

What is behind China's Terms of Trade Deterioration

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Abstract:

After entry into the WTO in 2001, alongside a dramatic increase in trading volume, China has also seen an ongoing deterioration in its terms of trade (ToT). Combining trade and industry data, we explore this phenomenon. Decomposing the contribution to the terms of trade by sector illustrates that the deterioration is a result of raw material industries and capital intensive industries, while labor intensive industries seem to contribute to terms of trade improvements. We put forward several explanations for these facts, including the "immiserizing growth" effect (terms of trade deterioration as exports expand), industry policy effects (unreasonable industry development policies) and domestic trade encouragement policy (unreasonable export subsidizing policies). We find that heavy investments into those industries without exit channels and those with large global market share lower the export/import elasticity, and lead to terms of trade deterioration, confirming the first and second explanations.

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