

# The Prospects for US-China Services Trade and Investment

## Executive Summary

**T**he dramatic expansion of trade and investment in services between China and United States has benefited both economies substantially and will continue to do so for the foreseeable future.

In China, the service sector already is growing, contributing to economic development and a rise in living standards by boosting the productivity of industrial enterprises. The expanding market for service-based jobs is vitally important to China's ability to absorb the large numbers of young workers and college graduates entering the job market each year. Historically, the growth of a service sector also is seen as a significant step in the evolution of a nation's economy.

For the United States, which is the world's largest service economy, trade and investment in services with China translates directly into high-wage US jobs and increased profits from investments in China that lead to further investment and job creation in the United States. The United States has a rapidly growing services trade surplus with China that slightly offsets the large manufacturing goods deficit. The more open the Chinese market for US service providers becomes, the more US services can be sold in China. These exports of services will continue to contribute positively to the US balance of payments.

From a broader perspective, the expansion of China's services infrastructure is essential to China's integration into the global economy and continued economic development. For example, China's establishment of a modern capital market will help China move toward a market-driven exchange rate. Market-based lending will help level the playing field between US and Chinese competitors. China's ability to provide pension and health care insurance to its citizens will enhance social stability and unlock capital resources tied up in precautionary savings. Improving the regulatory framework for services will help Chinese manufacturers and commercial firms to continue to move up the value chain, in all areas, from transportation, professional and financial services, and information technology, to retail, tourism, and hospitality, to name but a few.

These findings are the result of an extensive analysis of US-China services trade and investment conducted by Oxford Economics. The analysis demonstrates that China's initial implementation of its World Trade Organization (WTO) commitments in services already benefits both economies. But even full implementation of these WTO commitments will leave in place a range of impediments to the growth of China's service sector, as well as service trade and foreign investment. By removing these constraints, both the Chinese and US economies will realize the full

potential economic benefits of trade and investment in services detailed in this study.

### Benefits for China

■ Chinese industry is growing rapidly in part because of strong imports of knowledge services, network services (transport, communication, and information technology) and financial services from developed economies.

■ Oxford Economics estimates that the increase in China's service sector imports after 2001 resulted in higher average labor productivity of 0.3 percent. This productivity increase equates to an increase in Chinese GDP of \$6.5 billion. Of that, around \$650 million is attributable to service sector imports from the United States.

■ Higher productivity in Chinese industry means higher standards of living for millions of Chinese citizens—the goal of China's economic development plan.

■ If the impediments to service sector growth in China are fully removed, the benefit would amount to an additional 2.5 percent of GDP (\$138 billion in 2006 prices) by 2015. This would make the average Chinese household better off by \$300 to \$400, or RMB 2,300 to RMB 3,100 per year. In comparison, average household income in China was around RMB 30,000 (around \$3,700) in 2005. Service sector trade and investment flows with the United States would generate one-tenth of the gains in household income by 2015 in this scenario.

■ The growth in service sector trade and investment by 2015 will add up to 7 million jobs in China in relatively high-paying, high-productivity service industries if the impediments to service sector growth in China are fully removed.

### Benefits for the United States

■ The United States is already a net exporter of a broad range of services to China: the United States had a services trade surplus with China of \$2.6 billion in 2005. US service sector exports to China are growing rapidly—more rapidly than US service sector exports to any other economy. The United States is the world's largest exporter of services and is well positioned to benefit from China's rapidly growing demand for services.

■ US service companies provide high-skill services to customers, employees, and markets throughout China, largely in knowledge, network, and financial service industries

(including express delivery, banking, insurance, management consulting, and information technology services).

■ US service sector net exports and net income of service sector investments to China, worth \$3.1 billion in 2005, support some 37,000 jobs in high-productivity sectors of the US economy. This provides a permanent boost to US productivity—worth around \$460 million in 2005.

