

Policy Credibility and Firm Performance: Theory and Evidence From Chinese Trade Reforms

Kyle Handley (University of Michigan)

Nuno Limao (University of Maryland and NBER)

Rodney Ludema (Georgetown University)

Zhi Yu (Shanghai University of Finance and Economics)

Abstract: This paper examines how changes in trade policy credibility (or uncertainty) affect firm entry and technology decisions by exploring China's entry into the WTO (Dec 2001) as a shock that locked in Chinese tariff reductions reduced uncertainty about increases in protection in foreign markets. Using a heterogeneous firm model and Chinese micro-level production and trade data, the paper shows, both theoretically and empirically, that reduction of foreign tariff uncertainty and home input tariff uncertainty leads to an increase of both TFP of Chinese firms and their exports (in both intensive and extensive margins), while reduction of home output tariff uncertainty has an opposite impact.