China's Export Tax Rebate Policy

CUI Zhiyuan

Since the launch of the economic reforms in 1978, China's exports have been growing phenomenally, from $9.8 billion that year to $325.6 billion in 2002. The average annual growth rate was 15.6 per cent, or six per cent higher than the average annual GDP growth rate (9.5 per cent) over the same period.[1] China's share in world exports increased from less than one per cent in 1980 to five per cent in 2002, making China the fifth largest export country in the world (see Table 1). To encourage exports, the Chinese government formulated and implemented a series of policies of which the export tax rebate is one of the most important. At the same time, however, this rebate scheme has become a heavy fiscal burden on the central government.

Export tax rebate refers to the money the tax authority returns to exporting enterprises for the indirect tax they pay in the production and distribution process. It is commonly practised in international trade. To ensure fair competition, every country requires imported goods to be subject to the same tax rate as its domestically-produced counterparts. Therefore, regardless of whether export goods have been taxed by the exporting country, the importing country will still tax them. Thus, the main purpose of the export tax rebate policy is to avoid double taxation on export goods and to enhance a country's competitiveness in foreign markets. As far as WTO is concerned, the practice is not illegal. In fact, under both the General Agreement on Tariffs and Trade and the WTO, the export tax rebate is not considered a "subsidy" so long as the tax rebate does not exceed the amount of tax paid to domestic tax authorities.[2]

Three Stages of China's Export Tax Rebate Policy

The evolution of China's export tax rebate policy can be divided into three stages: 1985–93, 1994–7, and 1998 to the present. The Chinese government began to

ABOUT THE AUTHOR

Cui Zhiyuan (zcui@law.harvard.edu) is currently Visiting Senior Fellow at Harvard Law School. He received his PhD in political science from the University of Chicago. His research interests include the political economy of reform in China, and political and legal philosophy in general.

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Table 1: *China's Export Growth, 1978–2002*

Year	Exports (billion RMB)	Exports (US$ billion)	% Change Over Previous Year	China's Share in World Exports (%)	China's Ranking in World Exports
1978	16.8	9.8	—	—	—
1979	21.2	13.7	39.8	—	—
1980	27.1	18.1	32.1	0.9	26
1981	36.8	22.0	21.5	1.1	19
1982	41.4	22.3	1.4	1.2	17
1983	43.8	22.2	–0.4	1.2	17
1984	58.1	26.1	17.6	1.4	18
1985	80.9	27.4	5.0	1.4	17
1986	108.2	30.9	12.8	1.5	16
1987	147.0	39.4	27.5	1.6	16
1988	176.7	47.5	20.6	1.7	16
1989	195.6	52.5	10.5	1.7	14
1990	298.6	62.1	18.3	1.8	15
1991	382.7	71.8	15.6	2.0	13
1992	467.6	84.9	18.2	2.3	11
1993	528.5	91.7	8.0	2.5	11
1994	1,042.2	121.0	32.0	2.9	11
1995	1,245.2	148.8	23.0	3.0	11
1996	1,257.6	151.1	1.5	2.9	11
1997	1,516.1	182.8	21.0	3.3	10
1998	1,523.2	183.8	0.5	3.4	9
1999	1,616.0	194.9	6.0	3.6	9
2000	2,063.5	249.2	27.9	3.9	7
2001	2,202.9	266.2	6.8	4.4	6
2002	2,702.5	325.6	22.3	5.0	5

Sources: Caizheng bu zonghe jihua sibian (China Ministry of Finance, General Planning Bureau), *Zhongguo caizheng tongji nianjian 2001* (China Finance Statistical Yearbook 2001) (Beijing: Zhongguo caizheng jingji chubanshe, 2001), p. 462; China, State Statistical Bureau, *China Statistical Abstract* 2002 (Beijing: Zhongguo tongji chubanshe, 2002), p. 148; *Zhongguo dui wai jingji tongji nianjian 2000* (China Foreign Economic Statistical Yearbook 2000) (Beijing, 2000), pp. 17, 18. Figures for China's share in world exports in 2000–2 are from the EIU.

implement the export tax rebate policy in April 1985. In 1988, the "full refund" principle was established. By 1991, the export subsidy (above the amount of export rebate) was abolished. At that time, the old tax system (i.e., the industry and commercial standard tax system) was still in effect with its serious problem of overlapping taxation. As the export tax rebate rate was set by product categories, overlapping taxation made it difficult to determine how much tax should be rebated.

