

# The Influence of China's Financial Service Trade Liberalization on the International Competitiveness of the Financial Industry

Tingting Liu, Lingzhi Li\*

Nanjing University of Science and Technology, China

\*Corresponding author. Email: ltt1309@126.com

## ABSTRACT

As one of the "troikas" to promote economic growth, the importance of trade is self-evident. In the service trade, financial services have attracted much attention. As countries adjust the structure of service trade and gradually incline to financial services trade, it can be seen that financial services play an increasingly prominent role in economic development. However, will the liberalization of financial services improve the international competitiveness of the financial industry? On the basis of introducing the development status of China's financial services trade, this paper makes a theoretical mechanism and empirical analysis on the impact of the liberalization of financial services trade on the international competitiveness of the financial industry, and puts forward feasible countermeasures to improve the competitiveness of the financial industry in the future under the condition of China's financial services liberalization.

**Keywords:** *Liberalization of trade in financial services, financial stability, competitiveness*

background of the comprehensive opening of financial services.

## 1. INTRODUCTION

As a typical capital-technology-intensive service trade, financial service trade plays an increasingly important role in economic development, and its development level has become an important symbol to measure a country's international competitiveness. However, due to its late start and poor foundation, China's financial industry still lags far behind developed countries in terms of quantity and quality, and is at a disadvantage even compared with India, a developing country [1]. China's trade in financial services has been in deficit for a long time, with a deficit of 28.9 billion yuan in 2018. Moreover, the structure is unreasonable, with insurance service accounting for 59.5% and banking and securities service accounting for a relatively low proportion. The competitiveness of financial services trade is weak, with a trade competitiveness index of -0.21, which is far behind that of developed countries and even emerging economies. Therefore, this paper studies and discusses the influence of China's financial service trade liberalization on the international competitiveness of the financial industry based on the

## 2. STATUS ANALYSIS OF CHINA'S FINANCIAL SERVICE TRADE LIBERALIZATION

### 2.1. Development Status of China's Financial Services Trade

Since its accession to the WTO, China has been opening up its trade in goods and services to the outside world and deepening its trade development. This paper will measure the development status of China's financial services trade by studying the scale and structure of China's financial services trade. Regarding the degree of liberalization of China's financial services trade, we can start from the import and export quota of China's financial services trade. Therefore, regarding trade in financial services, we generally mean finance (except insurance) and insurance.

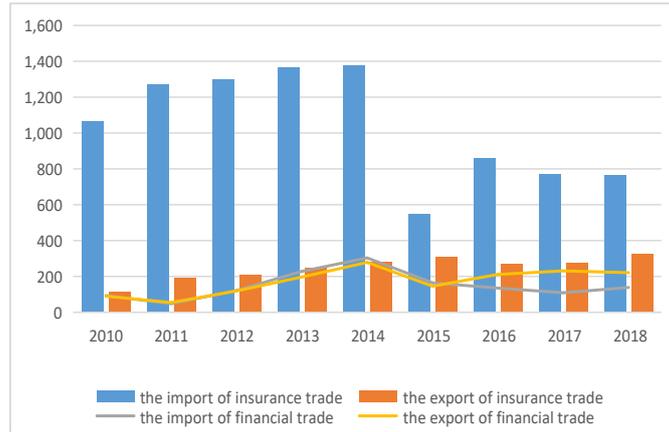


Figure 1 The import and export of insurance trade and financial trade in China (unit: RMB 100 million)

As can be seen from Figure 1, during the period of 2010-2014 in China, the increase of insurance import volume was very obvious, rising from 106.6 billion yuan in 2010 to 137.9 billion yuan in 2014, a total increase of 31.3 billion yuan in the five years, with an average annual increase of 5.87%. In 2015, exports fell to the lowest level in nearly a decade, to 54.9 billion yuan. The export of insurance services maintained a volatile growth, rising steadily from 11.7 billion yuan in 2010 to 32.5 billion yuan in 2018 after a decline in 2016. China's financial services exports increased from 9 billion yuan in 2010 to 27.8 billion yuan in 2014, with an average annual growth rate of 41.78%. Exports of trade in financial services, which were the largest in 2014, rose slightly after falling in 2015. Imports of financial services reached a high of 30.3 billion yuan in 2014.

