
China's Protective State measures¹ in the Crisis Era: Motivation and Effect

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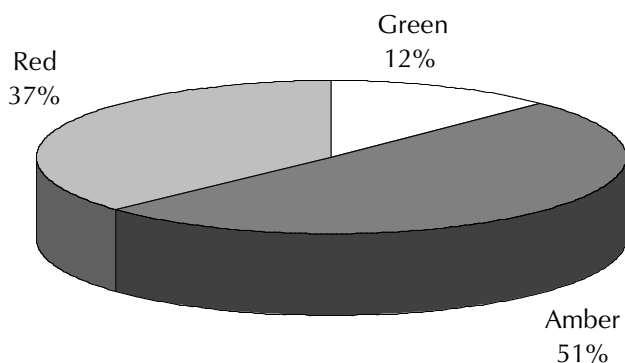
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1. Introduction

1.1 Global protectionism in the crisis-era

The US subprime mortgage crisis eventually induced global financial turmoil, which in turn led the world into the most severe downturn since the Great Depression. In the current crisis era, there has been unprecedented government intervention on a large scale. With governments endeavouring to protect national economies and domestic industries, protectionism has staged a comeback. According to the Global Trade Alert (GTA), since the First G20 Crisis-Related Summit, 1,155 policy changes have been taken in 611 announced state initiatives. Among them, only 12% are found to benefit foreign nations or involve no changes in the treatment of foreign commercial interests², while the rest (88%) are likely to³, or will almost certainly⁴, discriminate against foreign interests (see figure 1).

Figure 1 State Measures classified by GTA (by the end of November 2009)



Source: Calculated from the GTA database.

1 In this paper, we define the protective state measures as those that are damaging or damage foreign commercial interests. Roughly speaking, these measures include GTA's amber and red measures. The colour coding scheme used in the GTA database is described in Chapter 2 of this report.

2 These measures are classified "green" in the GTA database.

3 These measures are classified "amber" in the GTA database.

4 These measures are classified "red" in the GTA database.

There are several characteristics typical of contemporary protectionism. First, current protectionist measures are much more flexible and covert. Except for the traditional trade remedies (such as antidumping, countervailing and safeguard actions), more murky trade barriers (for example, certain forms of intellectual property protection, migration measures, public procurement rules, technical barriers to trade, etc.) have been implemented, which leaves less room for exporters to secure access to customers in protected markets. Second, protection has been extending to the cross-border movement of capital and labour, not just goods and services. Third, more measures are specifically devised against China, which is manifested, amongst others, by the high frequency of the special-safeguard measures.

Under such circumstances, the emerging export-oriented economies have been suffering. However, some developing countries have also turned into active implementers of protectionist measures. According to the GTA, developing economies⁵ have taken 59% of the red measures and 55% of the amber measures⁶. Russia, Argentina, China, India, and Indonesia are now among the top 10 countries to have imposed the most harmful discriminatory measures.

1.2 China's resort to protective state measures during the crisis

Since 2007, China has adopted a more "neutral" foreign policy, aiming to achieve moderate, balanced export and import growth. Due to the negative impact of the crisis on the domestic economy, a sharp decline of trade volume since the third quarter of 2008, and growing foreign trade discrimination, China adjusted its policies somewhat more towards a protective dimension. Between December 2008 and November 2009, it announced or implemented 29 state measures, of which only 3 were green measures, whilst 15 were amber measures and 11 were red measures⁷. There were 23 sectors, 331 tariff lines and 164 trade partners affected by the red measures.

