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Abstract: This study examines the features and determinants of Chinese intra-industry trade during the 1992–2001 transition period for 50 of China's trade partners. We disentangle total intra-industry trade (TIIT) into vertical intra-industry trade (VIIT) vis-à-vis horizontal intra-industry trade (HIIT), using data at the four-digit SITC level. The findings indicate that Chinese bilateral intra-industry trade, particularly VIIT, increased significantly during this transition period. VIIT appears to be positively related to differences in consumer patterns. HIIT is negatively related to these differences. In addition, we find that FDI has played an important role in determining IIT, especially VIIT. Other significant intra-industry trade drivers are geographical distance, economic size, trade openness and trade composition. Finally, the impact of China's liberalization policies and the special role of Hong Kong are demonstrated. We discuss a number of important business and political implications that can be drawn from our findings.

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1 Introduction

In the years following the Second World War, researchers have found much evidence of rapidly increasing intra-industry trade. Balassa (1966) first coined the term intra-industry trade to signal the simultaneous import and export of goods within one and the same industry in both trade partners. Since then, a large number of theoretical and empirical studies have sought to explain this phenomenon. Studies in this tradition mainly focus on three...
issues: (1) measuring the magnitude of intra-industry trade (e.g., Grubel and Lloyd 1975; Brülhart 1994); (2) developing theoretical explanations for intra-industry trade’s existence (e.g., Krugman 1979; Falvey 1981); and (3) examining the empirical determinants of intra-industry trade (e.g., Helpman 1987; Greenaway et al. 1994). The current study will add new elements to the literature in the third area for the special case of the emerging transition economy of China.

Trade in emerging economies such as China has attracted increasing academic attention due to their high growth rate and rapid integration into the world economy. Institutional reform programs have greatly changed the position of these countries in the world economy. International trade in these countries has developed quickly in terms of scale and structure, which played—and still plays—an important role in driving their economic development, as well as the restructuring of the world economy. With its huge population size, high development pace and unique reform program, China is a noticeable economic force in the current transition era. The multi-faceted liberalization of the Chinese economy has generated the success of China's trade, witnessing impressive growth rates and radical pattern shifts (e.g., Garnaut and Song 1999; Doi et al. 2002). The Chinese experience may provide vital information for the development of a coherent explanation and theory of intra-industry trade. The present study therefore aims to detect what country-specific factors influence bilateral intra-industry trade over the transition period by exploring a rich panel data set.

China started to introduce liberal economic policies in the area of foreign trade and investment in 1978. During the period from 1978 to 1992, the overall reform and opening-up policy reflected a gradual, step-by-step movement toward a more market-oriented system. Although the era of isolation was ended as a result, China’s trade barriers, including a plethora of tariff and nontariff measures, were still maintained at levels similar to those in highly protectionist developing countries. After 1991, though, the relaxation of the foreign trade and investment policies accelerated. For example, year after year simple mean tariffs have been cut down with large slices, which dropped average import tariffs from 43.2 percent at the beginning of the 1990s to 15.3 percent in 2001. In line with this process of accelerated liberalization, Chinese trade has expanded impressively, simultaneously producing a significant upgrade of China’s trade pattern. The ratio of exports to GDP increased from 19 percent in 1992 to 23 percent in 2001, and the share of manufactured goods in exports increased from