# Trade Creation, Political Sensitivity and Product Exclusions:
## the Political Economy of Agriculture Protection in China's FTAs

**Jianxing LYU**

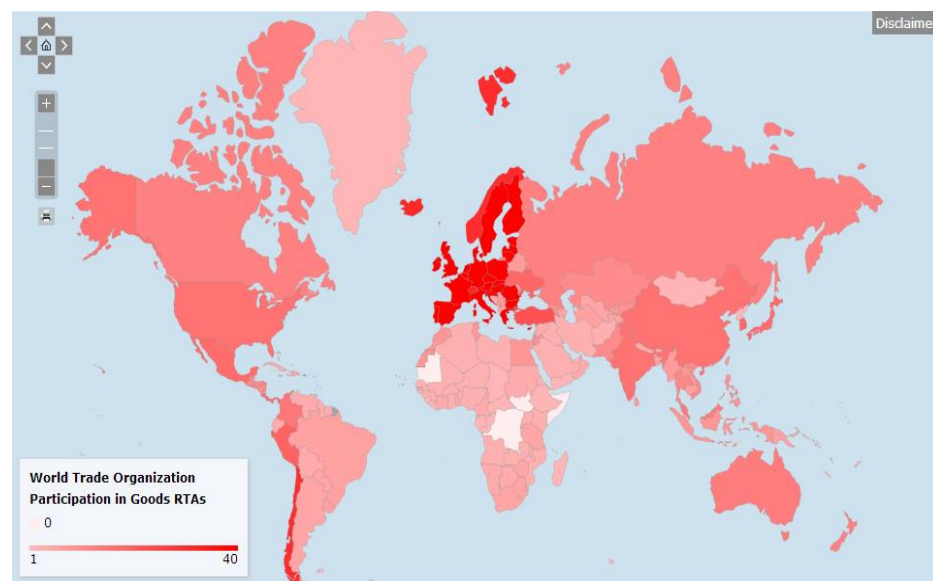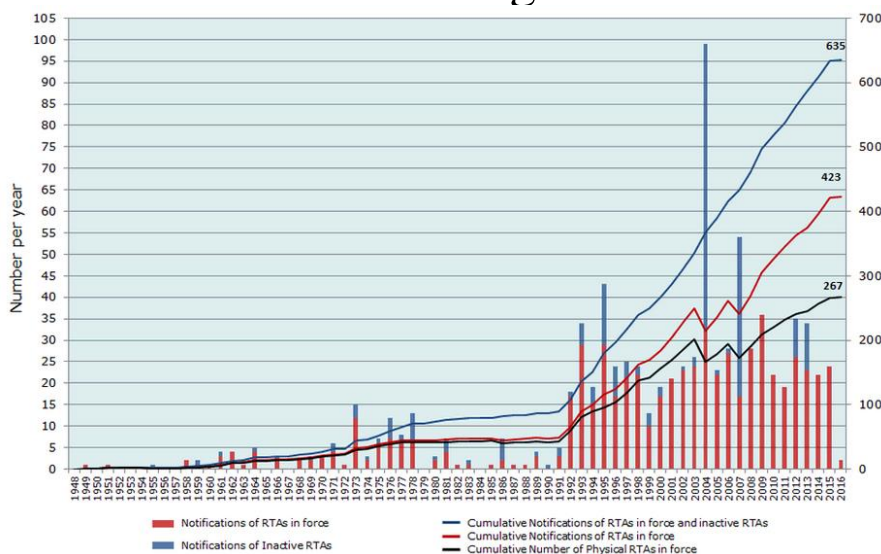**Renmin University of China**

**Guangzhou University**

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# Outline

- 1. Introduction
- 2. The stylized facts in China's FTAs
- 3. Theoretical framework and hypotheses
- 4. Econometric specification and data
- 5. Results
- 6. Conclusions

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# 1. Introduction

- Since the beginning of the 21st century, multilateral trade negotiations have reached a temporary impasse under the WTO, regional trade agreements (RTAs) have become increasingly prevalent.

- Almost all countries are involved in at least one of the preferential agreements.