In 1994, the government implemented a major tax system reform. It abolished the industrial and commercial standard tax (*gong shang tong yi shui*) and introduced a new value-added tax (VAT).[3] The basic rate of the value-added tax was 17 per cent, and a lower VAT rate was set at 13 per cent for basic foodstuffs, utilities, newspapers, and agricultural production inputs. For export goods, the VAT was zero.[4] That is to say, export goods would get a 17 or 13 per cent VAT rebate in accordance with the tax rate paid. To implement the export tax rebate, the central government earmarked a certain amount of its budget expenditure for it each year.

With the introduction of the new tax system based on the VAT, the export tax rebate increased drastically. In 1994, total realised export tax rebate reached 45 billion yuan, yet there was an additional 30 billion yuan worth of export tax rebate deferred to the first quarter of 1995 because of the central government's budget constraint. Thus, the export tax rebate in 1994 alone increased 150 per cent from 1993, which greatly exceeded the export growth (97.2 per cent). This is partly due to the fact that for some export goods, the actual VAT paid is lower than the stipulated rate because of preferential treatment. More importantly, "fiddling" in export tax rebate by forging VAT invoices was rampant. The central government's export tax rebate obligation was therefore too large to fulfil. Consequently, in 1995 and 1996 the government twice reduced the export tax rebate rate.

According to one estimate, the actual VAT paid for export goods was about three per cent lower than the stipulated rate. In light of this, China's State Council decided that from 1 July 1995, the new export tax rebate rate would be 14 per cent for export goods that were receiving a 17 per cent VAT rebate, and 10 per cent for those receiving a 13 per cent VAT rebate. For agricultural products and coal, the export tax rebate rate was three per cent (see Table 2).[5]

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1 The average annual growth rate of exports here is the geometric average calculated in US dollars.

2 *General Agreement on Tariffs and Trade*.

3 The VAT existed before 1994, but that year became the main source of government revenue.

4 See China, State Administration of Taxation, "Provisional Regulations of People's Republic of China", effective as of 1 Jan. 1994. (For small taxpayers, the VAT is six per cent.)

5 See China, Document of the State Council, "Circular on Reducing Export Tax Rebate Rate and Strengthening Export Tax Rebate Management", no. 3 (1995).

Table 2: *Changes in China's Export Tax Rebate Policy, 1995–6*

Date	Export Tax Rebate		
	for items paying 17% VAT	**for items paying 13% VAT**	**for agricultural products and coal**
1 Jul. 1995	reduced from 17% to 14%	reduced from 13% to 10%	set at 3%
1 Jan. 1996	further reduced from 14% to 10%	further reduced from 10% to 6%	remained at 3%

Note: Starting from 1 May 1994, VAT rates for agricultural products and coal were reduced from 17 to 13 per cent. See China, Documents of Ministry of Finance and State Administration of Taxation, "Circular on Adjusting VAT Rates for Agricultural Products and Exempting Some Items from VAT Taxation", no. 4 (1994); and "Circular on Adjusting VAT Rates for Metal and Non-metal Mineral Products", no. 22 (1994).

Sources: China, Document of the State Council, no. 3 (1995); China, Document of the State Council, no. 29 (1995).

However, even with the reduced rate, the central government's budget in 1995 for the export tax rebate (50 billion yuan) still could not cover all the tax rebate requests (90 billion yuan). Thus, the State Council further reduced the export tax rebate rate as of 1 January 1996. For export goods that were receiving a 14 per cent VAT rebate from July 1995, the rate was further reduced to 10 per cent, and for those receiving a 10 per cent VAT rebate, the rate was further reduced to only six per cent. For agricultural products and coal, the rebate remained unchanged at three per cent.[6] The lower rebates certainly reduced the central government's fiscal burden, but they had a negative impact on China's exports. In 1996, exports grew by a mere 1.5 per cent (as mentioned earlier, the average annual growth rate of exports from 1978 to 2002 had been 15.6 per cent).