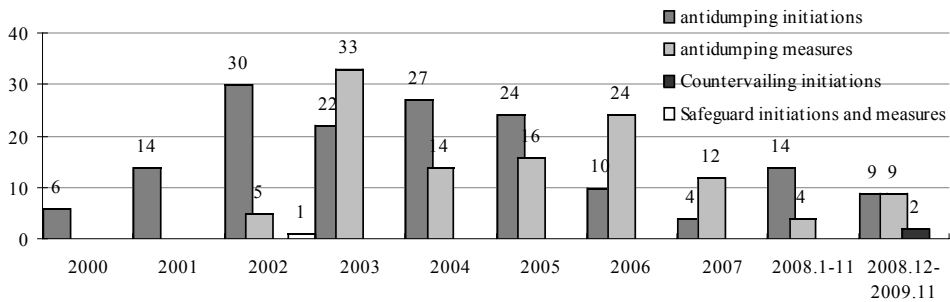
Despite the large number of affected trade partners it should be made clear that, with the exception of antidumping and countervailing, China's protective state measures have not discriminated against specific trading partners. Theoretically speaking, these measures set identical thresholds to foreign goods, services and investments. Furthermore, only 27 economies were affected by Chinese defensive measures towards domestic commercial interests, while the other 137 economies were damaged by the other measures. Moreover, figure 2 demonstrates that the frequency of Chinese antidumping usage has declined during the past 11 months. Such evidence reveals that China's contemporary state measures do not target countries but seek to mitigate external shocks. Still, most of these measures were devised to protect certain industries. And whilst these measures directly or indirectly provide domestic producers in targeted industries with preferential treatment or incentives, they are discriminatory.

In terms of the form of protective measures, China has not followed the powerful trend towards "murky protectionism" found in the industrialized world. The GTA's database reports that more than half of China's harmful measures were trade defence measures, such as antidumping, countervailing and safeguard actions. The remaining

5 The classification is based on the World Bank's definition on the developed and developing economies.

6 Both red and amber measures are thought to be harmful by GTA.

7 Source: GTA database.

Figure 2 China's implication of defense trade measures (2000~2009.11)

Source: WTO database and the announcements of Chinese Ministry of Commerce.

measures, which are intended to enhance the competitiveness of Chinese companies or industries, include export taxes or restrictions, investment measures, local content requirements, public procurement privileges, tariff measures, and the imposition of non-tariff barriers. Thus far, it could be argued that China's protective state measures are predictable. To give further clarification in this respect, figure 2 shows that among China's trade defence measures, antidumping actions have appeared with higher frequency, whereas the countervailing and safeguards, which are generally thought to be more harmful and less transparent, are seldom implemented.

2. Motivation for China's protective state measures

Protective state measures are far more than a purely economic problem; they should be analysed in a political economy framework. Generally speaking, there have been four motivations for China to take protective actions during the crisis: balancing multiple policy goals; maintaining the fair trade; strengthening industry competitiveness; and trade retaliation.

2.1 Balancing multiple policy goals

Chinese macro-economic policies have multiple goals. Given the background of a global financial crisis, employment, growth and industrial restructuring are priorities for policymakers. Under pressure to relieve the negative impact of the crisis, China's neutral foreign policies took a somewhat protective tilt.

With respect to employment, existing jobs were significantly affected by the financial crisis and appeared to decline remarkably. According to a sample survey conducted by the Chinese Ministry of Human Resources and Social Security (MORHSS), between October 2008 and January 2009, an average of 40% of companies had experienced a net shrinkage in jobs. Migrant workers, especially those in the coastal export-processing enterprises, bore the brunt of the impact of the financial crisis. According to the survey of the National Bureau of Statistics, in February 2009 there were more than 12 million migrant workers (accounting for 8.5% of the total) that had temporarily lost their jobs and returned home due to the impact of the financial crisis. At the same time, the registered urban unemployment rate rose, reaching new

records for the past three years. As the labour-intensive, export-oriented industries are the main employers for the surplus labour force, some protective policies were undertaken and targeted at stabilising and enlarging the relevant industries, such as the restructuring of the equipment manufacturing industry⁸ and the increase in VAT rebates for exporters⁹.

