Export Status Switching and Wages

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Abstract

In this paper we examine the relationship between tariffs and export status and the decision of firms to switch between being an ordinary exporter and an export processor as tariff rates change. Using detailed firm and trade dataset for China we find that a reduction in output tariffs leads to a decrease in wages for non-switching pure processing exporters. We also find that a fall in input tariffs leads to an increase the wages of those pure processing exporters who switch to become pure ordinary exporters. In contrast, pure ordinary exporters who switch to being pure processing exporters subsequently pay lower wages when they experience a reduction in input tariffs. We highlight that input tariff reductions at the firm level is a positive determinant of the firm decision to switch between different modes of exporting and most importantly, reductions in firm level input tariffs appears to encourage exporting firms to switch to another export status to upgrade their productivity level.

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Introduction

Between 1990 and 2009, China's share of world manufacturing exports grew from two percent to thirteen percent (Hanson, 2012). An important dimension of this impressive growth has been the remarkable but declining role of processing exports in China. In 1999, processing exports represented 53.7 % of China's total exports. By 2006 this percentage had been reduce to 53.6% and by 2012 it had fallen further but still accounted for around 34.8% of China's total exports. Recent studies have argued that the composition of trade matters for China and its trading partners. Koopman *et al.* (2012) and Kee and Tang (2015) find that the domestic value-added per USD for ordinary exports is more than twice that of processing exports. Recent work by Jarreau and Poncet (2012), and Yu (2015) also indicates that, in comparison to processing trade, the more traditional channel of ordinary trade entails substantially more technological upgrading and facilitates larger spillovers to the domestic economy.

In this paper we examine the impact of tariff reductions in China following China's decision to join the WTO in 2001 on the switching behavior of firms between different modes of exporting. The main difference between ordinary trade and processing trade in China is in terms of tariff treatment and hence on the ability of processing firms to sell their final products to foreign markets free from import and export duties. Manufacturing firms engaged in the processing business enjoy a zero tariff rate on the imports of all intermediate inputs for processing trade which has the immediate effect of reducing production costs relative to non-processors. The cost benefit that processors experience from these tariff exemptions may encourage other domestic producers to switch, either partly or entirely, from a domestic producer and ordinary exporter to an exporter processor.[1]

Methodologically we combine three major data sources (Chinese Industrial Firm dataset, Custom Trade dataset and Chinese applied tariff data) to construct firm-level

[1] A firm can be a part processing producer if it conducts both ordinary trade and processing trade. In this paper we call processing producers that export all of their output pure as processors and are firms, that participate in global markets only for the purpose of assembling and processing.

output and input tariffs and a firm level effective rate of protections (ERP) to investigate the impact of export mode and export mode switching on wages following a period of trade liberalization. The rest of the paper is organized as follows. In section 2 we describe the data sources and section 3 introduces the different trade modes in China. In section 4 we describe our estimation strategy and our measures of firm-specific tariffs and ERP. Section 5 presents our results and section 6 concludes.