ADBI Working Paper Series

Services Policy Reform in the People's Republic of China: Before and After the Global Financial Crisis

Ying Fan

No. 304
August 2011

Asian Development Bank Institute

Ying Fan is associate professor at the School of International Trade and Economics, University of International Business and Economics, Beijing. The author is grateful to Professor John Whalley, Christopher Findlay, and Xiaopeng Yin for their constructive comments. This paper is part of the research work under International Development Research Centre and Centre for International Governance Innovation (IDRC/CIGI) Project “Young China Scholars Research and Policy Engagement Network.”

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Suggested citation:

Fan, Y. 2011. Services Policy Reform in the People’s Republic of China: Before and After the Global Financial Crisis. ADBI Working Paper 304. Tokyo: Asian Development Bank Institute. Available: http://www.adbi.org/working-paper/2011/08/16/4676.services.policy.reform.prc/

Please contact the author for information about this paper.

Email: fanying@uibe.edu.cn; carafan@126.com

Asian Development Bank Institute
Kasumigaseki Building 8F
3-2-5 Kasumigaseki, Chiyoda-ku
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500
Fax: +81-3-3593-5571
URL: www.adbi.org
E-mail: info@adbi.org

Abstract

Adverse effects of the global financial crisis on international trade include falling demand, increased trade protectionism, and drying up of trade finance. Much attention has focused on the impact of the crisis on goods trade; however literature on its impact on services trade is limited, especially on the services trade in the People's Republic of China (PRC). This paper analyzes the impact of the global financial crisis on the PRC's services trade, discusses policy responses by the government, and puts forward policy suggestions. The main findings of the paper are as follows: Although the global economic and financial crisis spawned a synchronized recession leading to a contraction in the PRC's services trade, the crisis has had a moderate effect on the PRC's trade in services because of the lower internationalization of services. The PRC's trade surplus in goods decreased and its trade deficit in services increased after the crisis. Structural reforms are now urgently needed to help support the recovery of output and trade. A possible solution to rebalancing the trade balance (trade surplus in goods and trade deficit in services) would be to expand trade in services. The degree of openness for services is lower than for goods in the PRC. Further liberalization in services trade is the appropriate policy choice for the government. Continued policy and regulatory reform in favor of services trade will be vital to supporting economic recovery. Improved market access and national treatment of foreign service suppliers would help enhance the productivity and competitiveness of local services firms and upgrade the industry structure of services, which is essential for the country's economy to change from being driven by exports to being driven by domestic demand. Decreasing trade and investment barriers would help expand services trade and investment, and increase PRC involvement in the globalization of services.

JEL Classification: F13, F14

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1. THE GROWING IMPORTANCE OF SERVICES AND SERVICES TRADE IN THE PEOPLE'S REPUBLIC OF CHINA

1.1 The Growing Importance of Services

The services sector makes a direct and significant contribution to gross domestic product (GDP) and job creation. It makes an important contribution to employment growth, productivity, and innovation in most economies, and has become the most dynamic sector in the PRC as well. According to the National Bureau of Statistics, the share of services in the PRC economy increased considerably in the past three decades. In 1978, the sector accounted for 23.9% of GDP; by 2010 this had increased to 43.0%. In 1978, it employed 12.2% of all employees in the PRC; this increased to 34.1% in 2009. The PRC government regards the accelerated development of the services sector as an important way to promote the rationalization of economic structure, transform the economic development mode and the foreign trade development mode, as well as create job opportunities. If sufficiently competitive, services have the potential, in the long run, to generate new jobs for surplus labor currently located in rural areas.

The PRC's services sector is becoming more important. However, compared with other economies where the services sector is becoming the largest sector, the PRC is lagging because of the lower share of services in GDP. The services sector accounts for a significant proportion of GDP in most countries, including low-income countries, where it frequently generates over 50% of GDP. In 2006, services contributed 72% of GDP in industrialized economies and 54% of GDP in developing countries; the average share of services in world GDP is 69%. In the United States (US), the services share of GDP is 76.5%, United Kingdom 75.6%, India 53.7%, and Brazil 64.0%. In the PRC, the share of services in GDP is lower than developed and developing economies.

1.2 Services Trade

Given the growing importance of services trade in terms of its increasing contribution to the PRC's GDP and employment, it would also be of substantial importance to the country's economic development. Trade in services can improve economic performance and provide a range of traditional and new export opportunities.

From 1990 to 2010, services have been the fastest growing segment of world trade and for the PRC as well. From 1990 to 2000, the PRC's annual growth rate of services export was 18% and annual growth rate of services import 24% on a year-on-year basis. From 2000 to 2009, the annual growth rate of services export was 17% and annual growth rate of services import 18% on a year-on-year basis. The growth of the PRC's services trade exceeded the world average growth from 1990 to 2009. The PRC's position in world services trade for exports also increased from 12th in 2001 to 5th in 2009, and for imports from 10th in 2001 to 4th in 2009. The PRC has become one of the top five trading nations.

Despite the higher growth rate and increased ranking of the PRC's services trade, there has also been a services trade paradox in the PRC. In contrast to merchandise trade, the PRC's trade in services was of a smaller scale and had long been in deficit. The paradox was showed by the extremely lower share of services trade compared with goods trade. The PRC's share of services in total trade is lower than both the world average and that of the leading trading nations. From 1990 to 2009, the share of services in world trade was around 20%. For the PRC, the share of services in total trade is below 10%. The lower share of services in total trade reflected the lower share of services in the GDP.

The PRC's service paradox results from the bias in favor of merchandise manufacturing and heavy industries. Services play a key role in competitiveness and trade facilitation. The potential gains from more open services trade are greater than those from liberalizing goods. The lower share of services trade has impeded the expansion of benefits of trade liberalization in the services sector.