In terms of economic growth, the contraction of exports was a major negative factor. In November 2008 China's exports experienced their first decrease in total value in seven years, a fall which then accelerated. By August 2009, the peak-to-trough percentage decline of total exports reached 22.2%. Given the high degree of export dependency of the Chinese economy, this plunge brought about great macroeconomic difficulties and dislocation. In order to alleviate such pressures, the government introduced policies with the objective of boosting exports and stimulating domestic demand. The related trade protective measures included the local content requirements¹⁰, public procurement schemes,¹¹ restructuring of equipment manufacturing industry, and the increase of VAT rebates for exporters. Industrial restructuring to develop the advanced and high-technology commercial activities represented another direction of adjustment. Consequently, incentive measures have been imposed, including the restructuring of the ship-building industry¹² and the increase in the export-tax rebates granted to producers of high-technology and high-value added equipment, and for the abolition of import tariffs on key components of these technologies and on raw materials.¹³

2.2 Maintaining fair trade

The second motivation for China's protective measures is to maintain fair trade. This target has been achieved using antidumping investigations, all in line with WTO rules. Between December 2008 and November 2009, China initiated 9 antidumping investigations and took 9 antidumping measures, most of which were against raw chemical materials and chemical products. In fact, these products have always been the targets of anti-dumping investigations worldwide. In the case of China, some foreign companies, in order to seize the Chinese market, have taken to dumping which has resulted in serious harm to their Chinese rivals. Overall, China actively took trade remedy measures in order to protect the state and relevant corporate interests.

The example of China's antidumping against methanol helps to explain the factors motivating policy. Since 2008, China's methanol imports have surged. In the first four months of 2009, the total import of methanol was over 2 million tons and the

8 On 12 May 2009, Chinese Ministry of Information Industry (MII) issued a Planning Release entitled *Restructuring and Revitalization of Planning for the Equipment Manufacturing Industry*.

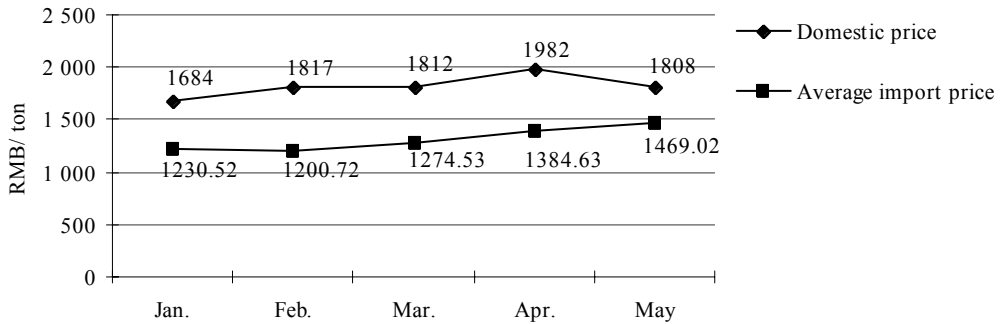
9 On 1 April 2009, Chinese Ministry of Finance and State Administration of Taxation published a Notice in which it was stated that the rebates to exporters from Value Added Tax would be increased.

10 On 26 May 2009, the National Development and Reform Commission (NDRC) officially announced its implementation of measures to ensure that local content would be prioritized in government contracts.

11 On 10 April 2009, the General Office of the State Council issued GUOBANFA (2009) No. 35, titled *Opinions for Further Strengthening the Management of Government Procurement*.

12 On 6 June 2009, Chinese Ministry of Information Industry (MII) issued a Planning Release entitled *Restructuring and Revitalization of Planning for the Ship-building Industry*.

13 On 12 May 2009, Chinese Ministry of Information Industry (MII) issued a Planning Release entitled *Restructuring and Revitalization of Planning for the Equipment Manufacturing Industry*.

Figure 3 The Price gap between domestic and imported methanol, January-May 2009.