From Figure 2, you can see that in 2018, other business services and travel services of the highest percentage, the sum of the proportion reached 44%, transport industry, and the proportion of the telecom industry is higher, but

China's financial services trade exports accounted for the proportion of China's service trade exports is very low, only 2%, this shows the structure of service trade of our country needs to be adjusted, high value-added financial services needs to be strengthened.

### 2.2. The Current Situation of Financial Service Trade Liberalization in China

The import or export of financial services and insurance trade and the structure of trade in services alone cannot fully explain the liberalization of China's financial services trade. Next, an index of the liberalization level of financial services trade will be introduced, namely the ratio of the total import and export of financial services trade to China's GDP.

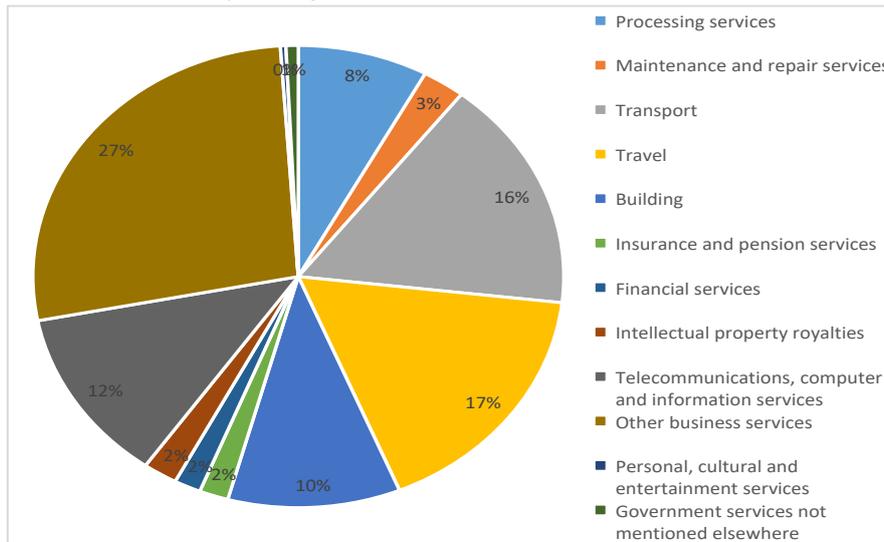
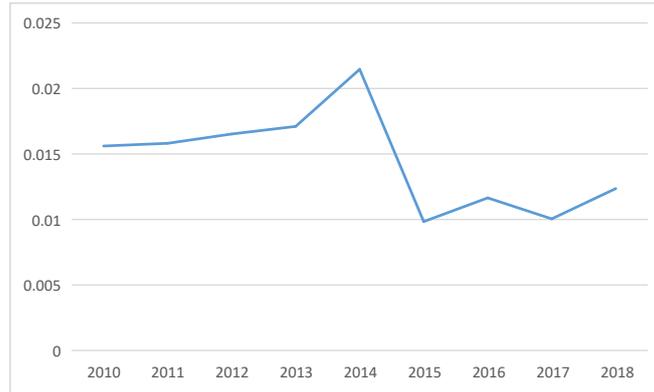


Figure 2 The proportion of exports of various services in 2018



**Figure 3** The ratio of China's financial services trade imports and exports to GDP from 2010 to 2018

The Figure 3 shows the ratio of import and export of financial services trade to GDP from 2010 to 2018. It can be seen from the figure that the ratio increased slightly from 2010 to 2014, and reached its peak in 2014, which also happened to be the previous peak period of the growth of total import and export of financial services trade. Correspondingly, the ratio fell in 2015, and the ratio of import and export of financial services trade to GDP fluctuated around 0.01 in subsequent years. From the above analysis, it can be seen that the openness index of China's financial services trade is always at a low level, with a small increase and a stable and gentle level fluctuation. It can be seen that the degree of financial service trade liberalization in China is still at a low level.