2. IMPACTS OF THE GLOBAL FINANCIAL CRISIS ON TRADE IN SERVICES

2.1 Overview

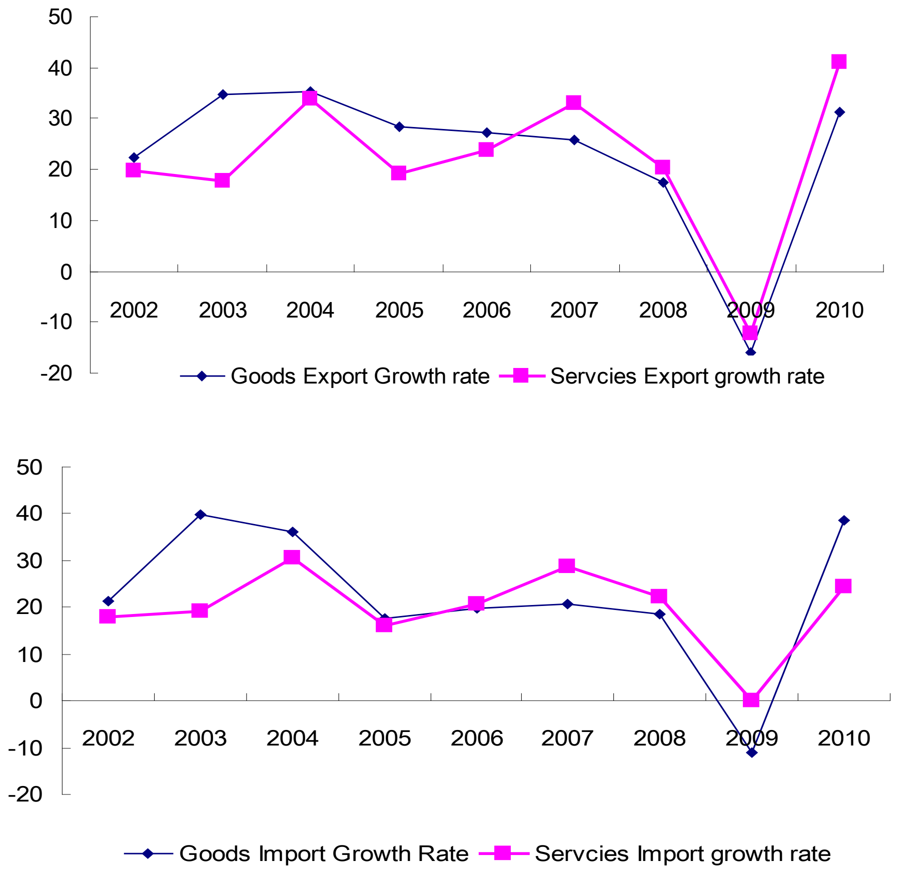
2.1.1 Trade in Services Trends

The financial crisis impacted international trade from two aspects: On the financial side, the crisis directly impaired the environment for trade financing with tougher conditions, reduced credit lines, and delayed trade settlement, thus adversely affecting international trade. On physical side, the financial crisis caused substantial depreciation of financial assets. The rapid reduction of wealth triggered a steep decline in investment and consumption, resulting in reduced demand for imports including services. The services sector is directly affected by the financial crisis, since financing itself falls in the category of services. And trade in services by nature is highly conditional on the operation of the physical economy. The downturn in demand for investment and consumption not only affected merchandise imports and exports, but directly affected the demand for services at the same time.

Under the impact of the financial crisis, the PRC's trade in services fell notably. In 2008, the PRC's services imports and exports (on balance of payment basis) amounted to US$304.45 billion, up 21.3% from 2007, while the growth margin dropped by 9.6%, of which the growth of services exports declined by 12.7%. Traditional services like transportation and tourism were more seriously affected by the financial crisis, while the services with high added value such as insurance, and computers and information were less affected, with the growth rate of their exports more than twice that of services exports as a whole on a year-on-year basis. In addition their export growth margin dropped by a smaller degree.

In 2009, the PRC's services imports and exports (on balance of payment basis) totalled $286.8 billion, down 6% from 2008. Of these, the growth of services exports declined by 12.2% and imports increased by 0.1%. Owing to the decrease of exports, the services trade deficit in 2009 increased by 150%. Transportation, royalties and licenses, insurance, and tourism all had big trade deficits. In 2009, the share of transportation and tourism was 53.6%. Compared with 2008, the share of traditional services like transportation and tourism decreased. Tourism used to be the services subsector that would run a trade surplus, but in 2009 it began to run a deficit. Other business services had trade surpluses in 2009, increasing by 104.2% from 2008.

Figure 1: Goods and Services Trade Growth Rate of the People's Republic of China 2002—2010 (%)



Source: Ministry of Commerce, People's Republic of China; State Administration of Foreign Exchange, People's Republic of China.

In the first half of 2010, according to balance of payments statistics of the State Administration of Foreign Exchange, the PRC's services trade recovered stably. Total services trade value amounted to US$165.63 billion, increasing by 31.7% on a year-on-year basis. Exports increased by 41.2% and imports increased by 24.5% on a year-on-year basis. The services trade deficit declined by 43.2% on a year-on-year basis.

2.1.2 Main Findings

The shifting V-curve of the PRC's services trade showed a sharp decline in 2009 and rapid trade recovery in 2010. The PRC faced deceleration in services trade growth rate, but the magnitude of its impact on the PRC was not considered to be very large.

Possible explanations for the shift in the V-curve of the PRC's services imports and exports include the following:

- **Services trade volumes rebounded symmetrically with the PRC's economic recovery.** The PRC's large stimulus package including vigorous and timely fiscal and monetary stimulus is a prime example. Growth picked up following a large increase in unemployment from the initial shock to world trade. The PRC's success in domestic stimulus not only helped stimulate the domestic economy but also boost local demand for services imports. The PRC is the only economy where services imports increased in 2009 instead of declining as in all the world's leading trading economies.

- **Service trade was more robust than goods trade because demand was less cyclical and dependence on external finance was less.** The impact of the crisis on the PRC—a country less dependent on merchandise exports other than services exports for growth—is far less dramatic. The performance of the domestic market and domestic demand remained positive.
- **The PRC's services sector is currently not totally integrated with global markets.** The global financial crisis had some adverse effects on the PRC's trade in services. But the influence of the crisis on the services trade was limited compared with goods trade. This was partly due to the degree of openness of the services sector, which is lower than for the goods sector. The PRC's services trade took a small share in total trade. Services exports were only 9.34% of total exports in 2008 and 9.73% in 2009; services imports were 12.44% of total imports in 2008 and 13.81% in 2009. Compared with firms in goods trade, most services firms are not involved in services trade.

2.2 Competitiveness in Services Trade

In 2008, the PRC ranked seventh in world services exports and fifth in world services imports. In 2009, the PRC's ranking in world services exports rose to fifth and its ranking in world services imports rose to fourth. In 2009, the PRC's share of world services exports was 3.8% (equal to one-fourth of US services exports) and the share of world services imports was 5.0%. In 2009, the PRC's share of world goods exports increased to 9.6% and of world goods imports to 8.0%. The country's share of world services trade was relatively lower compared with its share of goods trade.

The PRC had large trade deficits in services before and after the global financial crisis. In 2008, the services trade deficit was US$11.56 billion, an increase of 52% from 2007. In 2009, the services trade deficit was US$29.6 billion, an increase of 156% from 2008. The PRC's trade competitive index for services trade also declined from negative 0.04 in 2008 to negative 0.10 in 2009.

Temporary measures alone are not sufficient to correct imbalances in the PRC's pattern of economic growth and development, which are macroeconomic and structural in nature. The crisis reinforced the PRC's intention to undertake more longer-term structural reforms needed to strengthen its services sector and to diversify the economic and trade structure.

2.3 Trade Dynamics: Trade in Services by Subsector

2.3.1 Growth Rate Differed among Various Services Subsectors

The growth rate differed among 12 services subsectors in the PRC before and after the crisis. Almost all the subsectors recovered rapidly in 2010.

For exports, seven subsectors including transportation, travel, communication, construction, royalties and licenses, film and audiovisual, and other business services were affected by the global financial crisis—the value of their exports declined and growth rates were negative in 2009. Five other sectors including insurance, financial services, computer and information services, consulting services, and advertising and public-opinion polling were less affected by the crisis—the value of their exports increased in 2009 on a year-on-year basis. The emerging trade in the services sectors with high-added value such as insurance, and computer and messaging services were not as badly affected by the crisis after all—with export growth margins more than twice that of services sector exports as a whole. In the first half of 2010, almost all the services subsector grew rapidly in exports except communications service.