Source: CHEMINFO database. Note: The exchange rate: \$1=RMB6.8.

sales of foreign products in the domestic market increased by 838.3%, a manifestation of dumping. Behind the surge of imports, there was a large price gap between the domestic product and its foreign competitor (see Figure 3). The quantity of dumping and the abnormally low price of methanol have damaged the corresponding domestic companies and industry. According to the Chinese Petroleum and Chemical Industry Association, during the first quarter of 2009, the local methanol companies' average operating rate was only about 30%, and 90% of them saw their losses expand. Between January and April 2009, domestic methanol consumption increased by 51.5% while the production in the first five months of this year fell by 11.2%. Following WTO rules, the Chinese Ministry of Commerce initiated an anti-dumping investigation into the imports of methanol from Saudi Arabia, New Zealand, Malaysia, and Indonesia on 24 June 2009. This investigation sought to correct the distorted methanol market.

2.3 Strengthening industry competitiveness

Cultivating or strengthening industry competitiveness is another reason for protection. It is argued that proper protection in an open economy will help the emerging domestic industries to gain competitiveness. Some of China's recent protective trade policies were based on that premise.

Taking the dairy products as an example will explain the above logic for protective measures imposed in the crisis era. Seen comparatively, the Chinese dairy industry has a low competitiveness¹⁴ and faces great pressures from foreign rivals. During 2009 the international milk powder price declined rapidly. The import price dropped from its peak of \$4,565/ton in March 2008 to \$2,155/ton in May 2009, a fall of 52.79%. Accordingly, Chinese imports soared. In the first five months of 2009, China's import of milk powder reached 106,638 tons, a rise of 152.57% over the same period of the previous year. A large amount of cheap foreign milk powder threatened Chinese competitors, whose costs were around \$30 000/ ton. To retain more space for the domestic manufacturers, the Chinese Ministry of Commerce announced that it would impose automatic import licensing on fresh milk, milk powder, and whey from 1 August 2009. The restriction on import volume may help the domestic companies to

¹⁴ The revealed competitive advantage (RCA) index for Chinese dairy industry is 0.1, which should be explained as lack of competitiveness.

expand scale, so as to cut costs and gain competitiveness.

Similar to the restrictions in the dairy industry, China's ban on foreign entrants to the express business postal services sector provides another example of changed policy stance. Maintaining an average annual growth of over 20% in recent years, the express postal industry is one of the fastest growing sectors in China. As of April 2009, there were more than 2,000 express service providers and 7,000 branches. Despite this large number of providers, most companies were small-scale, which caused excessive competition and lower efficiency in the sector. In 2007, the volume of parcels and express post sent by Chinese companies was only 1.5 billion, which is one-fifth of that of comparable US companies. Statistics shows that UPS, FEDEX, DHL, and TNT, the four major international logistics giants, had together taken more than 70% of the Chinese market. To change the situation, China adopted a new Postal Law on 24 April 2009. Through preventing foreign capital from entering the express postal service and raising the entering threshold for local companies, the new law seeks to enhance Chinese companies' competitiveness in the corresponding field.

2.4 Trade retaliation

Trade retaliation is a special protective method for China during circumstances of global protectionism. China has retained the record for being the biggest victim of antidumping actions for 14 consecutive years and of countervailing actions for three years. Even though it suffered from many strict foreign trade restrictions, China seldom took revenge. However, this mild attitude was not reciprocated with accommodative trade conditions. Indeed, 35% of antidumping and 71% of anti-subsidy actions were against Chinese exports in the first three quarters of 2009. Under these circumstances, trade retaliation became one of the options for the Chinese government in the struggle for a better trading environment.

A typical case of Chinese trade revenge is the tyre wars with the US. On 11 September 2009, the U.S. government decided to impose a 35% anti-dumping tariff on Chinese tyre exports. On 13 September 2009, China launched anti-dumping and anti-subsidies investigations into automobiles and chicken meat originating from the United States. The implementation of China's trade counteraction does not indicate a preference for an all-out trade war, but is more a means of curbing the protectionist tendencies of some trading partners, and in so doing, facilitate international trade in order to create a more stable, predictable environment for development.

