Trade Policy and Consumer Welfare: A Case of China

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The purpose of the study is to examine how Chinese government values consumer's welfare during and after the process of China entering WTO. To honor the WTO commitments, Chinese government must reduce its general tariff level. Tariff, as one of the most important trade policies, affects government objective function in a direct way. Thus, those interest groups included in the government objective function could be affected when policy changed. All consumers, as an interest group, are poor organized to pursue their welfare. We can only study changes of the weight that Chinese government put upon them and to find the reason for the changes.

Based on the "Protection for Sale" model, governments are making trade policies to balance the government objective function—profits of different interest groups. Political economy analysis is suitable for China because Chinese government is always seen as a highly centralized one. Government objective function is closely related to policies it implements. The government is choosing tariff level to maximize its objective function. The equilibrium tariff is determined by the degree of concern of Chinese government on different interest groups. There are four interest groups—consumers, state—owned firms, local governments and the central government. The game between central and local government, as the central government wants more tariff revenue and local governments want to tax the foreign direct investments (FDI), influence the decision of foreign firms whether to directly invest in China or to export to China, which in turn affect the weight government put upon consumers.
A panel data of 28 provinces in the period of 1999-2006 is used to fit the econometric model. Data used were from provincial statistical yearbooks, Chinese Statistical Yearbooks and Chinese trade data obtained from the Customs General Administration. Using TSLS (Two Stage Least Square) and IV (Instrument Variables) method, we regress the state—owned firms' output share of total output on multinational share, imported goods share, a fixed effects of provinces, and other control variables. We calculate the weights using the estimated coefficients.

We find that state-owned enterprises weight witness a slight decline while consumer welfare increases, which is evidenced by the tariff downturn after entering WTO. From 1999 to 2006, the weight on consumers was only 0.179. But it increased to 0.195 from 2000 to 2006，and reached to 0.916 from 2002 to 2006. Consumer welfare is becoming more and more important in the government objective function, but it might have little to do with the central government kindness. It reflected the gaming between central and local government, as the central government wants more tariff revenue and local governments want to tax the FDI. The reason may be a sharp reduction of general tariff around 2001 China entering the WTO increased quantity of imported goods and thus increased consumer welfare. Since more fierce trade wars happened after China entering WTO, a better trade policy making system should be developed to meet needs of all involved parties.

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