- Up to December 1st, 2016，423 RTAs have been in force，more than 200 RTAs are under negotiation。



Source：WTO RTAs database

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- To adapt to the rapidly changing global economic environment;

- To facilitate the domestic economic structural transformation, China has been accelerating and promoting the negotiations of RTAs as well.

- Until December 31$^{st}$, 2016, 14 RTAs have been signed by China with other 22 countries/regions, and 9 free trade agreements (FTAs) are being negotiated.

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# 1. Introduction-continued

- US(NAFTA): sugar, citrus

- China(China-ASEAN FTA): rice, oil, sugar, tobacco, cotton, etc.

- Iceland(China-Iceland FTA): milk and cream, potatoes, blood and liver sausages, etc.

- Excluded or not?

-  Why?

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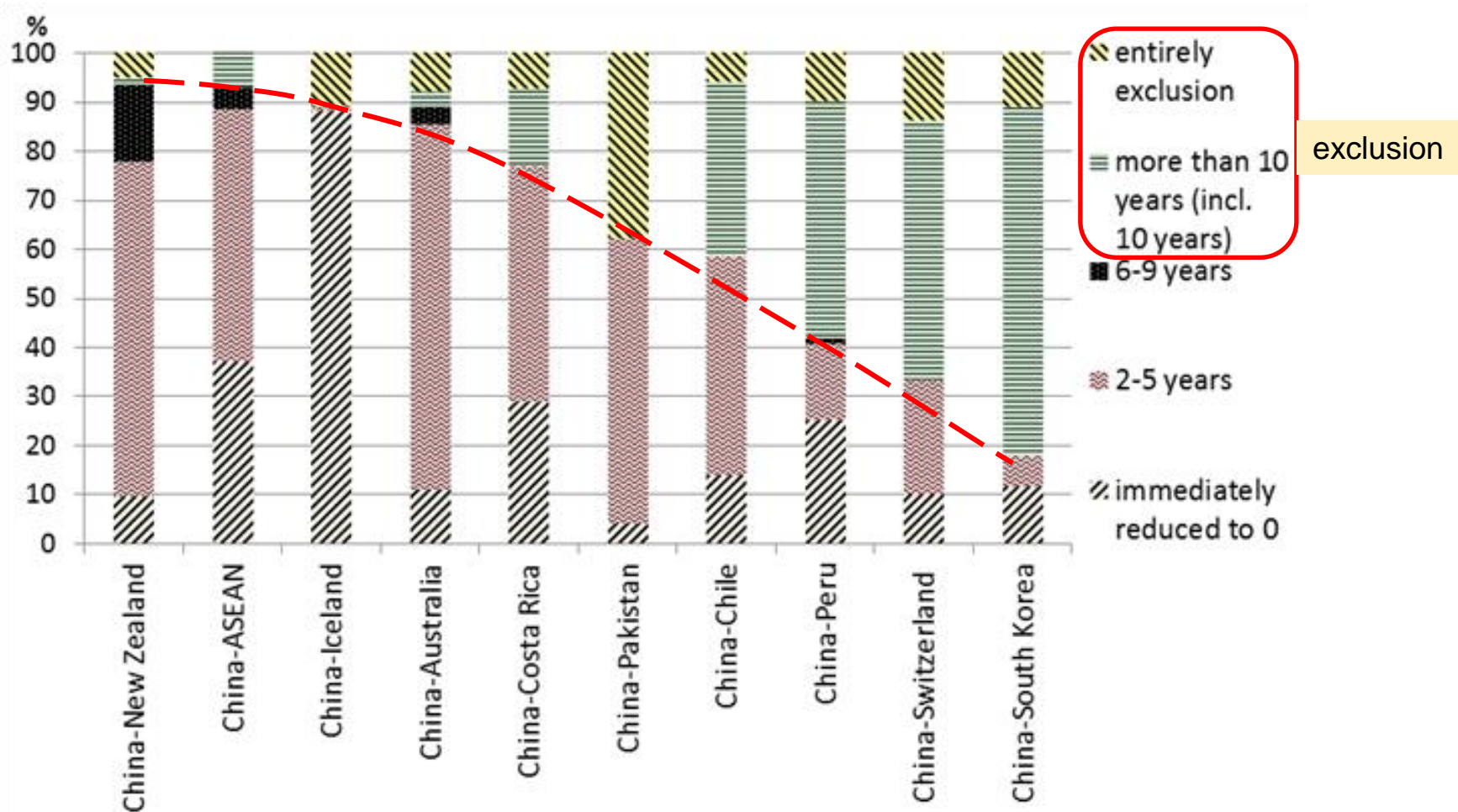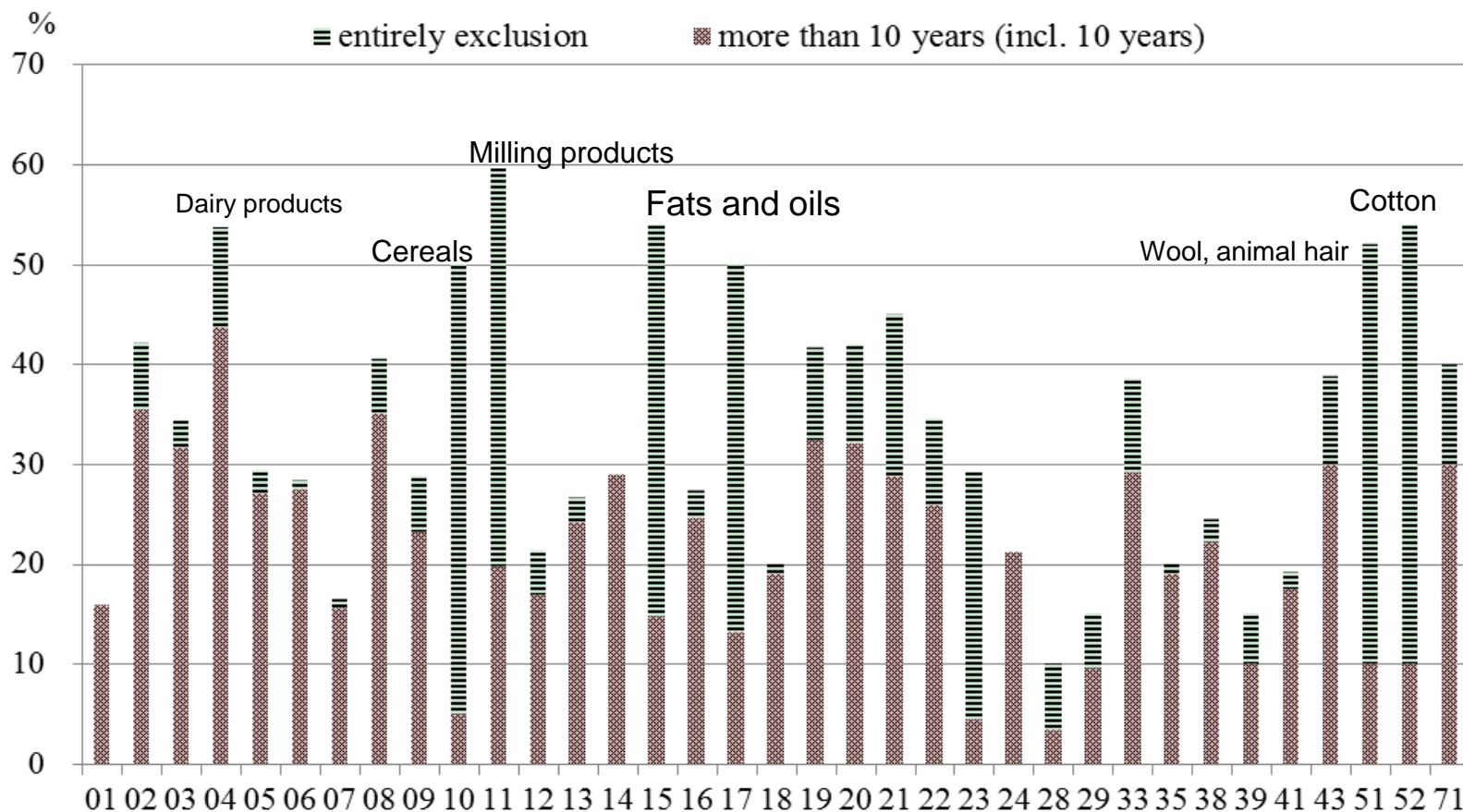
# 2. The Stylized facts in China's FTAs



