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China's plans and direction for further opening-up¹

This year marks the 40th anniversary of China's reform and opening-up, and will be the first year for China to hold the international import expo. This signals that China is further opening up its domestic market and striving to be more integrated with the world. Meanwhile, China is enduring the external uncertainties mainly from its biggest trade partner -- the U.S. One question should be asked: What is China's plan and direction for further opening-up?

Since China is shifting from a mid-high-income country to a high-income country, the trajectory of other major developed countries may be a reference for China's further opening-up process. With this in mind, it's necessary to compare the opening-up pattern of these countries with China.

One variable might fit this kind of observation -- the foreign value added in one country's final demand. This represents the amount of foreign input used in a country's consumption and investment. Examples include final goods consumed by households, capital goods invested by firms, or intermediate goods used to make products.

From an aggregated level, China has a very similar pattern compared with the United States, Japan, and the core 12 countries of the Eurozone. To be more specific, the

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proportion of foreign added value of China's final demand is slightly higher than the United States and Japan, and slightly lower than the core countries of the Eurozone. When adding up the manufacturing sector and service sector, there is not much difference in the domestic market openness between China and major developed countries.

However, when it comes to the disaggregated level, we can observe significant differences. The manufacturing sector is usually considered to be a measurement of traditional trade, and is also the main target of the import expo. The external proportion of final demand in the manufacturing sector in China is significantly lower than other major developed countries. China's manufacturing industry ultimately requires a lower value-added value outside China, which is 17.8 percentage points lower than the U.S., 4.7 percentage points lower than Japan, and 13.9 percentage points lower than the core countries in the Eurozone.

Where does this difference come from? If we further decompose the manufacturing sector, we can observe the major difference generally comes from the following industries: textiles, textile products, leather, and footwear; basic metals and fabricated metal products; and transport equipment.

This difference reveals the factors, trends, and potential policies that will shift China's future opening-up pattern: First, the external reliance of labor intensive industries might increase due to the increasing unit labor cost and GDP per capita. Second, the demand of commercial goods might increase with the ease of import restrictions. Third, industries that require more intermediate inputs might also increase the domestic use of foreign input.

The service sector, however, tells a different story. In stark contrast to the manufacturing industry, China's service industry requires higher foreign value added, which is 6.1 percentage points higher than the U.S., 12.5 percentage points higher than Japan, and 4.1 percentage points higher than the core countries of the Eurozone, reflecting China's high degree of external dependence in the service sector.

Looking closer at the service sector, the gaps are even bigger. The foreign value-added proportion in the final demand of China is much higher than other major developed economies. This is especially the case in the industry of "renting of machinery and equipment." In this sector, China's foreign value-added proportion accounts for about 69.6 percent, while the U.S. and the U.K. are merely 20 percent and Japan is only 7.7 percent. A similar case can be observed in the industry of "computer and related activities." While external value added accounts for 27.7 percent in Chinese domestic final demand, this number is only 15 percent in the U.S. and the U.K., and only 8.3 percent in Japan.

Based on the above comparison, the opening-up pattern in developed economies can be summarized as: "Tradable goods are more tradable, and non-tradable goods are more untradable." In economic terminology, tradable goods are usually referred to as goods that can be freely shipped across borders. The manufacturing sector is a typical representative of tradable goods. Conversely, the service sector usually deals with non-tradable goods.

This characteristic does not contradict the value-added trade development of the "goods-service-investment" trinity. On the contrary, it is the desirable choice of developed countries at a given international division of labor and income level.

For high-income countries, the traditional trade sector can achieve economies of scale and professional division of labor to the greatest extent through openness. The selection of production in specific fields and the opening of international goods markets enable consumers to diversify their product choices. This naturally leads to a higher proportion of foreign added value in the domestic final demand, that is, to make "tradable goods more tradable."

For the service sector, the added value of the service industry is generally high, and high-income countries have more advantages and competitiveness when developing their service industries. Therefore, the domestic value-added proportion in the final

demand for services in developed countries is higher. That is, "non-tradable goods are even more untradable."

Thus, the direction, purpose, and consequences of opening-up for manufacturing and service sectors are quite different based on the general experience of developed countries. Based on the comparison between China and major developed countries, there is ample space to open up the manufacturing sector. This opening up should emphasize the efficiency of the international division of labor and the enhanced utility of consumers through the diversification of goods and supply-demand matching.

However, China should be cautious in the opening-up of its service sector. First, the opening-up of the service sector should follow a certain sequence. This is especially the case in the financial service sector. Second, the opening-up of the service sector should emphasize the improvement of competitiveness in the service sector and the creation of value added. Third, services integrated with tradable goods and foreign affiliates trade in services should be emphasized.

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