become more and more critical to Chinas trade partners. While the entire world celebrates Chinas opening door to foreign investments and liberalizing her trade regime to rejoin the world economy, not too much attention has been paid to an interesting set of variations in the level of Chinas trade protection across different industries. The research project is motivated by this question of why particular industries received higher trade protection in both tariffs and other non-tariff barriers such as subsidies and quotas. In addition to the puzzle of cross-industry trade protection per se, the second purpose for adopting this industrial approach to understanding Chinas trade policymaking is to unlock the black box of her political system.

In terms of the academic significance of this research project, the project is going to help us better understand the economic policymaking in an authoritarian regime. The research on the political economy of trade policymaking has made remarkable progress after two important trade economists, Gene Grossman and Elhana Helpman developed the famous Protection for Sale model that greatly helps people understand how special interest politics can determine the cross-industry structure of trade protection. Their model, however, is geared towards explaining the trade politics in democracies. Chinas emergence as a major trade nation has posed an unprecedented challenge to trade scholars in academia. The authoritarian nature of Chinese government doesn't make the special interests less salient in Chinas politics of economic policymaking. Therefore, the lack of political economic models on non-democracies has left an academic niche for this research project to make a great contribution.

On the other hand, as far as the social significance of this research project is concerned, the project has at least two following important social implications. First of all, as China

becomes one of the major trading nations, understanding how China's trade policy has been made since late 1970s is critical to governments having close trade relationship with China. The result of the research can help adopt a more effective strategy towards China. Second, more importantly, the knowledge about the interaction between China's domestic politics and her foreign economic policymaking will be extremely helpful to private firms that have large investment in China. The research project can make multinational firms more well informed about the political and economic interest of important political actors in China and the ways in which they can move China's trade policy regime towards a more favorable one to them.

2 Content/Methodology of Research

Simply put, the motivation of this research project is the puzzle of different levels of trade protection received by different industries. The conventional wisdom points us to the grand development strategy adopted by developing nations. Under this perspective, macro-level theories such as export-led industrialization, import-substitution, and infant industry argument form the cornerstone upon which the cross-industry variations in trade protection are understood. Applying these views to China, however, is going to leave politics entirely out of the explanatory framework. The basic assumption behind these views is that the decision-makers are all economically rational and only care about the general social welfare. A closer look at China's policymaking process will, nevertheless, show they are actually quite politically rational and don't necessarily bear any concerns for the general social welfare in mind.

This research project aiming at understanding China's cross-industry variations in trade protection will put the interaction between trade-related bureaucratic agencies and state-owned enterprises (SOEs) in the center of the explanatory framework. The fact that industrial outputs of China's state-owned enterprises still account for a large portion of the Chinese economy nowadays makes it difficult to ignore both economic and political roles SOEs play in China's economic policymaking process. Both trade protection and fiscal transfers including bank loans from the government are regarded as SOEs' available options in their tool kit to keep them financially afloat when facing economic loss. Therefore, when governmental fiscal transfers are not available to SOEs, trade policy will become the most important avenue for them to retain economic rent. SOEs are then predicted by our theory to lobby the government for trade protection either through raising tariffs or imposing quotas.

In order to answer questions raised above, my methodology, following what a Stanford political scientist, David Laitin, termed the tripartite method, is composed of three parts, formal theory, comparative case studies, and statistical analysis. In the first place, in order to have a more solid theoretical underpinning, the research project will develop a revised Grossman-Helpman model that both incorporates China's institutional features and keeps the lobbying structure from the Grossman-Helpman model. Second, a statistical model testing different hypotheses derived from the model will be conducted in order to both strengthen the empirical underpinning and make effective causal inference. Finally, detailed case studies of auto, steel, and tobacco industries will also be conducted to demonstrate the formal logic highlighted in the formal model. In this final part, the project will mainly use in-depth interviews with government officials, Chinese economists, and managers in the SOEs to complete the entire picture of Chinese political economy.

3 Conclusion/Observation

With your generous support, the year-long field research in various cities in China had helped me collect useful data for testing the hypotheses derived from my theoretical framework from various interviews with both government officials and foreign investors. First of all, from an first-cut analysis, the agency problem in China's trade policymaking is serious. It's not only because the sheer size of China that makes it difficult to monitor the behavior of local Chinese officials, but also because its lack of institutional arrangements for political accountability and transparency. While, by definition, the authoritarian political system concentrates the political power in the hands of the top political leaders and therefore also imposes a hierarchical order on different levels of government, this authoritarian institutional feature apparently does not make policy implementation and coordination an easier task for the Chinese government as opposed to its democratic counterparts. The lack of formal mechanisms for holding the local political authority accountable to its citizens and foreign investors alike, in fact, makes the informational costs substantially higher than democratic countries. As a result, my interviewees constantly complained about the discrepancies between what central policies dictate and how they are implemented locally. This defies the popular perception of an authoritarian regime that it can be more efficient than a democratic one for having less political distortions from electoral processes.

Second of all, given the serious agency problem within the government, I also found that bureaucratic agencies in China are functionally very similar to special interest groups in democracies. While China launched her economic reforms in various areas 30 years ago, her government structure remains largely intact, and this socialist legacy has made its various ministries representatives of different industrial interests. As a result, even trade unions, which are normally the major lobbies for government favors in democracies, play very minor role in China's policymaking processes, the ministries managing particular industries are functional equivalents lobbying for government favors in China.

These are two major findings on which my further analysis will be based.