Figure 1: The average tariff reduction of agri-products in China's FTAs

# 2. The Stylized facts in China's FTAs-

Figure 2: The HS section distribution of sensitive agri-products in China's FTAs

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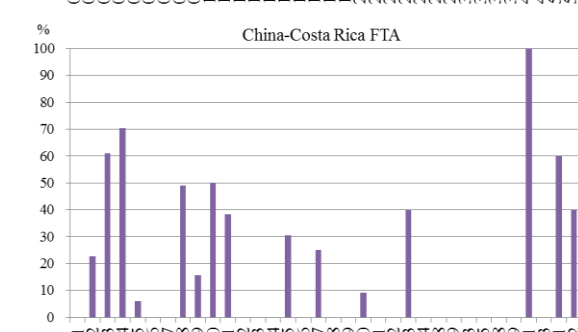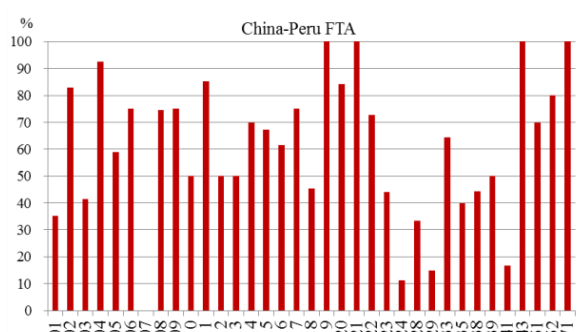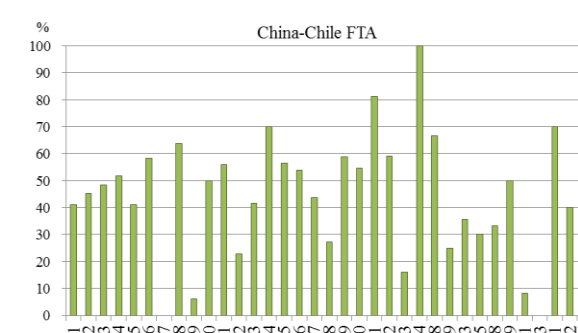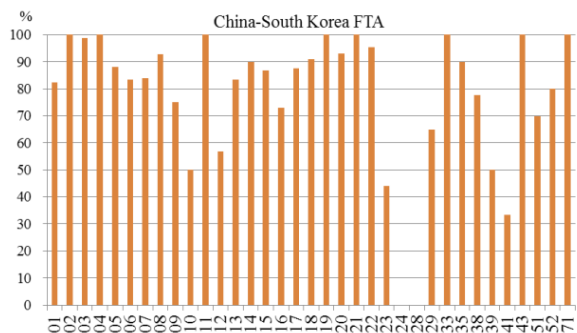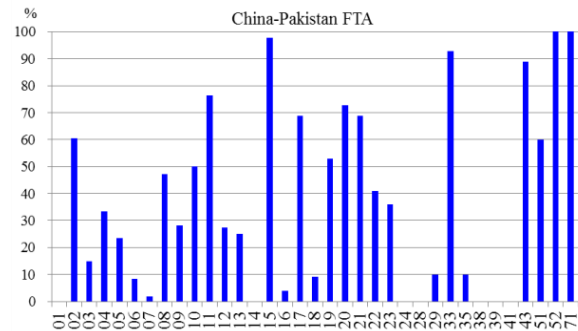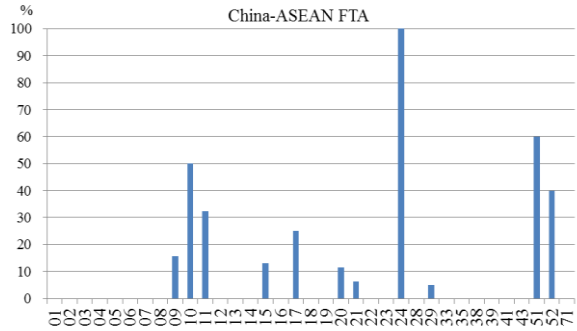
Figure 3: The shares of sensitive agri-products in each FTA- continued

