
Introduction

This book provides a preliminary analysis of the static costs of trade protection and the corresponding static benefits of liberalization for 25 highly protected goods in China. Chapter 2 describes the development of China's trade-administration system and sketches the obstacles to and prospects for further liberalization.

In chapter 3, we present our estimates of the static costs of protection in China and analyze the structure of Chinese trade protection. Chapter 4 provides a deeper analysis of China's trade regime and of the administrative barriers to rationalization and liberalization. Chapter 5 presents our recommendations for improving China's trade system. Five appendices to the main text provide greater technical detail on the modeling and methodology applied in this study as well as a brief description of some peculiarities of the Chinese trade regime—notably, significant smuggling activities and monopolistic market structures.

Before plunging into the detail, it is worth summarizing our broad conclusions. We confirm that the short-term costs of trade liberalization for the goods we examine will be substantial both in terms of lost domestic output (a drop of about \$40 billion, or 32 percent of preliberalization output in the protected sectors) and lost jobs (about 11.2 million workers in the protected sectors). However, the long-term benefits of liberalization would be substantial. The static benefits to consumers (the so-called Harberger rectangles and triangles) from fully liberalizing the protected sectors would amount to \$35 billion annually (about 1.1 percent of GDP), and the pure efficiency gains would be about \$5 billion annually. If the entire Chinese economy were liberalized, annual consumer gains would probably reach 2.6 percent of GDP.

For reasons that are well known to economists but less well known to policymakers, these static estimates substantially underestimate the probable dynamic gains from trade liberalization. Dynamic gains include the spur to domestic producers to cut costs and improve quality, the far greater range of goods and services made available to a liberalized economy, and the substantial erosion of monopoly power in individual markets and sectors of the economy. However, our estimate of the potential dynamic benefits of liberalization for the Chinese economy is limited to illustrative calculations of the benefits of introducing competition to four sectors that are characterized by either oligopolistic competition or monopoly (see appendix E).

China's current development stage is quite different from that of advanced countries such as the United States and Japan, and its institutions differ correspondingly. Competitive markets have long existed in the United States, and they are beginning to take hold in Japan. But China was steeped in the concepts and ideology of a planned economy for 30 years, until reform began in 1978. Although China is now on its way to becoming a market economy and its institutions are changing rapidly, reminders of its centrally planned past endure. The Chinese trade system—one of these reminders—is being radically revamped along with the rest of the institutional framework. Already, Chinese protection is not extreme in comparison to that of South Korea and Japan as measured by a similar analytic framework (Kim 1996; Sazanami, Urata, and Kawai 1995). However, there is still much work to be done. The next chapter briefly describes China's trade system and the obstacles that China must overcome if it is to liberalize further.