For imports, five subsectors including transportation, construction, insurance, consulting services, and other business services were affected by the global financial crisis—imports value declined and showed negative growth rates in 2009. Seven subsectors including travel, construction, financial services, computer and information services, royalties and licenses, advertising and public opinion polling, and film and audiovisual were less affected by the crisis and imports value increased in 2009 on a year-on-year basis. In the first half of 2010, almost all the services subsectors grew rapidly in exports except other business services.

2.3.2 Changing Services Trade Composition Postcrisis

The share of the PRC's traditional services subsectors such as transport and tourism in total services imports and exports declined slightly; other emerging services sectors such as insurance, computer and information services, and consulting increased gradually in proportion, although still very low. The basic composition of the PRC's services trade changed slightly, but the traditional services subsectors still were responsible for the largest share in total services trade. The global financial crisis did not affect the PRC's services trade composition much in the short run.

For exports, the share of transportation and tourism services declined from 56.3% in 2007 to 54.1% in 2008. In 2009, the share of traditional services subsectors declined to 49.2% and further to 48.1% in the first half of 2010. The emerging services subsectors including insurance, financial services, computer and information services, and royalties and licenses took a share of 42.7% in 2007 and 44.9% in 2008. The share rose from 49.8% in 2009 to 51.2% in the first half of 2010.

For imports, the share of transportation and tourism services declined from 56.5% in 2007 to 54.8% in 2008. In 2009, the share of traditional services subsectors rebounded to 57.1% and further to 60.1% in the first half of 2010. The share of emerging services subsectors including insurance, financial services, computer and information services, and royalties and licenses was 43.4% in 2007 and 45.4% in 2008, but the share declined to 42.9% in 2009 and to 39.4% in the first half of 2010.

Services Subsectors Run a Trade Deficit or Surplus

Services imports grew faster than exports and the trade deficit in services grew larger year-by-year. The total services trade deficit continues to grow postcrisis, but not all the subsectors have trade deficits (Figure 13).

In 2008, four services sectors including transportation, insurance, financial services, and royalties and licenses had trade deficits, while eight had a trade surplus. Among them construction services, tourism, consultancy, computer and information, and other business services are the top five, with a total surplus of US$21.23 billion.

In 2009, seven services subsectors including transportation, travel, insurance, financial services, royalties and licenses, and film and audiovisual had trade deficits. Transportation services had a trade deficit of US$23.01 billion, up by 93.1% on a year-on-year basis. Tourism services shifted from a trade surplus of US$4.69 billion in 2008 to a trade deficit of US$4.0 in 2009. Construction services had a trade surplus of US$3.6 billion, down from US$6.0 billion in 2008. Computer and information services had a trade surplus of US$3.3 billion, an increase of 6.2%. Consulting services had a surplus of US$5.2 billion, increasing by 13%. Other business services had a surplus of US$5.92 billion, increasing by 200% on a year-on-year basis.

2.4 Trade Dynamics: Trade in Services by Mode of Supply

Given the limited trade statistics on mode of supply, this section will discuss mode 3 in detail. [1]

2.4.1 Change of Foreign Commercial Presence in the PRC

The scale of services trade by mode 3 expanded in the PRC because of the opening up of trade and investment in services.

In 2008, 14,582 foreign-invested enterprises were newly established in the PRC's services sector, a decline of 9.8% from 2007 and accounting for 53.0% of the total number of newly established foreign-invested enterprises in 2008. The actual utilization of foreign investment amounted to US$54.94 billion, accounting for 50.7% of the total foreign capital actually utilized by the PRC, an increase of 3.5% over 2007.

In 2008, 262 newly approved foreign-invested construction enterprises were established and the actual use of foreign direct investment (FDI) amounted to US$1.09 billion, accounting for 2.0% of the total newly established foreign services enterprises and 2.9% of the total services FDI. FDI in entertainment, culture, and sports services amounted to US$230 million and 157 foreign enterprises were set up, down 40.7% on a year-on-year basis. FDI in financial services amounted to US$570 million, accounting for 1.5% of total FDI in services; 25 foreign-invested enterprises were set up in financial services and took a share of 0.2%; 452 foreign enterprises in real estate were newly established taking a share of 3.4%; and FDI in real estate amounted to US$18.59 billion with a share of 48.8%.

In 2009, 11,461 foreign-invested enterprises in the services sector were newly established in the PRC, down by 14.8% from 2008 and accounting for 48.9% of the total newly established foreign enterprises. FDI in the services sector (excluding banking, insurance, and securities) amounted to US$90.03 billion, declining by 2.6% on a year-on-year basis and accounting for 42.1% of total FDI in 2009.

In 2009, commercial presence in the real estate industry grew substantially; 569 foreign enterprises were newly established, an increase of 25.9%. FDI in real estate amounted to US$16.8 billion, down 9.7%. Commercial presence in construction and related engineering services declined: 220 foreign-invested enterprises were newly established, a decline of 16%. FDI mounted to US$690 million, a decline of 36.7%. In financial services, 52 foreign-invested enterprises were newly established (excluding banking, securities, insurance) and FDI amounted to US$460 million, a decline of 20.3%. In other social services, 148 foreign-invested enterprises were newly established and FDI amounted to US$1.57 billion, an increase of 184.9%.

FDI in the services sector amounted to US$29.74 billion in the first 8 months in 2010, up 36.75% from the same period in 2009, according to the Ministry of Commerce.

2.4.2 Change of Commercial Presence Abroad

In 2008, the PRC's services sectors made outward foreign direct investment (OFDI) of US$46.1 billion, up 135.6% from 2007, accounting for 82.5% of the PRC's total OFDI.

In 2008, OFDI in the financial sector rose sharply to US$14.05 billion, accounting for 30.5% of total OFDI in services, and increasing by 742.3% on a year-on-year basis. OFDI in leasing and business services amounted to US$21.72 billion, increasing by 287.3% and accounting for 47.1%; OFDI in wholesale and retail amounted to US$6.51 billion, declining by 1.4% and accounting for 14.1%; OFDI in information transmission, and the computer and software

[1] Mode 3: Commercial presence means the service is provided within A by a locally-established affiliate, subsidiary, or representative office of a foreign-owned and foreign-controlled company (bank, hotel group, construction company, etc.)

industry amounted to US$3.0 billion, declining by 1.7% and accounting for 0.6%; OFDI in transport, storage, and postal industry amounted to US$2.66 billion, declining by 34.7% and accounting for 5.8%; and OFDI in real estate amounted to US$340 billion, declining by 62.7% and accounting 0.7%.

In 2009, the global financial crisis adversely affected the PRC’s commercial presence abroad. However, the PRC’s OFDI net flows in 2009 reached US$56.63 billion, increasing by 1.1%. The PRC’s OFDI in the services sector was US$39.77 billion, declining by 13.7% from 2008 and accounting for 70.4% of total OFDI.