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# 3. Theoretical framework and hypotheses

■ 3.1 Traded goods

■ Grossman & Helpman (1995): "protection for sale" framework; the condition of forming FTAs.
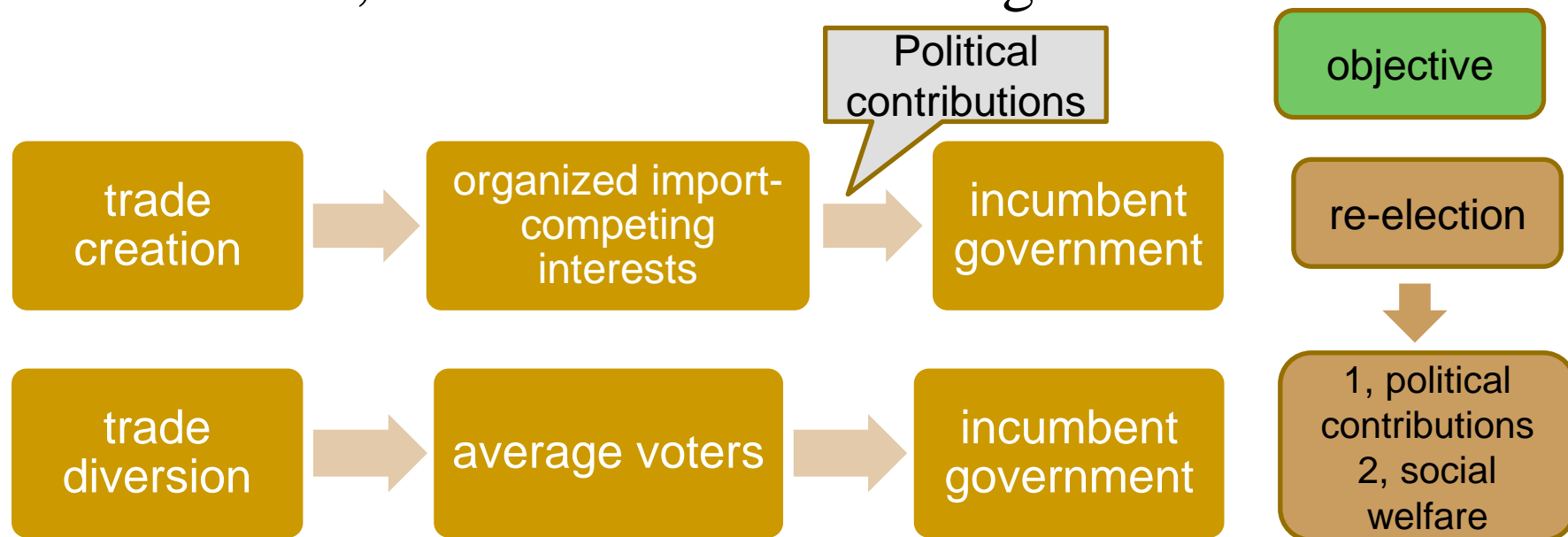
# 3. Hypotheses-continued

- Import-competing industry: the relative smaller community; concentrated production; the same political goals

- Average voters: a relatively larger community

- "collective action" problem

- China: invisible contributions, political connections

⇨ policy making.

- Hypothesis 1： *trade creation products are more likely to be excluded in China's FTAs.*

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# 3. Hypotheses-continued

- ■ 3.2 Non-traded goods

- ■ Unorganized industries also receive positive protection (Ederington & Minier, 2008). Why?