The 1997 Asian financial crisis made China's export situation even worse, with the economies of the neighbouring countries plunging and their currencies significantly devalued. To counter the negative impact of the crisis and promote exports, the Chinese government increased the export tax rebate rates for various products nine times from early 1998 to the end of 1999 (see Table 3). At the same time, the State Administration of Taxation increased the export tax rebate budget quota for 1999 from 57 billion yuan to 63.6 billion yuan. The effect of these policies became evident in 2000 with China's exports increasing by 27.8 per cent.

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[6] See China, Document of the State Council, "Circular on Reducing Export Goods' Tax Rebate Rate", no. 29 (1995).

Table 3: *Increases in China's Export Tax Rebate Rates, 1998–9*

Date	Export Goods	Increased Export Tax Rebate Rate
12 Feb. 1998	Textile inputs and finished products	Increase to 11%
20 Feb. 1998	Sugar from Xinjiang	Increase from 3% to 9%
16 Jun. 1998	Coal Steel product Cement Ship and boat	Increase from 3% to 9% Increase to 11% Increase to 11% Increase to 14%
23 Jul. 1998	Sugar	Reinstate export tax rebate rate at 9%
23 Sep. 1998	Aluminium, zinc, lead	Increase to 11%
2 Dec. 1998	Ships and boats	Increase from 14% to 16%
29 Jan. 1999	Machinery and equipment, electronic products, transportation, and instruments	Increase to 17%
	Agricultural machines	Increase to 13%
	Textile inputs and finished products, clocks and watches, shoes, pottery and porcelain, steel products, and cement	Increase to 13%
	Organic chemical materials, inorganic chemical materials, paint, dyestuffs, pigments, rubber products, toys and sports goods, plastic goods, and travelling goods	Increase to 11%
	Export goods that are receiving 6% tax rebate (including industrial products that are manufactured with agricultural inputs)	Increase from 6% to 9%
	Agricultural products	Increase to 5%
2 Aug. 1999	Clothing	Increase to 17%
	Export goods that are set at a 17% VAT but are receiving 13% or 11% tax rebate, textile inputs and finished products (excluding clothing), and electronic machine tools (excluding those that are receiving 17% tax rebate)	Increase to 15%
	Export goods that are set at a 17% VAT but are receiving 9% tax rebate	Increase to 13%
	Export goods (excluding agricultural products) that are set at a 13% VAT but are receiving a tax rebate rate of less than 13%	Increase to 13%
15 Dec. 1999	Diesel oil	Reinstate export tax rebate rate at 13%

Sources: Documents of Ministry of Finance and State Administration of Taxation (1998), nos. 27, 28, and 102; (1999) nos.17 and 225; Documents of State Administration of Taxation (1998), nos. 118, 152, and 207; Documents of Ministry of Finance, State Administration of Taxation and Customs (1999), no. 289.

The Dilemma of China's Export Tax Rebate Policy

The export tax rebate enables Chinese products to enter foreign markets at real cost price, and has thus helped fuel the remarkable growth of China's exports. However, it has increasingly become a heavy fiscal burden for the central government. From 1991 to 1997, it consumed more than one-fifth to one-third of the central government's total expenditure (Table 4), crowding out other expenditures on education, social security, etc. Because the export tax rebate was too big to fulfil, the State Council reduced tax rebate rates twice within six months between 1995 and 1996. The proportion of tax rebate in the central government's total expenditure dropped to 14–15 per cent in 1998 and 1999, but climbed to 19 per cent in 2000 with increased tax rebate rates.

Table 4: *China's Export Tax Rebate and Central Government's Total Expenditure, 1985–2001*

Year	Export Tax Rebate (billion RMB) (1)	Central Government's Total Expenditure (billion RMB) (2)	% of Export Tax Rebate in Central Government's Total Expenditure (3) = (1) / (2)
1985	1.8	79.5	2.3
1986	4.3	83.6	5.1
1987	7.7	84.6	9.1
1988	11.5	84.5	13.6
1989	15.3	88.9	17.2
1990	18.6	100.4	18.5
1991	25.5	109.1	23.4
1992	26.6	117.0	22.7
1993	30.0	131.2	22.9
1994	45.0	175.4	25.7
1995	55.0	199.5	27.6
1996	82.8	215.1	38.5
1997	55.5	253.3	21.9
1998	43.6	312.6	13.9
1999	62.7	415.2	15.1
2000	105.0	552.0	19.0
2001	107.2	575.4	18.6

Sources: Caizheng bu zonghe jihua sibian (China Ministry of Finance, General Planning Bureau), *Zhongguo caizheng tongji nianjian 2001* (China Finance Statistical Yearbook 2001) (Beijing: Zhongguo caizheng jingji chubanshe, 2001); China, State Statistical Bureau, *China Statistical Abstract 2002* (Beijing: Zhongguo tongji chubanshe, 2002), p. 61.