### **2.3. Problems Existing in the Liberalization of China's Financial Services Trade**

Although China's financial service market is opening wider to the outside world, there are still some problems: unreasonable structure of trade liberalization; There are still problems in the identification of foreign financial institutions; the regulation and law of China's financial industry also need to be improved.

#### **2.3.1. Unreasonable structure exists in the liberalization of trade in financial services**

The problem of unreasonable structure exists in two aspects. First of all, China's financial services trade exists regional imbalance phenomenon [2]. According to statistics, about 90% of foreign Banks are located in Shenzhen, Xiamen, Zhuhai, Shanghai and other special economic zones. Second, the structure of foreign financial institutions is unreasonable. At present, the type structure of foreign banks in China mainly focuses on commercial foreign financial institutions, which are dominated by branches of foreign banks, while the number of other types of foreign financial institutions is very small. All these

restrict the business of foreign financial institutions and their positive role in China's financial development.

#### **2.3.2. There are still problems in the identification of foreign financial institutions**

First of all, foreign financial institutions in China enjoy preferential "super national treatment" compared with domestic financial institutions in terms of taxation, marketing methods and policy burden, which results in unfair competition and puts mainland financial institutions with poor competitiveness at a more unfavorable position in the competition with foreign financial institutions [3]. In addition, there are still a series of restrictions on the business scope, business object, business area and branch establishment of foreign-funded financial institutions in China, so that foreign-funded financial institutions are in fact in a "low national treatment" status. These two phenomena fully explain the immaturity of China's financial market and seriously hinder the liberalization of China's financial service trade.

#### **2.3.3. Supervision of foreign financial institutions needs to be further strengthened**

Although since opening up to the financial services industry in our country, has been in financial institutions, regulatory to a lot of effort, has made certain achievements, but overall China's financial regulatory system is not perfect enough, the specification and the irregularities in foreign investment management institution, caused many dangerous financial security hidden danger [4]. The regulation of foreign financial institutions needs to be further strengthened.

## **3. THE INFLUENCE PATH OF FINANCIAL SERVICES TRADE LIBERALIZATION ON THE**

## **INTERNATIONAL COMPETITIVENESS OF THE FINANCIAL INDUSTRY**

The influence of the liberalization of trade in financial services on the international competitiveness of the financial industry is reflected in the entry of foreign Banks, the opening of the stock market and the opening of the insurance market.

### **3.1. Entry of Foreign Banks**

By increasing the number of financial service providers participating in market competition and expanding the scale of financial service products that can meet diversified market demands, foreign Banks enter the domestic market and change the market structure to perfect competition, so as to maximize the improvement of resource allocation efficiency brought about by market competition. Easing restrictions on foreign Banks' access could improve the quality, price and availability of financial services available at home. Therefore, the entry of foreign Banks improves the international competitiveness of financial services trade by promoting the development of the country's financial industry.

However, the entry of foreign financial institutions may take unfair ways of competition and damage the order of competition. Foreign Banks can reduce the financial stability of host countries by withdrawing from their markets or by infecting them with problems from their home countries [5]. Because foreign Banks have different priorities and business priorities, their lending models tend to ignore domestic needs that need to be prioritized. And as foreign Banks increase their presence, the ability of some domestic sectors to access capital may be compromised.

### **3.2. Opening of the Stock Market**

Opening up the stock market usually means that the country can fund economic growth by attracting more foreign investment, which in the short term is reflected in a rapid rise in stock yields. At the same time, in order to reduce investment risk, foreign investors often put forward higher requirements on the information transparency and disclosure criteria of the stock market of the host country. In order to protect themselves from the controlling shareholders, they will also make reasonable demands on the accountability of the company's management and the protection of shareholders' rights. The improvement of these institutional factors will reduce the shareholding risk and capital cost and improve the capital allocation efficiency [6].