- ■ Food security; politically sensitive products

- ■ Hypothesis 2: politically sensitive products are more likely to be excluded in China's FTAs

# 4. Econometric specification and data

- **4.1 Econometric specification**

$$tariff\_exclusion_{ij} = c + a\ Trade\_creation_{ij} + \beta\ Politically\_sensitive_i$$
$$+ \gamma \mathbf{x} + \delta_i + \delta_j + \varepsilon_{ij}$$

- Tariff_exclusion: equals to 1 if the length of tariff reduction transition period are more than 10 years(incl.) or entirely excluded (MFN tariffs), otherwise equals to 0.

- Trade_creation: following the method of Baldwin & Murray (1977),

$$\ln(Trade\_creation_{AB}) = \ln\left(M_{ABO} \times \xi_d \times \left(\Delta t / (1 + t_0)\right)\right)$$

- Politically_sensitive: equals to 1 if the product is national strategic product, otherwise equals to 0.

- Control variables: negotiation power, RCA, intra-industry trade, Import ratio, FTA signing time, country fixed effect, HS section fixed effect, etc..

# ■ 4.2 Data

- Dataset: 10 FTAs, including China-ASEAN FTA, China-New Zealand FTA, China-Iceland FTA, China-Australia FTA, China-Costa Rica FTA, China-Pakistan FTA, China-Chile FTA, China-Peru FTA, China-Switzerland FTA, and China-South Korea FTA

- Sample size: HS 6-digit level, 8210 agri-products

- Data sources: legal text of each FTA; UN Comtrade database; WTO database

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## Table 1: The descriptive statistics for variables in the regression

| Variable | Obs. | Mean | Std. | Min | Max |
|---|---|---|---|---|---|
| tariff_exclusion | 8210 | 0.3437 | 0.4750 | 0 | 1 |
| lntrade_creation_Baldwin_2 | 1881 | 1.2154 | 3.5204 | -11.2451 | 13.1049 |
| trade_creation | 2101 | 0.4517 | 0.4978 | 0 | 1 |
| national_strategic_product | 8210 | 0.0926 | 0.2898 | 0 | 1 |
| political_sensitive | 8210 | 0.3663 | 0.4818 | 0 | 1 |
| gdp_ratio | 8210 | 38.2494 | 46.6508 | 3.2732 | 135.4444 |
| rca_c | 7650 | 0.7779 | 1.6430 | 0 | 16.4806 |
| rca_p | 7057 | 3.4488 | 25.2397 | 0 | 1097.6410 |
| gl_index | 2492 | 0.0771 | 0.1948 | 0 | 0.9975 |
| import_ratio | 7112 | 3.2197 | 13.9118 | 0 | 100 |
| trade_balance_c | 7650 | 0.1128 | 0.8202 | -1 | 1 |
| intermediate_product | 8210 | 0.5920 | 0.4915 | 0 | 1 |
| labor_intensive_product | 8210 | 0.9220 | 0.2681 | 0 | 1 |
| time_sign | 8210 | 5.1000 | 2.3855 | 1 | 8 |

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## Table 2: Regression results for product exclusions

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| lntrade_creation_Baldwin_2 | 0.117*** | | 0.118*** | |
| | (0.023) | | (0.023) | |
| national_strategic_product | | 3.698*** | 1.648* | |
| | | (0.858) | (0.938) | |
| trade_creation_dummy | | | | 0.202* |
| | | | | (0.105) |
| political_sensitive | | | | 0.613*** |
| | | | | (0.131) |
| gdp_ratio | 0.078*** | 0.056*** | 0.079*** | 0.072*** |
| | (0.019) | (0.009) | (0.019) | (0.017) |
| Constant | -5.865*** | -4.989*** | -6.189*** | -0.643 |
| | (0.699) | (0.979) | (0.738) | (0.771) |
| Other control variables | yes | yes | yes | yes |
| Country fixed effect | yes | yes | yes | yes |
| HS section fixed effect | yes | yes | yes | yes |
| N | 1429 | 2410 | 1429 | 1612 |
| pseudo $R^2$ | 0.639 | 0.535 | 0.642 | 0.592 |

*=1 if the tariff is more than the mean value before negotiation*

*=1 if the import growth ratio of the 3-year average (2012-2014) to another 3-year average (2001-2003) is larger than 1*