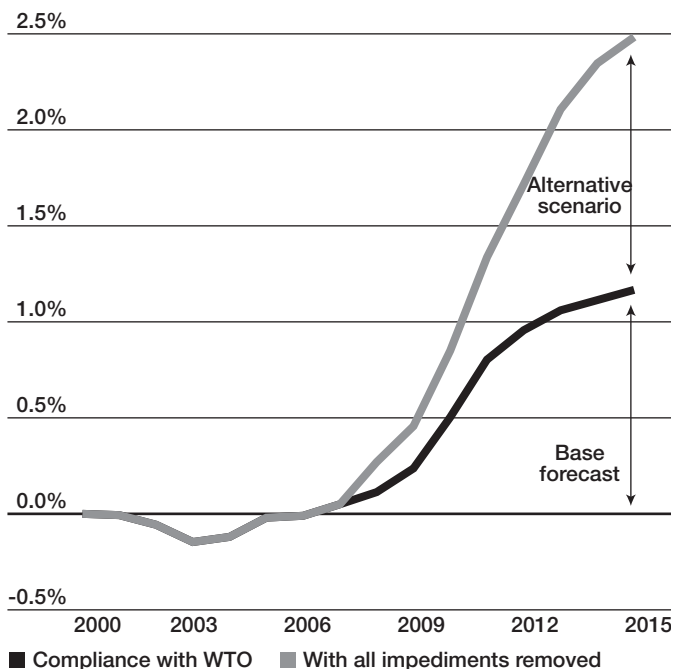
■ If the outstanding impediments to service sector growth in China are fully removed, the bilateral services trade surplus with China will increase to around \$60 billion by 2015, supplemented by extra income derived from US service-related investments in China worth \$7 billion. This would boost US GDP in the short term by about 0.3 percent.

■ The average US household would be better off by about \$500 per year in 2010 as a result of this growth in services trade with China.

■ The significant and growing US current account surplus in services with China (including repatriated profits from service sector foreign direct investment) is supporting the growth in service sector employment in the United States. The removal of all impediments to growth in services trade and investment with China would create up to 240,000 high-paying US service sector jobs by 2015.

### Impact of removing all impediments to growth in China's service sector trade and investment

% impact on China's GDP



Source: Oxford Economics

■ In the long run, removing the remaining impediments to China's services market could boost US GDP by up to 0.2 percent, resulting in a permanent benefit for the entire US economy. By 2050, US service sector exports to China could reach between 1.5 percent and 3.5 percent of US GDP. The US surplus on service sector trade with China could be worth around 1 percent of US GDP, while inflows of profits from US service sector investments in China could contribute a further 0.5 percent of GDP to the US current account of the balance of payments.

### Realizing these benefits

This study makes clear that the benefits of service sector trade and investment accrue to both economies. Implementing fully China's WTO commitments is an essential first step to maximizing the advantages for both economies of service sector links. Implementation is well under way, and both economies will reap the substantial benefits in the years to come.

But greater benefits will be realized in both China and the United States if PRC regulations, implementing rules, and license approvals are adjusted to increase the pace and scope of service sector reform.

In practice, this would entail:

■ Increasing the transparency of the regulatory environment for foreign service providers, through early publication of proposed regulations, consultation with foreign and domestic industry, participation in international service sector forums, and adoption of international standards and norms

■ Progressively deregulating markets for the provision of services, to encourage the growth of those services

■ Addressing current restrictions on market access and expansion (including foreign ownership, industry, and geographic limitations) so that foreign expertise in the service sector can become another tool to further China's Five-Year Plan objectives

■ Creating a level playing field, by reducing government support for domestic enterprises in the services markets

■ Continuing to gather and publicize sectoral data about the performance of the Chinese economy, to enable all participants in the economy to understand more clearly how quickly the various service sectors in China are growing, and what their future growth prospects might be

Adopting such measures would generate significant benefits for China and the United States, helping China to move more quickly and effectively to achieve its own economic development goals.