In 2009, OFDI in transportation, storage, and postal industry amounted to US$2.07 billion, declining by 221.1%; OFDI in wholesale and retail was US$6.14 billion, declining by 5.8%; OFDI in the financial sector was US$8.73 billion, declining by 37.8 %; and OFDI in leasing and business services amounted to US$20.47 billion, declining by 5.7%. OFDI in these four areas amounted to US$37.41 billion, accounting for 94.1% of the PRC’s total OFDI in the services sector.

In 2009, OFDI in some emerging services subsectors such as scientific research, technical services, geological prospecting, as well as the real estate, accommodation, and catering industry grew rapidly. Among them, OFDI in scientific research, technical services, and geological prospecting amounted to US$780 million, increasing by 365%; OFDI in real estate amounted to US$940 million, increasing by 176.7%; and OFDI in the wholesale and retail subsector amounted to US$70 million, increasing by 153.8% on a year-on-year basis.

By the end of 2009, PRC state-owned commercial banks had set up a commercial presence in the US, Japan, United Kingdom, and 28 other countries and regions, with 50 branches, 18 subsidiary bodies, and 3 million employees of which 2.9 million are foreign employees.

2.5 Trade Dynamics: The PRC’s Trade in Services by Partners

Hong Kong, China; the US; European Union (EU); Japan; and members of the Association of Southeast Asian Nations (ASEAN) are the top five services trading partners of the PRC. Hong Kong, China is both the leading market for exports and source of imports for the PRC in services trade. The PRC’s trade value with these partners decreased or fluctuated, but the basic trade structure was not changed postcrisis.

In 2008, the PRC's major service trade partners concentrated in Hong Kong, China; the US; the EU; Japan; and ASEAN. Both services import and export with major trading partners increased on a year-on-year basis.

For the sum of services imports and exports, the trade value of these five partners with the PRC accounted for 68.4% of the PRC’s total services trade in 2008. Among them, Hong Kong, China was the leading trading partner of the PRC in services. The PRC’s services import and export value with Hong Kong, China amounted to US$68.18 billion, accounting for 22.4% of total services trade. The US was the 2nd largest trading partner of the PRC in services, accounting for 15.2%; the EU ranked 3rd with 14.7%; Japan ranked 4th with 8.2%; and ASEAN ranked 5th accounting for 7.7% of the total services trade.

For exports, Hong Kong, China was the PRC's largest export market in services. In 2008, the PRC's services exports to Hong Kong, China amounted to US$41.9 billion, accounting for 28.6% of total services exports. The US accounted for 15.6%, the EU14.6%, Japan 7.4%, and ASEAN 7.1%.

Hong Kong, China was the PRC's largest source of imports in services, accounting for 16.6% of the PRC’s total services imports. The EU ranked 2nd, accounting for 14.9%; and the US ranked 3rd, accounting for 9.6%.

For trade balance, despite the large trade deficit in services in 2008, the PRC had a trade surplus of US$15.62 billion with Hong Kong, China. Australia was the largest trading partner with whom the PRC had a trade deficit in services; it amounted to US$5.52 billion. The PRC's trade deficit in services with Japan amounted to US$3.86 billion; the Republic of Korea US$2.68 billion; and the US US$0.73 billion.

In 2009, the PRC's services imports and exports still concentrated in Hong Kong, China; the US; the EU; Japan; and ASEAN. Exports to these major trading partners showed a decreasing trend, and imports remained at the same scale as the previous year.

The trade value of the five partners with the PRC amounted to US$171.47 billion, accounting for 59.8% of the PRC's total services trade in 2009, falling by 8.6%. Among them, Hong Kong, China was still the leading trading partner in services. The PRC's services import and export value with Hong Kong, China amounted to US$63.5 billion, accounting for 22.1% of total services trade, declining by 7.1%. The EU (25) accounted for 14.8%, Japan 8.6%, the US 8.3%, and ASEAN 7.7% of China's total services trade.

For exports, Hong Kong, China was still the PRC's largest export market in services. In 2009, the PRC's services exports to Hong Kong, China amounted to US$37.19 billion, accounting for 28.9% of total services exports. The EU accounted for 13.3%, the US 7.4%, Japan 7.3%, and ASEAN 6.4%.

For imports, Hong Kong, China was still the PRC's largest source of imports in services. Imports from Hong Kong, China amounted to US$26.31 billion in 2009, accounting for 16.6% of the PRC's total services imports. The EU accounted for 12.8%, the US 9.6%, Japan 8%, and ASEAN 9.9%.

For trade balance, Hong Kong, China was the largest source of the PRC's service trade surplus in 2009; the surplus amounted to US$10.88 billion. In 2009, the US became the leading source of the PRC's trade deficit in services, with the deficit rising sharply to US$7.46 billion, increasing by 33.1% on a year-on-year basis. The PRC's trade deficit in services with Japan amounted US$5.69 billion, Australia US$4.89 billion, and the Republic of Korea US$4.53 billion.

For commercial presence, Hong Kong, China and the EU were the PRC's main destination for OFDI in services. In 2009, the PRC's OFDI in the services sector in Hong Kong, China was US$28.92 billion, accounting for 72.7% of the PRC's total OFDI in services. The OFDI was directed at services subsectors such as leasing and business services accounting for 48.2%, financial services 25.9%, and wholesale and retail 16.8%. The PRC's OFDI in the EU services sector was US$26.7 billion, accounting for 6.7% of the PRC's total OFDI in services. The OFDI was directed to leasing and business services accounting for 86.7%, and financial services for 7.9%.

3. PRECRISIS SERVICES TRADE POLICY

3.1 The PRC's Services Schedule

The General Agreement on Trade in Services (GATS) differs from the General Agreement on Tariffs and Trade (GATT) in its approach to World Trade Organization (WTO) basic principles: members may take exemptions to the obligation of most favored nation treatment (MFN) and grant national treatment only in sectors listed in their schedules, subject to conditions and qualifications set out. A specific commitment in a services schedule is an undertaking to provide market access and national treatment for the service activity in question on the terms and conditions specified in the schedule. When making a commitment, a government therefore binds the specified level of market access and national treatment, and undertakes not to impose any new measures that would restrict entry into the market or the operation of the services.

In nearly all schedules, commitments are split into two sections: First, horizontal commitments that stipulate limitations that apply to all sectors included in the schedule; these often refer to a particular mode of supply, notably commercial presence and the presence of natural persons. Any evaluation of sector-specific commitments must therefore take the horizontal entries into account. In the second section of the schedule, commitments that apply to trade in services in a particular sector or subsector are listed.

The PRC's service industry was opened to a level close to that in developed countries, covering 10 of the 12 major GATS service categories and 100 of the 160 minor categories. The schedule for the PRC has not only high sector coverage but also commitments in key subsectors. The PRC has made specific commitments for 93 service subsectors. Among 26 basic groups of services subsectors, the PRC made 22 commitments; these did not include research and development, postal services, health and social services, and recreational services. It made relatively broad commitments upon its accession to the WTO as a developing country.