On the other hand, the opening of the stock market also brings a lot of instability. All the instability that could result from an open market stems from the flow of hot money. Because hot money is highly sensitive to short-term economic benefits, even a small impact on the

economy may cause a variety of financial flows, which will aggravate the impact of economic impact and worsen domestic economic problems. Open markets also mean exposure to foreign influence. If, for some reason, foreign stock prices are more volatile than domestic ones, opening up could cause domestic prices to become more volatile as well.

### **3.3. Opening of the Insurance Market**

Like the opening of the banking sector and the stock market, the opening of the insurance market can promote the development of the host country's financial system. When foreign insurance companies are allowed to enter, Chinese insurance companies will also have access to the insurance market of the other side, breaking the single situation of providing foreign insurance services for their import and export. Under reasonably prudent regulation, foreign insurers have the potential to improve the efficiency of the financial system, and their participation in emerging markets can lead to improved productivity and efficiency, higher economic growth rates, transfer of technology and management knowledge, and other micro and macro benefits [7].

However, national insurance enterprises and foreign insurance enterprises jointly seize the Chinese insurance market and share segmentation, which may lead to a certain degree of loss of business of national insurance enterprises, and thus lead to a decline in market share. Once the liberalization, foreign insurance companies after the intervention, most of the management personnel from the domestic recruitment, the rational flow of talent is an inevitable, this is bound to cause China's insurance industry has been short of high-quality talent "drain" to the treatment of foreign enterprises, thereby causing the instability of the domestic insurance talent team.

Therefore, the liberalization of trade in financial services plays a positive role in promoting economic growth, improving efficiency and promoting financial stability, but the necessary conditions are macroeconomic stability and sound financial supervision and regulation system. As an important part of financial liberalization, trade in financial services may also cause financial turbulence under certain conditions and exert a negative impact on the country's financial services trade.

## **4. EMPIRICAL STUDY ON THE IMPACT OF FINANCIAL SERVICES TRADE LIBERALIZATION ON THE INTERNATIONAL COMPETITIVENESS OF THE FINANCIAL INDUSTRY**

Based on the theoretical analysis above, this section will select relevant variables and establish an empirical model to understand the impact of financial services trade liberalization on the international competitiveness of the

financial industry, so as to study how to improve the international competitiveness of financial services trade.

**4.1. Model Establishment, Variable Selection and Data Source**

*4.1.1. Selection of model variables*

This paper uses FOI index to measure the degree of liberalization of China's financial services trade. The formula is:  $FOI = (FX + FI) / GDP \times 100\%$ , where FX and FI respectively represent the export and import of a country's financial services trade, that is, the degree of liberalization of a country's financial services trade is equal to the percentage of its total financial services trade in a country's GDP. This paper uses TC index to measure the international competitiveness of financial services trade. The TC index takes into account both import and export factors in a comprehensive way. Its advantage is that it can eliminate the disadvantage that the data cannot be compared due to the size of different countries, and it is an effective tool to analyze the international competitiveness of industries. The calculation formula is  $TC = (X_{ij} - M_{ij}) / (X_{ij} + M_{ij})$ , where  $X_{ij}$  and  $M_{ij}$  represent the exports and imports of  $j$  products in country  $I$ .

*4.1.2. Model establishment*

To investigate the impact of changes in the level of liberalization of financial services trade in a country on the international competitiveness of the financial industry, an empirical model is introduced as follows:

$$TC_i = \alpha_0 + \alpha_1 FOI_i + \alpha_2 TRADE_i + \alpha_3 CPI_i + u_i \quad (1)$$

As mentioned above, TC represents the level of international competitiveness of China's financial industry and is the explained variable. FOI is an indicator of liberalization of trade in financial services and an explanatory variable. TRADE and CPI are the control variables. On the theoretical basis, this paper expects that FOI is positively correlated with TC, TRADE and TC, and that inflation CPI will hinder the development of the financial industry.

