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China Policy Brief

OECD Better Policies Series

MARCH 2017

www.oecd.org/china

Investment

FOSTERING FOREIGN DIRECT INVESTMENT IN SERVICES SECTORS

- Efficient services sectors are important not just for the service component of economies, but are essential for the competitiveness of manufacturing sectors as well.
- China has recently undertaken important steps to liberalise foreign direct investment (FDI), placing the country among the top FDI reformer countries according to the OECD FDI Regulatory Restrictiveness Index.
- Additional reforms, particularly in the digital network and supply-chain services underpinning global value chains (GVCs) – transport, logistics, telecommunications, and computer services – can further help upgrade China's participation in GVCs.

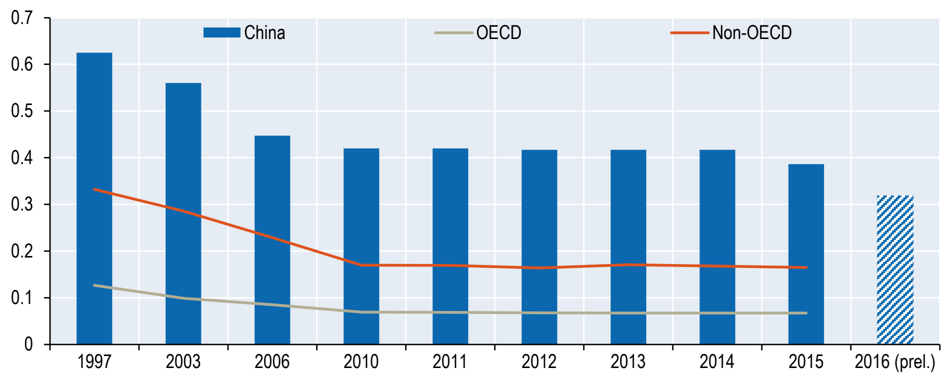
What's the issue?

The OECD's work on Trade in Value Added and global value chains shows that well-functioning transport, logistics, finance, communication and other business and professional services are all needed to ensure a co-ordinated flow of goods and services along manufacturing value chains. Yet world-class services sectors cannot be developed if isolated from best international practice and world-class inputs. China – as other countries – therefore has much to gain from removing remaining restrictions on foreign direct investment in services sector. China has taken important steps to ease barriers on foreign investment in recent years, placing the country among the top FDI reformer countries according to the OECD FDI Regulatory Restrictiveness Index (see Figure). The revision of the *Catalogue for the Guidance of Foreign Investment Industries* in 2015 – the main instrument governing foreign investment in the country – helped ease investment conditions in key services sectors such as distribution and rail transport. Subsequent reforms in 2016 brought further improvements by easing investment screening requirements in some sectors, bringing China's FDI regime closer to international levels of openness and transparency. These steps were crucial in empowering trade and investment in services.

Despite these significant reforms, there are areas in which China can further remove restrictions on foreign direct investment in order to fully use the opportunities it brings. China continues to apply limits

China has significantly eased restrictions on foreign investment, but there is still room for further reforms

OECD FDI Regulatory Restrictiveness Index, from 0 (open) to 1 (closed)



Note: The OECD FDI Regulatory Restrictiveness Index covers only statutory measures discriminating against foreign investors (e.g. foreign equity limits, screening & approval procedures, restriction on key foreign personnel, and other operational measures). China's preliminary score for 2016 reflects only the reform of the foreign investment approval system implemented in October 2016.
Source: OECD FDI Regulatory Restrictiveness Index Database, www.oecd.org/investment/fdiindex.htm.

on foreign ownership in various services sectors listed in the *Catalogue for the Guidance of Foreign Investment Industries*. These include prohibitions on majority foreign ownership in domestic air and maritime transport companies, and a full prohibition on foreign investment in postal and domestic express services. Limitations on foreign ownership also apply in basic telecommunications services and in "value-added telecommunications services", which include a number of ICT services. Although China undertook important reforms in 2016, most services sectors included in the *Catalogue* remain subject to screening, with FDI approval being conditioned on proof of net economic benefits to the Chinese economy. China also applies labour-market tests for the movement of intra-corporate transferees, whereby the hiring of foreigners requires demonstration of special needs and lack of suitable domestic candidates.

Why is this important for China?

Services generate just over half of China's GDP and employ more than a third of its workforce. They are thus a major contributor to the country's economic growth, productivity, and earnings. Services also play a key role in enabling the development of GVCs, accounting for over 40% of the value-added embodied in China's manufactured exports. Recent OECD work has found that services trade restrictions can impose the equivalent of an estimated 25% tax on business users of key services such as computer services, construction, insurance, and accounting. Openness to foreign investors seeking to provide services locally is therefore an important driver of the competitiveness of Chinese firms. It can bring about streams of local value creation, skill upgrading, technology transfers, innovation, and quality jobs that are foregone every time restrictive policies deter a firm from expanding abroad. In recognition of the potential that exists for further developing China's services sectors, the government's 13th Five-Year-Plan for Economic and Social Development (2016-20) aims to raise the share of services in GDP over the coming years.

Further reading

Rouzet, D. and F. Spinelli (2016), "Services Trade Restrictiveness, Mark-Ups and Competition", *OECD Trade Policy Papers*, No. 194, OECD Publishing. http://dx.doi.org/10.1787/5jln7dlm3931-en

OECD (2016), *OECD Services Trade Restrictiveness Index (STRI): The People's Republic of China*. www.oecd.org/tad/services-trade/STRI_CHN.pdf

OECD FDI Regulatory Restrictiveness Index. www.oecd.org/investment/fdiindex.htm

What should policy makers do?

- Remove remaining limits on foreign ownership in key services sectors such as air and maritime transport, basic telecommunications, and ICT services.
- Loosen screening and approval conditions for foreign investment in the services sectors that are included in the *Catalogue for the Guidance of Foreign Investment Industries*.
- Consider eliminating labour-market tests that hamper the temporary movement of foreign personnel (e.g. intra-corporate transferees and business visitors).
- Ease conditions on capital transfers and limitations on cross-border mergers and acquisitions.