The importance of the different modes varies from sector to sector. Sectors committed are more often "unbound" under mode 1 (cross-border supply) than under other modes, while commitments under mode 2 (consumption abroad) tend to be unrestricted. A relatively large number of limitations tend to be attached to commitments under mode 3 (commercial presence) and mode 4 (movement of natural persons). Examples of limitations under mode 3 include foreign equity limits, restrictions on types of legal entities, and limitations on number of suppliers. Mode 4 commitments are usually set out in the horizontal section of the schedule.

The PRC committed to the substantial opening of a broad range of services subsectors through the elimination of many existing limitations on market access. It also made certain horizontal commitments, which are commitments that apply to all sectors listed in its services schedule (Table 2).

3.2 Implementation of the GATS Commitments

Since its accession to WTO, the PRC has been liberalizing its services sector closely in line with its GATS commitments. The PRC government has recognized the importance and benefits of services liberalization for economic growth, and continued to make its trade policy regime more transparent.

The second trade policy review for the PRC was held on 21 and 23 May 2008. The WTO Secretariat report,[2] along with a policy statement by the PRC government,[3] was the basis for the second trade policy review by WTO's Trade Policy Review Body. According to the review report, the PRC has continued to adopt measures to increase transparency of its trade and trade-related policies, practices, and measures. It has been liberalizing its services sector closely in line with its commitments under the GATS. Relevant legislation is being operated consistent with WTO rules. The PRC has made efforts to comply with its WTO obligations, pursuing substantial reform programs, in both its trade and investment regimes.

After accession to WTO, the PRC government established a set of new rules and regulations to promote opening up of its services sector. These rules and regulations mainly included the Regulation on Administration of Commercial Franchise, Detailed Rules for the Implementation of the Regulations on the Administration of Foreign-Funded Banks of the People's Republic of China, Measures for the Information Disclosure of Commercial Banks, Measures for the Administration of Trust Companies, Measures for the Administration of Finance Leasing Companies, Measures for the Overseas Investment with Insurance Funds, Administrative Measures for Insurance Licenses, Measures for the Administration of Foreign

[2] WTO. 2010. Trade Policy Review: China: Report by the Secretariat. WT/TPR/S/199

[3] WTO. 2010. Trade Policy Review: Report by the People's Republic of China. WT/TPR/G/199

Stock Exchanges' Representative Offices in China. These laws and regulations embody the PRC’s WTO commitments and incorporate measures of autonomous liberalization, demonstrating the PRC’s positive stand to opening up its trade in services.

The PRC made its trade regime more transparent by introducing the Regulation on Open Government Information, which entered into force on 1 May 2008. As a designated government publication to make public trade-related laws and regulations, *China Foreign Economic and Trade Gazette* had published more than 3,300 laws, regulations, and specific measures by the end of 2007.

For mode 3—commercial presence—prior to the PRC’s WTO accession, foreign companies in many services sectors did not have an unqualified right to apply for a license to establish or otherwise provide services in the PRC. They could only apply for a license if they first received an invitation from the relevant PRC regulatory authorities, and even then the decision-making process lacked transparency and was subject to inordinate delay and discretion. In its accession agreement, the PRC committed to licensing procedures that were streamlined, transparent, and more predictable. The PRC’s services schedule called for the implementation of relatively minor additional commitments by 11 December 2007, in areas such as taxation services, management consulting services, travel and tourism services, and rail transport services. These commitments are the last ones scheduled to be phased in pursuant to the PRC’s scheduled commitments.

Since joining WTO, the PRC has gradually lifted the limits on foreign investment in the services sector in aspects such as geographic regions, equity, and business scope. The sector is more open to the outside, resulting in attraction of more foreign investment and expansion of commercial presence in the PRC.

The PRC established a set of new rules and regulations to promote opening up of its services sector. These laws and regulations incorporate measures of autonomous liberalization, demonstrating the PRC's positive stance toward opening up its trade in services. Several new domestic trade-related laws were adopted, including the Property Law, Enterprise Income Tax Law, Anti-Monopoly Law, and Law on Enterprise Bankruptcy. These laws contribute to a more rule-based predictable business environment, particularly important for foreign investors. Recently the PRC has been moving to ensure equal access for domestic and foreign investors.

3.3 Measuring the Services Policy

The PRC's services commitments at accession were recognized for their breadth and significance. The country has been steadily implementing its commitments. The services market is open and the government tries to provide fair, non-discriminatory access in line with its WTO commitments.

Eight years after its WTO entry, the PRC needs to continue to improve in some areas, including access by foreign companies; more transparency in domestic regulations; smoother administrative procedures, especially licensing procedures; capital requirements for financial institutions; clearer guidelines on access to the telecommunications industry for joint ventures; and rules governing domestic distribution of foreign products. In the PRC, some services subsectors are still subject to a certain degree of state control and lack of competition. Several continue to be characterized by state involvement and state interference in the economy that is still noticeable, distorting market functioning. There are still some restrictions on foreign investment and private-sector activities in several of the individual subsectors including banking, insurance, securities, asset management, and telecommunications services.

The PRC’s regulations have generated significant concerns with regard to the implementation of important commitments in the area of banking services. Excessive and often apparently discriminatory capital requirements by international norms have continued to restrict market entry for foreign suppliers in many areas, such as banking, securities, asset management, telecommunications, and construction services. In addition, in banking, insurance, and legal services, branch restrictions and related practices limit market access for foreign suppliers. In other areas, particularly construction services, problematic measures appear to be taking away previously acquired market access rights.

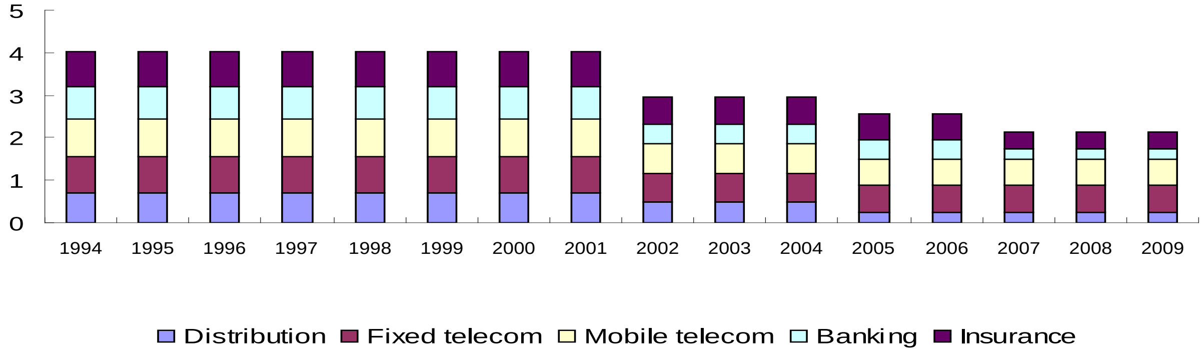
National treatment concerns have remained, particularly for banking and insurance. In some subsectors, particularly insurance services, the licensing process was characterized by lengthy delays. The PRC still does not allow foreign credit card companies and other suppliers to provide electronic payment processing and related services for domestic currency transactions.