The designers and promoters of the tax rebate policy did not anticipate this situation. They believed that the export tax rebate would not become a heavy fiscal burden to the Chinese government because increased exports would give rise to increased imports which in turn would bring in more import VAT and excise taxes to the government.[7] The logic of this reasoning might be valid, but in reality, increased exports do not necessarily lead to increased import tax revenue, and the export tax rebate has indeed become a heavy burden to the Chinese government.

As Table 5 shows, from 1994 the export tax rebate grew faster than both exports and VAT revenue, except in 1997 and 1998 when tax rebate decreased.[8]

Table 5: *Comparison of Growth of Export Tax Rebate, Exports, VAT Revenue, Import VAT, and Excise Taxes in China, 1994–2001*

Year	Export Tax Rebate		Exports		VAT Revenue		VAT and Excise Taxes on Imports	
	(billion RMB)	% Change Over Previous Year	(billion RMB)	% Change Over Previous Year	(billion RMB)	% Change Over Previous Year	(billion RMB)	% Change Over Previous Year
1994	45.0	50.0	1,042.2	97.2	230.8	—	32.5	—
1995	55.0	22.2	1,245.2	19.5	260.2	12.7	38.3	17.8
1996	82.8	50.5	1,257.6	1.0	296.3	13.9	44.8	17.0
1997	55.5	–33.0	1,516.1	20.6	328.4	10.8	50.8	13.4
1998	43.6	–21.4	1,523.2	0.5	362.8	10.5	55.6	9.4
1999	62.7	43.8	1,616.0	6.1	388.2	7.0	101.6	82.7
2000	105.0	67.5	2,063.5	27.7	455.3	17.3	149.2	46.9
2001			2,202.9	6.8				

Sources: Caizheng bu zonghe jihua sibian (China Ministry of Finance, General Planning Bureau), *Zhongguo caizheng tongji nianjian 2001* (China Finance Statistical Yearbook 2001) (Beijing: Zhongguo caizheng jingji chubanshe, 2001), pp. 350, 376, 381, 462; China, State Statistical Bureau, *China Statistical Abstract* 2002 (Beijing: Zhongguo tongji chubanshe, 2002), p. 61.

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7 See Zhou Xiao Chuan and Ma Jian Chun, *Zou xiang kai fang xin jingji* (Towards an Open Economy) (Tianjin: Peoples Publishing House, 1993), pp. 207–8.

8 In 1994, exports grew 32 per cent over the previous year if we calculate the figure in US dollars (see Table 1), which was lower than export tax rebate growth (50 per cent). The huge disparity between the two export growth rates for 1994, i.e., in Chinese yuan (97.2 per cent) and US dollars (32 per cent), may be due to the difference in exchange rates at the time.

Moreover, the increase in import VAT and excise taxes was slower than the increase in exports in 1995 and 1997. The reasons for the export tax rebate growing faster than exports and VAT revenue include widespread tax rebate cheating and reduced VAT rates for preferred products.[9] The growth of import tax revenue in some years did not measure up to the pace of export growth possibly because of import tax reduction and exemptions granted to preferred importing enterprises.[10]

Besides tax rebate cheating and VAT reduction/exemption, another factor that has made export tax rebate a heavy fiscal burden for the central government is the new arrangement of the 1994 tax reform with regard to VAT revenue distribution and export tax rebate obligations between the central and provincial governments. Before the 1994 reform, the export tax rebate obligation was borne by both the central and provincial governments: the central government was responsible for export tax rebate paid to central government (ministries') enterprises, while the tax rebate obligation to local enterprises was shared between the central and provincial governments at a ratio of eight to two.[11] The reform not only introduced a new tax system, but also created new central-provincial fiscal relations, the so-called tax assignment system (*fen shui zhi*).