3. Effect of China's protective measures

3.1 Helpful in achieving the macro-economic goals

During the crisis, China has launched a series of protective state measures, which have played an active role in achieving macroeconomic objectives. First of all, these policies were helpful in reversing the rapid decline of Chinese exports. Statistics show that the percentage export contraction began to turn around in September 2009, and kept growing for the seven consecutive months (see table 1). In particular, the highly-protected, labour-intensive products have led to resumed export growth.

Table 1 Chinese export between October 2008 and October 2009

	Export (thousand US dollars)	Accumulated Export (thousand US dollars)	Accumulated Growth Rate (%)
Oct. 2008	128,327,028	1,202,330,946	21.9
Nov. 2008	114,987,285	1,317,161,607	19.3
Dec. 2008	111,157,222	1,428,545,709	17.2
Jan. 2009	90,453,600	90,453,600	-17.5
Feb. 2009	64,894,649	155,325,420	-21.1
Mar. 2009	90,290,547	245,539,934	-19.7
Apr. 2009	91,934,722	337,420,869	-20.5
May 2009	88,757,886	426,142,046	-21.8
Jun. 2009	95,411,208	521,531,055	-21.8
Jul. 2009	105,420,240	627,097,202	-22.0
Aug. 2009	103,707,009	730,736,122	-22.2
Sep. 2009	115,937,994	846,649,410	-21.3
Oct. 2009	110,762,383	957,360,575	-20.5

Source: Statistics of Chinese General Administration of Customs.

Secondly, the above-mentioned measures have effectively limited export volatility in labour-intensive sectors, thereby becoming positive factors for maintaining employment and growth. According to Customs, the decline of Chinese labour-intensive exports was 20.5% less than that for aggregate exports. Between January and October 2009, the export of clothing and accessories dropped by 10.9%, textile products by 12.9%, footwear by 6%, plastic products by 8.4%, and toys by 11.3%. In contrast, China's export of electrical products fell by a larger measure of 18.6% during the same period.

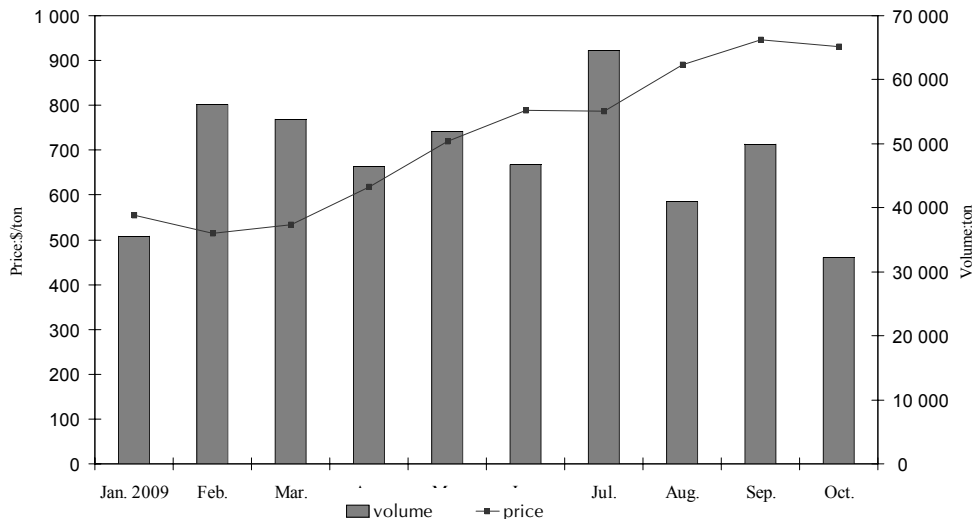
Thirdly, these measures helped to stimulate domestic demand and so have contributed significantly to the Chinese government's goal of "guaranteed growth". It is worth mentioning that the restructuring plans for ship-building and equipment manufacturing industries are seen as essential measures. Their supplier industries are situated upstream of traditional manufacturing industries. By providing the producers of the final consumer goods with capital and technical know-how, they have generated strong knock-on effects on surrounding industries. All of these measures will be conducive to achieving an 8% growth rate of GDP during the crisis-era and afterwards.