*4.1.3. Data sources and empirical research methods*

The main data sources are the world bank, the national bureau of statistics, the state administration of foreign exchange and other databases and statistical yearbooks. The quarterly data from 2010 to 2018 are selected. Eviews10.0 measurement tool is adopted to conduct unit root test, co-integration test and causal test for time series data.

**Table 1** Definition of model variables and data sources

Variable	Referred to	Define	The data source
Free trade in financial services	FOI	The proportion of a country's financial services trade in its GDP	Statistics of safe
Trade competitiveness index	TC	The ratio of a country's trade balance in financial services to its total imports and exports	Statistics of safe
Trade liberalization index	TRADE	The ratio of a country's imports and exports to its GDP	Statistical yearbook of the national bureau of statistics
Inflation indicator	CPI	Consumer price index	World bank database

**4.2 Empirical Study on Liberalization of Trade in Financial Services and International Competitiveness of the Financial Industry**

*4.2.1. Unit root test of the model*

In order to avoid false regression and ensure the validity of the estimated results, we must test the stability of each time series. And the most common way to test the stationarity of data is the unit root test. The results are shown in table 2.

**Table 2** Unit root test results of variables

		ADF (0)	ADF (1)
Intercept term	FOI	3.227008	7.753405
	TC	1.237802	9.354638
	The TRADE	1.654767	6.252788
	The CPI	5.688444	5.335684
	5% critical value	2.948404	2.951125
	10% critical value	2.612874	2.614300
Including intercept term and trend term	FOI	3.141829	7.700452
	TC	4.345744	9.221579
	The TRADE	4.973945	6.112601
	The CPI	1.904465	9.465438
	5% critical value	3.544284	3.548490
	10% critical value	3.204699	3.207094
Intercept terms and trend terms are excluded	FOI	1.101798	7.867923
	TC	1.539111	- 9.24.724
	The TRADE	0.727743	8.025685
	The CPI	1.145205	5.218995
	5% critical value	1.950687	1.951000
	10% critical value	1.611059	1.610907

It can be concluded from table 2 that financial services trade liberalization index FOI and control variable CPI are stable in the original time series, while financial international competitiveness index TC and trade openness TRADE are stable at the level of first-order difference of 5%. Therefore, the unit root test of all variables in the model passed, and the time series was stable.

**4.2.2. Co-integration test**

By constructing the regression equation, according to the sample data:

$$TC = 7.012552 * FOI + 0.062811 * TRADE - 0.006008 * CPI - 0.199836 \quad (2)$$

$$R^2 = 0.925935 \quad DW = 1.862004$$

The residual was tested by ADF. According to the co-integration equation, a constant term (intercept term) was included. Given the significance level  $\alpha=0.05$ , the critical value  $C(\alpha)=-5.591280 > \tau$  -statistic  $=-5.172423$ , the null hypothesis was rejected, that is, there was a co-integration relationship. So FOI and TC are cointegration sequences.

**4.2.3. Causality test**

Test the causal relationship between FOI and TC:

**Table 3** Results of causality test

Lag	The null hypothesis	P values
1	FOI does not Granger cause TC	0.0380 (pass)
1	TC does not Granger cause FOI	0.1798(failed)
2	FOI does not Granger cause TC	0.2130(failed)
2	TC does not Granger cause FOI	0.7079(failed)

Through the granger causality test to study the relationship between FOI and TC, we found that at the level of 5%, FOI and TC were unidirectional.

**4.3. The Conclusion**

To sum up, the specific analysis results of the empirical test are as follows:

First, the unit root test results show that FOI, TC, TRADE and CPI have all passed the unit root test, indicating that the variables are stable.

Second, the results of OLS regression analysis show that the explanatory variable FOI has a significant influence on the explained variable TC, and the coefficient value is positive, which means that the liberalization of China's financial services trade has a significant promoting effect on the improvement of the international competitiveness of the financial industry.