Restrictions on trade in services impose costs, limit domestic and international competition, decrease efficiency, and permit incumbent service suppliers to charge prices above those in a competitive market. Restrictions in services trade usually take the form of government regulation. Administrative regulation includes reporting, information and application procedures, and burdens on start-ups, implied by both economy-wide and sector-specific requirements that restrict domestic market mechanisms and curb international transactions. Economic regulation includes all other domestic regulatory provisions affecting product market competition, such as state control and legal barriers to competition.

Gootiiz and Mattoo (2009) calculated the overall restrictiveness of services trade polices of 56 countries in 2005. The PRC belongs to the group with the highest services trade restrictiveness index (STRI) and more restrictive services policies than most developed countries and some underdeveloped countries such as Cambodia, Nigeria, and Mongolia. The PRC's STRI is lower than that of other Asian economies such as India, Indonesia, Thailand and Philippines.

On the basis of time-series developments in the PRC's regulations, Ying Fan (2009) calculated the STRI of the PRC's services sector, mainly on specific subsectors such as distribution, telecommunications, and financial services. The results provide evidence that the PRC's trade barriers in services are decreasing. Total trade barriers are decreasing; the degree of market openness differed across subsectors. The STRI for distribution services is the lowest and STRI for communication services is the highest.

Figure 2: The PRC's Service Trade Restrictiveness Index by Subsector



Source: Fan, Ying. 2009. China's Services Policy—Pre- and Post-WTO Accession. Working paper presented at Trade and Industry in Asia Pacific: History, Trends and Prospects, Australian National University, Canberra, 19–20 November 2009.

Decreasing the PRC's services barriers is essential for integration into the global economy and continued economic development. The country is already benefitting from implementation of the WTO commitments in services. But there are still a range of impediments to the growth of the PRC's services sector, as well as service trade and foreign investment. The government should remove these constraints to realize the full potential economic benefits of trade and investment in services.

The PRC is in a position to be more transparent about its regulation and trading regime. Greater transparency has been in its own interest, since this would preclude any unnecessary misunderstanding of its trade practices and measures, and foster better decision-making. The government will accelerate liberalization of services to boost development of economy.

4. POSTCRISIS SERVICES TRADE POLICY

4.1 Policies Adopted in Response to the Global Financial Crisis

To fight against the negative impact of the global financial crisis on the economy, the government adopted proactive fiscal policy and moderately loose monetary policy to expand domestic demand and successfully alleviated the impact of the crisis on the goods export sector. The goods trade policies adopted to deal with the downward trend included changing the policy of restricting exports and restoring tax rebates, strengthening export credit insurance service, adopting loose monetary policy and alleviating enterprises' financing problems, improving processing trade policy, and stabilizing the yuan (CNY) exchange rate.

Compared with policies adopted for goods trade, the policies adopted for services trade by the PRC government were limited. Most of the policies aiming to stimulate the domestic economy are not specific to services. The PRC has implemented a number of policies to stimulate and rebalance the economy, to increase consumer spending, to restructure and subsidize certain industries, and to boost incomes for farmers and rural poor.

The PRC government introduced limited policies in the services sector to respond to the global financial crisis including the following:

(i) The 2-year 4 trillion yuan (CNY, which equaled 586 billion US dollar) stimulus package (equivalent to 13.3% of the PRC's 2008 GDP) provided stimulus to the services sector, including public transport infrastructure, rural infrastructure, environment projects, technological innovation, health, and education.

(ii) To decrease reliance on manufacturing, the government relaxed FDI restrictions on some services subsectors, notably telecommunications and tourism, and has been delegating licensing authority to local governments for establishing and modifying operations of "encouraged" foreign-invested enterprises and certain selected sectors, as well as certain types of foreign-invested enterprises, such as foreign invested joint-stock companies.

(iii) The central bank liberalized monetary policy and provided directives to commercial banks to provide financing and funding to help firms invest overseas, including OFDI in the services sector.

(iv) The government has continued to review, revise, or amend its trade and related laws including the Anti-Monopoly Law (effective 1 August 2008); its first comprehensive competition law; and the Patent Law (effective 1 October 2009), which strengthened patent protection by increasing penalties against infringement. It has also reformed its tax system to render it more neutral; in particular, this involved the unification of enterprise income tax rates for all companies (domestic and foreign), and the transformation of the value-added tax (VAT) from a production-based to a consumption-based tax.

4.2 Services Policies: Challenges and Opportunities

4.2.1 Opportunities

Become a major beneficiary of world trade in services. World trade in services recovered during 2010. The weaker downturn in services trade during the global crisis could reflect less dependence on intermediate inputs as much as less reliance on trade finance of certain services sectors like communications. With the continued rise of world services trade, new trading opportunities and new services were created by the rapid improvement in communications and large reduction in costs. Distance-related barriers that previously disadvantaged suppliers and users in remote locations were becoming less relevant. Attitudes of governments and expectations of citizens were also changing. In many parts of the world, more services were being opened-up to private commercial participation. The combination of technological and regulatory innovations enhanced the tradability of services, and thus created new opportunities for all the economies including the PRC.

Transform the economy from manufacturing oriented to service oriented to expand trade in services. The global financial crisis was a blow to foreign trade. It was also a push to alter trade modes. The crisis prompted the PRC to rethink its development strategies. It is facing the choice between growth driven by goods exports and growth driven by domestic demand. The need to find new and sustainable sources of growth is becoming crucial. The PRC’s transformation of its economic growth pattern needs to expand trade in services. For the welfare of the majority of people, the PRC needs to resist protectionism and become more, not less, integrated in the global economy to continue to reap the benefits of global knowledge, technologies, and innovation. Trade in services plays a special role in knowledge transfer and exchange. It can enable the PRC to benefit from international research, contracts, use of new equipment that incorporates newer technology, and exchange of knowledge and experience. Knowledge transfers have been helped through trade in services in telecommunications, retail, banking, and information technology training.

Utilize the large domestic services market generated by urbanization and industrialization. Industrialization and urbanization will generate huge market demand. Urbanization has become an important driving force to the PRC's economic growth and social development. In the next 10 years, the PRC will meet the great historical turning point where the urban population exceeds the rural population. Emerging manufacturing and service industries will spread from coastal areas inland, and thousand of cities will prosper, and continuously generate huge market demand for goods and services and drive the long-term rapid development of the PRC's economy. With the acceleration of the PRC's industrialization and urbanization process, market demand for services import will rapidly grow.

Take advantage of the large potential for services. The PRC can sustain service-led growth because of the great deal of room for catch-up and convergence. The globalization of services provides opportunities for the PRC to find niches—beyond manufacturing—where it can specialize, scale-up, and grow. Comparative advantage can just as easily be in services as in manufacturing or agriculture. In the case of the PRC, value added in services accounts for 40% of GDP, and services only account for 11% of the PRC's external trade. Taking advantage of this potential includes two sets of actions: one is a more neutral policy and incentives environment; another is supportive investments in the services sector.