3.2 Effective on protecting domestic industries

Antidumping represents a large share of Chinese state measures taken during the crisis. Anti-dumping duties, like the ordinary tariff, will often raise the domestic price of imported goods and reduce imports. By doing so, it can enlarge the space for domestic industries to develop. Since December 2009, most of the antidumping investigations or duties have had the anticipated impact on import prices. In the case of phenol¹⁵, after the announcement of antidumping duties, the import price rose from \$513.9/ton in February to \$931.3/ton. At the same time, the import volume,

15 Chinese Ministry of Commerce announced the antidumping duties on phenol origin from Japan, Korea, US and Taiwan on February 1 2009.

Figure 3 Import volume and price of phenol (2009.1~2009.10)



Source: Statistics of Chinese General Administration of Customs.

although not so sensitive as the price to the antidumping duties, tended to decline (see figure 4). In most of the other antidumping actions, there existed a similar adjustment on import price and volume of the relevant products. In summary, antidumping measures improved the business condition for the damaged companies and enhanced their competitiveness.

Quantity restrictions, for example the automatic import licensing of dairy products, are another form of state measure imposed with the aim of protecting certain industries. Such restrictions are also efficient at squeezing out room for the development of upstream industries. Since the imposition of restrictions on dairy goods, the imports of milk, milk powder, and whey have dropped significantly. To compensate, domestic production has been raised. Statistics show that profitability has returned after one-year of losses in the dairy industry. Meanwhile, the domestic dairy producers recovered with higher production and better quality. In September 2009 alone dairy production increased by 30.92%.

3.3 Ineffective in deterring foreign protectionism

During the crisis, one of the rationales for undertaking China's state measures is to curb foreign discriminatory measures against Chinese exports. However, current steps have not reached the expected results. Compared with other times in history, there is no apparent decrease in antidumping and countervailing actions against Chinese exports. China is still the biggest victim of such damaging foreign measures. According to the GTA, during the crisis 284 unfavourable foreign measures have been announced or implemented against China.

Perhaps one of the reasons for this outcome is that most Chinese policies do not target particular trading partners, or maybe even the right trading partners. For sure,

some of China's protective measures concentrate on products originating from its major trade partners: Japan, South Korea, EU, and U.S. The fact is, however, that many of the discriminatory measures taken against Chinese products have been initiated by other economies including India, Russia, Argentina, and Turkey¹⁶. It is therefore evident that China could hardly prevent the latter unless it takes actions which clearly target those economies that frequently target Chinese commercial interests.

4. Conclusions

During the financial crisis, China has put forward a series of protective state measures aimed at providing itself with stable, sustainable, and predictable external conditions for development. In this regard, Chinese state measures are of the nature of moderate protection. It has been argued that these moderate protective policies were effective in solving the employment, industrial nurturing, and economic growth-related challenges facing China, but lack effectiveness in overcoming external difficulties. In particular, these policies were not enough to change the fact that China is suffering disproportionately under global protectionism. At present, the intensity and frequency of China's protective measures are much less than the attacks it is facing. Chinese protective policies are far from curbing the foreign protectionism attacks. In the future, China should devise policies with more externalities so as to increase its bargaining counters in international negotiations, and strive for a more friendly international environment for development.

Most of China's protective measures in the current crisis era have not been clearly targeted against specific trading partners; even the trade-remedy actions taken were rather more defensive than offensive. Meanwhile, such policies have identified definite sectors and goals to protect, and therefore have become predictable. In addition, China's state measures during the financial crisis can be classified into two forms: industry policies and trade remedies. Among them, the former aimed at achieving multiple macro-economic goals. Abiding by WTO's rules, the latter was expected to facilitate fair and stable trade and to eliminate possible industrial damage. Accordingly, Chinese state measures taken during the financial crisis, although to a certain degree protective, are much less damaging than traditional protectionist measures.

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¹⁶ According to GTA, the top 10 economies that have discriminated against China are Korea, Japan, United State, EU, Russia, Malaysia, Mexico, New Zealand, Philippines and Thailand.

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