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## Comments by Deborah Swenson, on **Chinese Services Gaining Significance in Global Production Chains**

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**Deborah Swenson:** China's economy in the present day is remarkably different than it was, even in comparison with its structure in 2000, just prior to China's WTO entry. For this reason, although others have looked at the earlier performance of China's economy, it is valuable to look at its more recent performance and to be aware of the factors that have influenced its ongoing transformation. Along with China's WTO entry, which supported China's rapid export growth, other factors that came into play in the 2000s include the 2008 global financial crisis, the heavy entry of domestic firms in China, and substantial wage increases in China, particularly for skilled workers. Given the scope of these changes, Heli Simola's work on Chinese value-added in global value chains (GVCs) provides important perspectives on changes in China's engagement in globalized production between 2000 and 2014.

Though there are too many results provided in Simola's work to comment on all facets of China's changes described in her paper, four of Simola's results are particularly interesting. First, Simola documents that domestic value-added share of China's GVCs increased. This finding is striking because it stands in stark contrast with the declining domestic value-added shares that have typified the change for other countries. Second, to the extent that China's domestic value-added share is rising, this is in part due to the increase in the provision of services in China. Thus, although China has been viewed as gaining success as the factory to the world, the GVC data suggest that China's rising strength in services should not be overlooked. Third, observation of China's production in GVCs reveals that the contribution of low-skilled labor is declining, which suggests that China has been involved in product upgrading. In further support of such a conjecture, Simola shows that China's share of global R&D services in GVCs has also been rising. Taken together, these developments document that policymakers and policy analysts will need to recognize the salient changes in China's production capabilities as they assess the capabilities of China's economy or seek to provide policy prescriptions for China or its partners.

In thinking about Simola's results, it is important to ask where they are a strong or weak indication of developments in China's economy. In this regard, readers should pay attention to Simola's definition of GVC activity; taking China as the final producer in the production chain, Simola characterizes the contributions of China's input providers compared

with those provided by input providers from the rest of the world. Although this definition was reasonable in earlier years when China concentrated on assembly activities, this definition of China's GVC contributions will become a less and less accurate representation of China's overall activities as China's strength in providing intermediate inputs to other global producers grows. The accuracy of this representation is also challenged by the paper's assumption that factor proportions are the same for domestic output as they are for production for export. Although this factor is acknowledged by the author, and is one that is common in the literature because of data limitations, it may be more of a problem in evaluating Chinese economic activity due to the high levels of export, and the strong engagement of foreign firms in China's economic production.

Simola's analysis would also benefit from increased consideration of the factors that underpin the observation of the increased importance of services in China's GVC activity. Because it is notable that China's provision of high versus low skill services has risen, the next step in this line of research should pay more attention to the composition of this shift. In particular, because the data involve 56 sectors, Simola could provide further information on the developments that have led to China's move to greater relative use of high-skilled services. In addition, because services are now embedded manufactured products (e.g., software included in a manufactured product), the distinction between the provision of goods versus services is weakened. Even if these distinctions cannot be discerned in the data, Simola should make an effort to explain how these developments are likely to influence her conclusions.

In the future, economists and policymakers should work to understand which factors explain the developments identified in other work by Simola. Through the use of a constant market share analysis, Simola (2017) is able to show the components of the changes are driven by changes in demand for China's products, either due to changes in product demand, or due to changes in the level of demand tied to the destination markets where they sell. Any residual difference between the realized changes, and the changes tied to product or market demand developments, are attributed to China's rising competitiveness. At a deeper level, it would be useful to study how this increase in apparent competitiveness is linked to firm decisions (e.g., R&D effort, import of intermediate inputs) versus China's policy effects either in regard to domestic institutions or external policy. The results also suggest the importance of further study of foreign investment effects on China, given the links between FDI and GVC participation. Finally, given the scale of China's economic activities, interpretation of GVC changes requires economists to address the role of scale economies. Even if policy or other favorable factors have supported China's changes, China may be unique if economies of scale allowed, which were feasible in China it to capture a greater share of global GVC activity than would be possible for smaller countries that are otherwise similar in endowments or policy decisions.

In sum, this paper is highly worthy of attention because it highlights key changes in China's GVC activities between 2000 and 2014. It suggests that productive avenues for future work will involve the examination of more disaggregated data, as a means of learning about the mechanisms or causes of the changes. The results also indicate the value of taking a closer look at the connection between foreign investment and foreign firm activity in China as these elements influenced later changes in China's GVC activity and composition.

## Reference

Simola, Heli. 2017. China's Growing Role in Global Production Boosted by Strong Competitiveness: Evidence from International Input–Output Tables. BOFIT Policy Brief No. 2. Helsinki: Bank of Finland, BOFIT Institute for Economics in Transition.