Become a services trading power. In April 2010, the Ministry of Commerce released the Foreign Trade Development Strategy in the Post-Crisis Era report, which clearly states the goal of making the country a strong trading power by 2030. Specific targets for 2020 are a total trade value of US$5.3 trillion, breaking down to US$4.3 trillion in goods and US$1 trillion in services. The PRC is expected to play a leading role in setting up international trade rules.

Capitalize on the potential benefits of services liberalization. Trade liberalization in services helps generate economic growth by creating bigger markets, which stimulates technology and encourages lower cost. Services liberalization is strategically important for technology transfer and development. Producer services such as telecommunications, banking, insurance, construction, and transport help to shape overall economic performance. FDI in services sectors typically brings with it new skills and technologies that spill over into the wider economy in various ways. Trade liberalization can help increase the supply of services by offering an environment conducive to attracting foreign investment and by lowering cost through competition. The gains from more investment and greater domestic competition also go with building greater export competitiveness in both goods and services.

4.2.2 Challenges for Services Trade Postcrisis

Substantial barriers remain to trade and investment in services and regulations impede domestic and foreign services suppliers. Not all of these are discriminatory but may stem from barriers to entry which apply equally to domestic and foreign suppliers. Integration for services has remained slow outside of a few specific subsectors including telecommunications, road and air transport, and financial services. Nonetheless, significant restrictions remain, such as foreign participation limits, foreign investment limits, and private-sector activities in some services sectors. In banking, stringent qualification requirements remain, including high minimum asset requirements on sole or controlling shareholders and high minimum paid-up capital amounts, restrictions on the supply of credit-card services, and restrictions on the business scope of foreign bank branches. The stock market in the PRC continued to develop during the period under review, and the process of converting shares of state-owned enterprises (SOEs) to be traded in the market has progressed.

Opening services markets leads to long-term gains but is neither adjustment- nor risk-free in the short term. Moving toward a more competitive environment may take time and may impose significant burdens as the adjustment takes place. Services subsectors that previously enjoyed heavy protection will be strongly against further trade liberalization. Badly designed reforms may unnecessarily complicate the adjustment process, or even more seriously, lead to monopoly rents being transferred to private, perhaps foreign, owners.

Incentives for both the central and local governments may be weak. Instability might ensue if liberalization of the services sector is not accompanied by adequate prudential supervision and regulation. The absence of well-designed universal service requirements for new services participants, especially from the private sector, in the market could also result in reduced access to services for vulnerable groups or geographically remote regions. Avoiding unnecessary friction and ensuring the efficiency and viability of more open, market-oriented service regimes is a big problem for the government. Designing an institutional framework that will favor structural reform, while enhancing social dialogue, and public understanding and acceptance of reform measures, is a big challenge.

Reform to pursue benefits across different policy areas in a complementary manner and to foster synergies between policies in services is difficult. Integrating regulators in services subsectors and harmonizing services trade-related policies under a variety of regulators is a very difficult problem facing the PRC. The Ministry of Commerce regulates both domestic and foreign trade, works to attract foreign investment, and is the supervisory body for all distribution services in the PRC. In 2006, it set up the Department of Trade in Services to be responsible for trade promotion in services. However, in the PRC, many administrations are responsible for the regulation of different services subsectors. For communication services, the national telecommunications regulatory authority is the Ministry of Industry and Information Technology. It has a nationwide regulatory system comprising provincial branches—the provincial telecommunication administration—with regulatory functions in their respective provinces. The other two regulatory agencies in telecommunications are the State Administration of Radio, Film, and TV responsible for awarding licenses for broadcasting and managing censorship of content; and the National Development and Reform Commission responsible for regulating basic telecommunications prices and interconnection charges. For financial services, the China Banking Regulatory Commission is the main regulator for banking along with the People’s Bank of China and the State Administration of Foreign Exchange. The insurance regulator, the China Insurance Regulatory Commission, is responsible for the approval of operating licenses. The China Securities Regulatory Commission is responsible for the regulation of the securities subsector. Harmonizing the policies made by these regulators involved in services is very difficult.

Harmonizing conflict between central and local governments in making services policies is not easy. Tension often arises between the central and local governments over policy making. The PRC has multiple jurisdictions and each is more interested in its local development than the overall development of the country. Such a situation has led to the problem of contradictory decision-making and local protectionism. Each region has its own unique trade and investment barriers, and interpretation of regulations differs. Balancing the relationship between local community outcomes and the national long-term strategy is not easy. Future services policy reforms should encourage local authorities to focus on promoting the services sector, consistent with the principles of sustainable development.

Developing the appropriate policy mix to expand services trade while achieving regulatory objectives efficiently is complicated. Regulators’ knowledge of regulation is sector-specific. Their focus often is not on international trade and/or investment or supporting competition within national services trade strategies. The policy adjustment challenge faced by the PRC differs both in nature and extent from that faced by the advanced industrialized economies; so does the required policy mix and the ability to implement policies. PRC regulators have difficulty developing an efficient framework of regulation that achieves regulatory objectives while keeping regulatory burdens on enterprises to the necessary minimum, fostering competition, and helping ensure genuine market openness in services.

4.3 Possible Directions for Services Policy Reform

4.3.1 Develop an Effective Policy System Linkage in Services

Within the system of trade in services, the role played by the cross-sector liaison mechanism in policy coordination is to be strengthened. Under the general framework of the liaison mechanism, more effective working mechanisms are to be developed for key sectors and subsectors according to their respective natures. These are to offer coordinated solutions to problems of overall significance for trade in services. A liaison mechanism between the government and enterprises is to be established. Industrial associations for trade in services are encouraged throughout the country. A coordinating mechanism and a working system for promoting trade in services will be formed by ensuring close cooperation between different sectors and subsectors and tight liaison between the government and enterprises.

4.3.2 Expand Exports of Services by Key Subsectors

Efforts will be concentrated on increasing exports of key subsectors by offering a sector-specific exports guidance catalogue. Independent services export brands are encouraged. A number of enterprises with core competencies in trade in services will be created. Producer services, including transportation, telecommunications, logistics, distribution, and financial services, are a prerequisite to ensuring and sustaining economic growth. Trade in services has the advantage of being high in added value, and low in energy consumption and pollution. By developing trade in producer services, the quality for growth of trade in goods will be upgraded. The aim is to achieve coordinated development between trade in goods and trade in services through mutual complementary efforts by the two. Trade promotion in services is needed to serve the enterprises' trade and investment strategy.

4.3.3 Reduce Trade and Investment Barriers in Services by Policy Mix

Trade and investment barriers include both discriminatory barriers against foreign services providers and domestic regulation that applies to all firms whatever their nationality. Restrictions on inward FDI, entry (ownership) limitation, and operating requirements would have effects on foreign services providers. There is a positive relationship between FDI in services and the performance of domestic firms in services. Reducing barriers to trade and investment in services helps improve the productivity and competitiveness of services firms. The PRC should work on its policy mix to further open services markets. These markets need to be opened by improving services regulation and ensuring that regulations do not impede market access. Discriminatory policies need to be removed to increase export and import opportunities for services providers.