The tax assignment system divides all taxes in China into three categories: taxes (revenues) belonging fully to the central government; taxes that are dedicated to the provincial government budgets; and, taxes for which revenues are designated for sharing between the central and provincial governments. The VAT falls into the third category, with the central government retaining 75 per cent and provincial governments 25 per cent. The export tax rebate, i.e., the VAT rebate to exporting enterprises is now completely shouldered by the central government. In other words, the central government only receives 75 per cent of the VAT, but has to

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9 According to one estimate, export tax rebate cheating in 1994 was as high as over 10 billion yuan. See Chen Bingcai, *Guoji shou zhi de lilun yu shi jian* (The Theory and Practice of International Payment) (Beijing: China Planning Publishing House, 1996), pp. 47–8.

10 From 1994 to 1998, the ratio of import VAT and excise taxes to total imports were respectively 3.3 per cent, 3.5 per cent, 3.9 per cent, 4.3 per cent, and 4.8 per cent. It increased to 7.4 per cent and 8.0 per cent in 1999 and 2000. Calculated from data in Caizheng bu zonghe jihua sibian (China Ministry of Finance, General Planning Bureau), *Zhongguo caizheng tongji nianjian 2001* (China Finance Statistical Yearbook 2001) (Beijing: Zhongguo caizheng jingji chubanshe, 2001), pp. 381 and 462.

11 China, Document of the General Office of the State Council, "Circular on Sharing the Obligation of Export Tax Rebate between the Central and Local Governments", no. 7 (1991).

refund 100 per cent to exporting enterprises. This certainly aggravates the central government's fiscal burden.

While the export tax rebate consumes the lion's share of the central government's expenditure, exports have become an important driving force for China's GDP growth (Table 6). According to one prominent Chinese economist,

Table 6: *China's Export Growth and GDP Growth, 1978–2001*

Year	Exports		GDP	
	(billion RMB)	% Change Over Previous Year	(billion RMB)	% Change Over Previous Year
1978	16.8	—	362.4	11.7
1979	21.2	26.2	403.8	7.6
1980	27.1	27.8	451.8	7.8
1981	36.8	35.8	486.2	5.2
1982	41.4	12.5	529.5	9.1
1983	43.8	5.8	593.5	10.9
1984	58.1	32.6	717.1	15.2
1985	80.9	39.2	896.4	13.5
1986	108.2	33.7	1,020.2	8.8
1987	147.0	35.9	1,196.3	11.6
1988	176.7	20.2	1,492.8	11.3
1989	195.6	10.7	1,690.9	4.1
1990	298.6	52.7	1,854.8	3.8
1991	382.7	28.2	2,161.8	9.2
1992	467.6	22.2	2,663.8	14.2
1993	528.5	13.0	3,463.4	13.5
1994	1,042.2	97.2	4,675.9	12.6
1995	1,245.2	19.5	5,847.8	10.5
1996	1,257.6	1.0	6,788.5	9.6
1997	1,516.1	20.6	7,446.3	8.8
1998	1,523.2	0.5	7,834.5	7.8
1999	1,616.0	6.1	8,206.8	7.1
2000	2,063.5	27.7	8,940.4	8.0
2001	2,202.9	6.8	9,593.3	7.3

Sources: Caizheng bu zonghe jihua sibian (China Ministry of Finance, General Planning Bureau), *Zhongguo caizheng tongji nianjian 2001* (China Finance Statistical Yearbook 2001) (Beijing: Zhongguo caizheng jingji chubanshe, 2001), pp. 462, 449; China, State Statistical Bureau, *China Statistical Abstract 2002* (Beijing: Zhongguo tongji chubanshe, 2002), p. 61.

Justin Lin, a 10 per cent growth in China's exports since the 1990s has prompted a one per cent growth in GDP.[12] If Lin's analysis is tenable, then from 1990 through 2001, the average contribution of exports to China's GDP growth was close to 16 per cent.[13] Although domestic demand is still the major source of China's GDP growth, the role of exports is no longer marginal.[14] In order to maintain China's rapid economic growth, the growth momentum of exports has to be sustained. Therein lies the dilemma of the export tax rebate: without the tax rebate, export growth levels off and GDP growth slows down; whereas with the rebate, the central government has a heavy fiscal burden and cannot undertake the beneficial social programmes it would like.

