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An Analysis of Service Trade Regulations in Korea, China, and Japan and its Policy Implications

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I. Introduction

Over the past 40 years, the share of world services trade in world total services has significantly increased. In particular, the technological developments in the ICT and transportation sectors, along with movements toward trade liberalization, have contributed to this increase. The share of services trade in total trade for Korea, China and Japan has increased as well. However, the services trade's share of GDP still remains low compared to that in developed countries.

Meanwhile, the growing trend of servitization across the world resulted in the services sector gaining recognition as the new growth engine in Korea, China and Japan. In this regard, all three countries are actively promoting policies to upgrade the competitiveness of their services sector, and services trade liberalization is one of the many policy options they can consider.

In this report, we analyze the regulatory factors which restrict the trade in services of Korea, China and Japan to derive implications for Korea to enhance competitiveness in its ser vices sectors by promoting trade in services in the three countries.

II. Recent Trends and Determinants of Trade in Services in Korea, China, and Japan

In 2015, the share of services export in total exports reached 15.1% in Korea while China and Japan's share of services exports were reported at 11.8% and 20.7%, respectively. Comparing each country's services export share in total exports between 2008 and 2015, Korea's services share has decreased from 17.4% in 2008, while China and Japan's services trade share has increased respectively from 9.7% and 15.8% in 2008. All three countries witnessed an increased share of imports in services sector in total import during the same period. All three countries marked an increase in trade deficit in their services sector during the same period. Looking at the trade structure, all three countries' export share of other community, social and personal service activities, which includes legal and accounting services, came out high.

In addition to the gross trade volume, we also looked into the services trade trend in value added using the World Input Output Database. During the period of 2000–2014, the growth of value added services trade exceeded the growth of value added goods trade in all three countries. Within the services sector, the wholesale trade and commission trade's share came out the highest among all services sectors. Last but not least, the interdependency of services trade value added among the three countries has increased from 2000 to 2014, with the share of services trade of China for Korea and Japan's services import value added showing particular growth.

In terms of regulation on trade in services of China, Japan and Korea, the overall OECD Services Trade Restriction Index (STRI) indicates that the three countries further liberalized their services sector during 2014 to 2016. In detail, in 2016, Japan's scores on the STRI in 21 out of 22 sectors were lower than the OECD average[1] In the case of Korea and China, five and twenty sectors' restrictive scores were reported to be higher than the OECD average, respectively.

With the STRI, this study conducted an empirical analysis to investigate how the level and difference in regulations affect trade in services in the three countries. The empirical results show that higher STRI is negatively associated with services trade in Korea and Japan. Another important result to note is the effect of FTAs on services trade. Korea's FTAs appear to have a significantly positive effect on Korea's services trade, while no such effect was visible in the case of Japan and China.

III. Regulations and Determinants of Trade in Services in Korea, China and Japan

As an attempt to search for sector-specific policy implications, our study chose five industries for in-depth study, including legal, accounting, courier, insurance and, additionally, healthcare services.

First, in legal services, Korea and China's markets were relatively more regulated than Japan's. While liberalization in Japan's legal services sector has contributed to competitiveness in its legal sector, this was not the case in Germany and France among others, where the countries' domestic law firms gave dominance to English law firms. A country's sector liberalization must include a detailed feasibility study and carefully consider the possible side effects to maximize the positive consequences generated from the liberalization. Second, the accounting services sector has been pointed out as one of the most restrictively regulated sectors in Korea, based on the OECD STRI. Such a negative evaluation can be attributed to the qualifications required from a Korean university to obtain a license as an accountant. It appears necessary for Korea to reorganize the related system. Meanwhile, Korea has concluded FTAs with the United States and the EU and opened its legal and accounting services market to a large extent. Because the OECD STRI is based on the most-favored-nation standard, the index has a tendency to undervalue Korea's services sectors regulations. For example, under the KORUS FTA, as of 2017, Korea allows United States law firms to hire a Korean lawyer, and this addi-

1 The OECD STRI ranges from 0 to 1. 1 indicating closed and 0 representing open.

tional market access is not reflected in the STRI.

In the case of the courier and insurance services sector, the Chinese market is more regulated than that of Korea and Japan. Among the five policy areas within the STRI, the restrictions on foreign entry were the main factors contributing to China's high STRI score. Meanwhile, in the case of Japan, barriers to competition were the main factor. This implies the importance to create a government-level cooperation channel which focuses not only on foreign entry, but also on indirect market restrictions.

In addition, the report also conducted an in-depth study on the healthcare industry, an industry which all three countries are focusing on due to their rapidly aging populations. China seemed to be engaged in active measures to open its market compared to Korea and Japan. For example, China has granted permission to establish hospitals in seven areas, including Beijing, and to establish welfare facilities for the elderly under the China-Australia FTA, while Korea and Japan have not made any additional commitments since the Uruguay Round. Meanwhile, the healthcare sector is included in Korea and Japan's special economic zone plan and the two countries continue to make efforts for further deregulations in the sector.

IV. Policy Implications

Based on the study results and its implications, this report suggests the following recommendations for the Korean government and enterprises. First, while the WTO debate remains stalled, a comprehensive and high-level FTA can be the second-best policy option to create new market access, generate the momentum for regulatory reforms and enhance regulatory transparency. As of 2017, Korea is engaged in the follow-up FTA negotiations on services and investment with China and also in China-Japan-Korea FTA and RCEP negotiations with Japan and China, in which the Korean government should continue to strive to realize a high-level FTA. In this regard, in-depth research on the latest developments in market liberalization taking place on the domestic and international scene, especially in regard to advanced countries, is necessary. Second, an official government-level cooperation channel is needed to discuss the reasons behind the different service sector regulations between the three countries, to discuss the possible elimination of discriminatory measures and to promote regulatory harmonization in the services sector. An in-depth discussion for services market liberalization can be burdensome for the three countries in the short term when considering their relatively low sector competitiveness. However, keeping in mind how enhancing the service sector's competitiveness can also generate spillover benefits to competitiveness in the goods sector, the three countries could first start a joint study on the effect of services trade on each economy, and this report can serve as the starting point for further research. Third, the Korean government needs to develop a more updated, detailed, systematic information system to support the internationalization of Korean firms. In particular, a more specific database of foreign companies would be helpful for Korean companies seeking potential business partners. Fourth, all three countries are utilizing the special economic zone strategy and the Korean government could search for possible cooperation opportunities at the government level and provide relevant information to Korean companies.