Notes: Dependent variable is tariff exclusions (products excluded =1, otherwise=0); robust standard errors are in parentheses; for independent variables the data are all from one year before the negotiation of each FTA; following Hong (2013)'s research, we also used other import demand elasticity (3, 8, 20), and the results are almost the same; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

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## Table 3: The robustness checks for product exclusions A

| | (1) Without zero tariff | (2) Without zero tariff | (3) Small trading partners | (4) Big trading partners | (5) Small trading partners | (6) Big trading partners |
|---|---|---|---|---|---|---|
| trade_creation_dummy | 0.222** | | | | 0.539* | 0.223* |
| | (0.107) | | | | (0.302) | (0.117) |
| political_sensitive | 0.571*** | | | | 1.584*** | 0.442*** |
| | (0.132) | | | | (0.402) | (0.138) |
| lntrade_creation_Baldwin_2 | | 0.118*** | 0.051 | 0.149*** | | |
| | | (0.023) | (0.063) | (0.025) | | |
| national_strategic_product | | 1.648* | 0.935 | 1.652* | | |
| | | (0.938) | (1.031) | (0.943) | | |
| gdp_ratio | 0.075*** | 0.079*** | -0.091*** | 0.283*** | -0.027*** | 0.234*** |
| | (0.018) | (0.019) | (0.006) | (0.033) | (0.007) | (0.029) |
| Constant | -0.653 | -6.189*** | 67.787*** | -10.298*** | -1.160 | 0.973 |
| | (0.797) | (0.738) | (11.724) | (1.008) | (0.802) | (0.858) |
| Other control variables | yes | yes | yes | yes | yes | yes |
| Country fixed effect | yes | yes | yes | yes | yes | yes |
| HS section fixed effect | yes | yes | yes | yes | yes | yes |
| $N$ | 1579 | 1429 | 104 | 1310 | 163 | 1432 |
| pseudo $R^2$ | 0.604 | 0.642 | 0.392 | 0.694 | 0.433 | 0.633 |

Notes: Dependent variable is tariff exclusions (products excluded=1, others=0); robust standard errors in parentheses; all independent variables are one year lag of each FTA's negotiation; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

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## Table 4: The robustness checks for product exclusions B

| | (1) traded products | (2) traded products | (3) non-traded products | (4) non-traded products |
|---|---|---|---|---|
| lntrade_creation_Baldwin_2 | 0.118*** | | | |
| | (0.023) | | | |
| national_strategic_product | 1.648* | | 2.999*** | |
| | (0.938) | | (0.486) | |
| trade_creation_dummy | | 0.202* | | |
| | | (0.105) | | |
| political_sensitive | | 0.613*** | | 0.695*** |
| | | (0.131) | | (0.060) |
| gdp_ratio | 0.079*** | 0.072*** | 0.033*** | 0.037*** |
| | (0.019) | (0.017) | (0.005) | (0.005) |
| Constant | -6.189*** | -0.643 | -2.784*** | -2.903*** |
| | (0.738) | (0.771) | (0.627) | (0.582) |
| Other control variables | yes | yes | yes | yes |
| Country fixed effect | yes | yes | yes | yes |
| HS section fixed effect | yes | yes | yes | yes |
| $N$ | 1429 | 1612 | 4340 | 4340 |
| pseudo $R^2$ | 0.642 | 0.592 | 0.366 | 0.370 |

Notes: Dependent variable is tariff exclusions (products excluded =1, others=0); robust standard errors in parentheses; all independent variables are one year lag of each FTA's negotiation; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

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# 6. Conclusions

- products which experience trade creation or which are politically sensitive are more likely to be excluded in FTAs.

- Overall, the Chinese government would seek more economic benefits from trading partner.

- Moreover, for big-trading partners, the Chinese government would use its negotiation power to seek both political and economic objectives.

- For small-trading partners, however, with objectives of diplomacy or showing the "big country morality", the Chinese government would use the negotiation power to seek more political objectives than economic objectives.

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# Thank you for your attention!

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