Possible Solutions to the Dilemma

In my view, there are two possible solutions to this dilemma. The first is to reduce the share of "processing trade" (*jiagong maoyi*) in China's total exports.[15] As shown in Figure 1, the share of such goods in China is as high as 55.4 per cent of total exports. This is quite unusual, since it means more than half of China's exports are from "export-processing zones" or "export enclaves". Since the import materials for these "enclaves" are free of import duties and VAT, there is a strong incentive

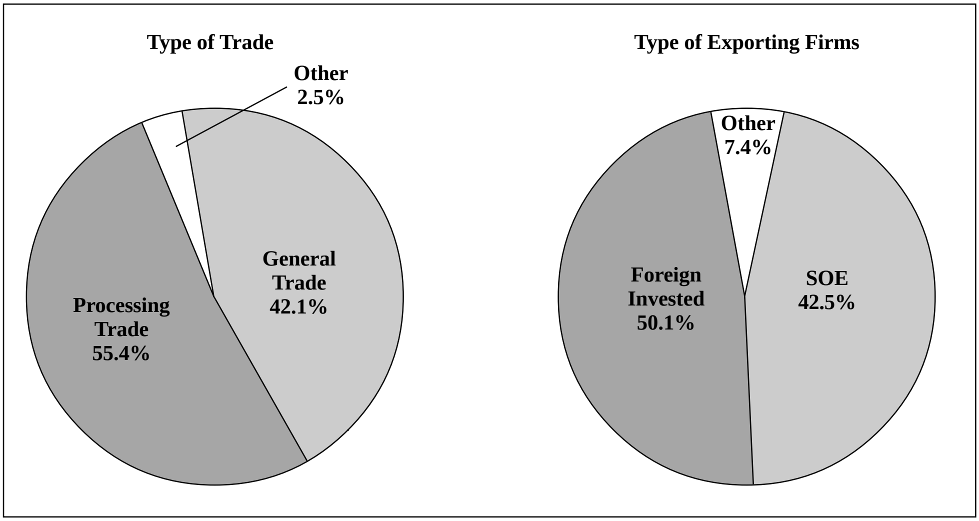
12 Lin and Li believe that many studies, which use an accounting identity of GDPs, underestimate the contribution of exports to China's economic growth in the past 20 years because in their models the indirect impact of exports on domestic consumption, investment, and government expenditure have been overlooked. They employ a new model to capture the indirect contribution of exports on GDP growth and arrive at the above conclusion. See Lin and Li, "Export and Economic Growth in China: A Demand-oriented Analysis", Center for Study of the Chinese Economy, Peking University, Paper No. C2002008, 23 May 2002.

13 During this period, the average annual growth rate of China's exports was 14.9 per cent, while GDP grew at 9.4 per cent. By Lin's estimate, a 14.9 per cent export growth rate translates into 1.49 per cent GDP growth. Thus the contribution of exports to GDP growth was 15.9 per cent (1.49 / 9.4 = 15.9 per cent).

14 For more discussion, see John Wong and Sarah Chan, "Why China's Economy Can Sustain High Performance: An Analysis of its Sources of Growth", *EAI Background Brief*, no. 138 (Dec. 2002).

15 "Processing trade" *(jiagong maoyi)* is a unique concept that the Chinese use in their foreign trade statistics. It is derived from China's Custom practice and refers to a special category of export products that are manufactured or assembled solely or mostly from imported raw materials or semi-finished goods. The imported raw materials or semi-finished goods are totally or partially exempted from import tariffs.

Figure 1. *Composition of China's Exports, 2001*



Source: Zhongguo dui wai jingji maoyi nianjian 2002 (China Foreign Trade Yearbook 2002) (Beijing, 2002), p. 826.

for firms engaging in "general trade" (*yiban maoyi*) to convert to "processing trade". This will further decrease the government revenue from import taxes. By reducing the share of processed goods, the government can add to its coffers and therefore reduce the burden of the export tax rebate.

Another solution, a more fundamental one, is gradually to expand domestic demand, thus reducing the role of exports in promoting GDP growth. China, as a large continental country like the United States, should depend mainly on its internal market as the engine of growth. The dilemma of the export rebate policy will exist so long as China's internal market is underdeveloped due to the income gap between the rural areas and cities, and between the classes.