Processing Trade, Firm Productivity, and Tariff Reductions: Evidence from Chinese Products*

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Abstract

This paper explores how processing trade, jointly with output and input tariff reductions, can improve firm productivity. Output tariff reductions generate productivity gains via competition, whereas input tariff reductions do so by saving firm's cost. More importantly, processing firms enjoy extra gains from processing trade. Using highly disaggregated Chinese product-level trade data and firm-level production data from 2000–2006, after constructing firm-level tariffs based on product information and controlling for possible endogeneity, I find that a 10% output tariff decrease generates a 10% increase in firm productivity gains, which is around twice higher than the productivity gains from cutting input tariffs. The logarithm of productivity of processing firms, on average, is .05 higher than those of non-processing firms.

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