Third, the Granger causality test results show that FOI is the Granger cause of TC index, which indicates that the liberalization of financial services trade is the Granger cause affecting the international competitiveness of the financial industry, while the improvement of the competitiveness of the financial industry has no adverse effect on the liberalization of financial services trade. The TC index will increase by 7.012552% if the openness of trade in financial services increases by 1%.

## **5. SUGGESTIONS ON IMPROVING THE INTERNATIONAL COMPETITIVENESS OF CHINA'S FINANCIAL INDUSTRY UNDER THE LIBERALIZATION OF TRADE IN FINANCIAL SERVICES**

### ***5.1. Optimize the Structure of Financial Services Trade***

China's financial services trade has been in deficit, and insurance trade in financial services trade is relatively large, the overall development of imbalance. This shows that the international competitiveness of China's financial services trade is weak, and it mainly relies on the import of financial services to meet the domestic market's demand for new financial products and services. There are also significant structural problems in China's financial markets compared with those in mature market economies.

In order to solve this problem, we must vigorously develop the financial industry and improve the export quality of financial service products. We should take the initiative to move closer to the rules of the international market, deepen the reform of the domestic financial system, achieve direct financing and indirect financing, and build a modern capital market system that is compatible with the open economic status of major countries, with a complete range of types, a reasonable structure, efficient service, safety, stability and sustainable development [8].

### ***5.2. Strive to Improve the International Competitiveness of China's Banking Industry***

The degree of financial service trade liberalization in China is not high, largely because the international competitiveness of China's banking industry is not strong.

In the process of financial service industry opening to the outside world, only strong international competitiveness is the most reliable guarantee of domestic financial security under the condition of financial opening [9]. However, the competitiveness of China's financial industry has not been effectively improved for a long time. The main reason is that the basic status quo of China's financial industry competition, which promotes the expansion of quantitative financial assets with low cost, has not been changed. In the future, China's banking industry must consolidate its business level. We should constantly improve our international competitiveness by encouraging the innovation of financial instruments, reducing non-performing assets and cultivating talents.

### ***5.3. Build a More Open Regulatory System for Trade in Financial Services***

Considering that China's financial supervision system is not yet perfect, the supervision of foreign financial institutions needs to be further strengthened. To build a more open supervision system of financial service trade and improve information transparency is conducive to improving international competitiveness. Firstly, the major commercial Banks should implement the relaxation of liquidity control to improve the autonomy and efficiency of commercial Banks in providing financial services [10]. Meanwhile, it also pays attention to the information disclosure of commercial Banks, requires Banks to establish strict internal control system, and divides the supervision degree of each major bank. The monitoring frequency and content of financial service trade risks are generally determined by different risk levels, and it pays attention to continuous supervision.

## **REFERENCES**

- [1] Wang.l.R. Research on the international competitiveness of China's financial services trade based on VAR model, *International trade*,7(2016):55-58.
- [2] HE.f. Liberalization of trade in financial services, financial development and economic growth in China, Southwestern University of Finance and Economics, 2016.
- [3] Kang.z.k. Empirical study on influencing factors of China's financial services trade competitiveness, *Business economics research*,(2017):134-136.
- [4] Zhang.t. The promoting effect of financial services trade liberalization on FDI absorption, Shanghai University, 2007.
- [5] Zhao.m.z. The impact of China's financial service trade liberalization on financial development,

University of International Business and Economics,  
2014.

[6] Wang.x.d. Research on statistical methods of international competitiveness of China's financial services trade, *Jiangsu business theory*, 9(2019):90-92.

[7] Jiang.w.h. Analysis and Suggestions on the international competitiveness of China's financial services trade, *Jiangsu business theory*, 7(2017):94-96.

[8] Huang.l.n. Research on the impact of China's financial services trade liberalization on economic growth, *Capital University of Economics and Business*, 2018.

[9] Xie.w. Research on the impact of China's financial services trade liberalization on economic growth, *Xiangtan University*, 2016.

[10] Xiang.n. Comparative analysis on the liberalization of brics financial services trade, *University of International Business and Economics*, 2015.