4.3.4 Reform the Tax System to Strengthen the Services Sector

The PRC should accelerate reform of its tax system to speed up the transition of its economic growth pattern from a goods to a services orientation. The government will replace sales tax with VAT for the services sector to unify tax implementation on goods and services in 5 years. According to the Ministry of Finance, beginning from 2011, the government will start a pilot program to impose VAT on some producer services, while reducing the sales tax on them at the same time. The gradual unification of taxes on goods and services will boost development of the services sector. Before 2011, VAT was levied only on manufacturing, while services were subject to a business tax that raises a much smaller amount of revenue. Given the heavy dependence of local governments on VAT revenue, they have a strong incentive to promote manufacturing, rather than services. The current framework of the finance and tax system, which was set up in 1994, can no longer adjust to rapid economic growth and solve emerging problems. Uniform VAT implementation on goods and services will offer incentives for the local government to promote the services sector. The PRC will make better use of the role of taxes in accelerating transition of the development pattern. In addition, a preferential tax policy should be implemented to help some small- and medium-sized services enterprises; the policy will aid services subsectors involved in protecting the environment and creating new jobs. Some subsectors can add not only fiscal revenue for local governments but also help create job opportunities for citizens and migrant workers and improve people's standard of living. Tax breaks should be offered to enterprises in these sectors. More favorable tax policies should be implemented to support the efforts of qualified services enterprises to list on the stock markets. The PRC will also give provincial governments the power to adjust local tax categories, rates, and cuts in the next 5 years to ensure their fiscal revenues are in accord with administrative responsibilities.

4.3.5 Reform the Competition Policy to Provide Equal Opportunity for all Services Providers

SOEs still have a dominant presence in the services sector—this constrains competitiveness and productivity. The high market concentration limits the entrance of new domestic and foreign enterprises, thus reducing the benefits of enhanced competition and liberalization. Against this background, wide-ranging reforms are needed to turn services into an efficient and competitive sector. This would strengthen domestic sources of growth and support government efforts to rebalance the economy. The Competition Policy should be reformed by reducing market concentration in the sector. The resulting liberalization and improved competitiveness would lower production costs and prices, and increase the quality of services provided to consumers and producers. Recent efforts by the government to improve enforcement of the Antitrust Law are steps in the right direction by avoiding abuses of dominant position in the services markets after deregulation. More openness to foreign participation in such areas as banking, telecommunications, and professional services will foster liberalization efforts. In this regard, a reliable intellectual property rights regime, which is crucial for the development of services, where copyrights and trademarks are important, would help attract more FDI into the sector, and encourage domestic firms to innovate.

4.3.6 Reform the Financial Policy for Private and Small and Medium-Sized Enterprises in the Services Sector

Services exports should be encouraged by a combination of ways including discount interest loans, financial allowances, and rewards. The inefficient allocation of financial resources enhances the dominance of SOEs in the provision of services. While significant progress in financial sector liberalization has been achieved, the current system remains biased toward large SOEs, which absorb about two-thirds of total lending. In contrast, private enterprises, which tend to be more efficient and innovative, receive only one-fourth of available credit. Notwithstanding their significantly smaller allocation, private firms generate about 50% of GDP and are the primary source of employment generation in the PRC. Deepening financial sector reform is important for improving capital allocation to move to an innovation-based economy and grant wider access to finance. Given the superior performance of private companies in the PRC, more efficient capital allocation would translate into higher GDP growth. Furthermore, more sophisticated capital markets will bring benefits to self-employed entrepreneurs, and small- and medium-sized enterprises, which are critical players in a vibrant services sector-based economy.

4.3.7 Negotiate Market Access for Services Exports under GATS and GATS+ Commitments

WTO and the regional and bilateral trade agreements provide mechanisms for liberalizing access to services markets. Commitments by WTO members on services take the form of a partial listing of sectors that are subject to market access and national treatment obligations. Trade agreements can potentially help the PRC government implement policy reforms that enhance the contestability of services markets opposed by domestic interest groups. By committing to certain multilateral or bilateral trading rules, the government can make domestic policy reforms more credible. The trade agreements act as domestic policy reform anchors. The PRC will make progressive liberalization under the bilateral and regional free trade agreement framework through binding GATS + commitments and make progressive liberalization under the WTO GATS framework through binding GATS commitments. The government should also stimulate services exports by improving market access through multilateral and regional negotiation channels.

4.3.8 Diminish Negative Effects of Trade Liberalization through Reform of Complementary Policies

Specific benefits are likely to result from the liberalization of trade in services. However, services liberalization also carries risks. Making appropriate regulation and other complementary reform policies will help ensure that liberalization delivers the expected benefits. The trade-related policy reform challenges facing the PRC are preference erosion and revenue loss. Policy to provide adequate income support and provide certain compensation to those who experience loss is necessary. Undertaking reforms across different policy areas in a complementary way can reduce the adjustment cost of policy reform. Comprehensive policy reform is more effective than piecemeal strategies.

5. CONCLUSION

The main conclusions and policy recommendations of this paper are as follows:

- The PRC’s services exports sector was impacted by the global financial crisis. But the crisis did not change the overall pattern of the PRC’s trade in services by sector and by partner in the short run.
- The share of services in GDP and services-related employment in total employment are relatively lower in the PRC. The relative underdevelopment of the services sector is a direct consequence of the economic development model adopted, which favors manufacturing with a focus on manufactured exports. As a result, policy incentives have directed investment into the production and export of goods, discouraging investment in services.
- The PRC’s economy has come to a turning point because of the global crisis and because of domestic tensions engendered by the export-led model. To ensure sustainable growth, the PRC must rebalance its economy toward the domestic market and the services sector.
- A well-developed services sector plays a major role in improving production efficiency and promoting technical progress and innovation. More favorable measures aimed at boosting the sector's development should be implemented.
- While manufacturing greatly benefited from liberalization brought about by the successful opening-up policy, progress with openness has been limited in the services sector. The restricted exposure of the sector to FDI, and its implicit technological transfer, has limited the expansion of the sector and the quality of services provided. It has constrained the potential of trading services, which explains the persistent deficit observed in the services account of the balance of payments.
- Despite the ambitious services liberalization commitments that the PRC agreed to when it joined WTO, the implementation and enforcement are not perfect in some fields. SOEs still dominate the services sector; this constrains competitiveness and productivity. The high market concentration limits the entrance of new domestic and foreign players, thus reducing the benefits of enhanced competition and liberalization.
- The PRC’s policy reform in services should focus on strengthening the contribution of services trade to economic growth and removing the trade and investment barriers in services. Liberal trade and investment policies contribute to growth, innovation, and

competitiveness, and avoid policy reversal. Because of downstream linkages, particular benefits are likely to arise from the liberalization of trade in services. Services barriers contribute to effective taxation, rather than protection. The PRC's services sector can be further liberalized by building sound institutions, fostering an appropriate services policy framework, removing any anti-export bias, improving firms' access to international services markets, and reducing other domestic barriers to services trade and investment.

- Trade liberalization policy should be backed by supportive action in other policy areas to complement the reform process. A comprehensive policy response is crucial for the PRC.
- Trade liberalization in services also carries risks. Making appropriate regulation and other complementary reform policies will help to ensure that liberalization delivers the expected benefits.

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