

# Production subsidies -- the secret to China's success?

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The secret of China's exporting success may lie in unfair production subsidies, according to new research presented at the Royal Economics Society annual conference by a team from The University of Nottingham's Globalisation and Economic Policy Centre (GEP).

The economists behind the research say it raises serious questions about whether China is being fair with its trading partners.

The GEP research, based on data from nearly half a million firms over a six-year period from 1999 to 2005, including analysis of rare production subsidy data, shows a clear link between Chinese government subsidies and increases in firm exports.

China's growing participation in international trade has been one of the most prominent features of its economic reform. It is the world's third-largest exporter, and the fastest growing exporter among members of the World Trade Organisation (WTO), which it joined in December 2001.

GEP's Dr Yundan Gong, one of the paper's co-authors, said: "During negotiations to secure this WTO membership the Chinese government made an important commitment to eliminate subsidies, which are seen as unfair by the international community. Economists are sceptical about how committed China has been to doing this. Our research shows that, even as late as 2005 these subsidies were still very high, and have had a significant impact in supporting the country's exporting activities."

According to the GEP team, in 2005 China gave \$US 2.3bn in subsidies to State Owned Enterprises (SOEs) and between 1995 and 2005 general subsidies amounting to a total of \$US 310bn were given to firms.

Exporting has been a key driver in China's economic success and maintaining exports is seen as key to China's continued economic growth — other research cited in this paper shows that a 10 per cent growth in exports leads to a one per cent growth in GDP in China.

Success is not just confined to labour-intensive manufacturing in which China might be expected to have a natural comparative advantage. China has seen a recent shift in the nature of its exports towards more sophisticated products. The total export value of electrical machinery and high-tech products, including products such as computers, electronics, aerospace technology and telecom equipment has risen from \$US 640bn in 2005 to \$US 1048bn in 2007. Exports of labour-intensive products like toys and plastics have shown modest or even negative growth.

Over the same period there has been a shift in the nature of production subsidies — in 1999 they were highest in the textiles and ordinary machinery sectors. By 2005 firms in the instruments and meters industry received by far the highest levels of subsidies. Econometric modelling of the data shows that doubling production subsidies leads, on average, to a 2.1 per cent increase in the level of exports.

Dr Gong said: “The research supports those economists who have argued that subsidies have helped drive China's export success, which has been at the heart of its recent economic boom. This raises serious questions about whether China needs to further adapt its trade practices and reduce such subsidies to fully comply with its WTO committals.”

Source: University of Nottingham

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