



## Service Programs---New Chances for the US-China's Economies

Weidong Sun (Corresponding author)

Jiangsu Finance and Economics College of Vocational Technology

8 Meicheng East Road, Huai'an 223003, Jiangsu, China

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Visiting Scholar at New York Institute of Technology, USA

Tel: 86-517-83858381 E-mail: dragoninmainland@yahoo.com.cn

William J. Lawrence

School of Management, New York Institute of Technology, USA

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### Abstract

For years the US and China have cooperated closely on manufacturing programs, which helps China become the world manufacturing center. While both have gained much from the cooperation, there are also increasing frictions, disputes, complains and dissatisfaction with each other because of the huge trade unbalance problem and others significant issues. The US is eager to expand export to China, but China seems hesitate to decide what to import from the US. This paper presents an analysis of the benefits of the US-China cooperation with a primary focus on the service sector which remains a large and untapped opportunity in China. The goal of the paper is to explore a new route to relieve the trade balance issues as they separately impact both nations. While focusing on analyzing several immediate opportunities, the paper also investigates several new ideas that rest on technology as well as entrepreneurial development.

**Keywords:** The US-China economies, Service sector trade, Win-Win

### 1. Introduction

China is a rapidly developing and increasingly more influential market economy. It is currently ranked as the third largest economy in the world after the US and Japan with a nominal GDP of US\$4.4 trillion. (Note 1) The Chinese economy has been growing at a relatively fast pace for the past 30 years with an average annual GDP growth rate above 10%.

Two factors contribute much to China's rapid economic growth. Export trade has increased annually from 20.1% in 2001 to 40% of its economy in 2008. Chinese exports rose from \$14 billion in 1979 to \$1429 billion in 2008, while imports over this period grew from \$16 billion to \$1133 billion in 2008. (Note 2) A report (Note 3) released by WTO shows that from January to June, 2009, for the first time, China took the lead as the world's export champion, surpassing Germany. It is predicted by a Chinese government commercial official that China will possibly pass Germany as the largest exporter in 2009 (Note 4).

Foreign direct investment (FDI) represents the second major contributor to China's rapid growth rates of late. China has remained one of the world's premier destinations for FDI since it gained access to the WTO in 2001. In 2008 alone, China absorbed \$111.17 Billion of FDI. That represented an increase of 27.65 percent for the year and can be compared to 21% drop in global FDI and a 32 % slump in FDI for developed nations.

Evidences suggest that it will be hard for China to maintain its current growth if it continues to follow its recent historical development path. The high export volume has created increasing trade disputes between China and its trading partners. Statistics provided by the American Chamber of Commerce indicates that between 2001 and 2008, the US trade deficit with China increased from \$83.10 to \$268.04 billion (excluding service trade), accounting for 28.8% of the US total trade deficit. Decreasing the trade imbalance between US and China is a top concern in US-China relations. The rapid Chinese growth, stimulated by large exports and its huge FDI, largely the result of strong manufacturing sector, has been at the expense of wage and tax reform, rising pollution, energy, and effective land use programs and a more reasonable utility distribution and cost formula.

However, China can still break through the development bottleneck if it appropriately restructures its strategy to better reflect short term problems it has tended to ignore. China must begin to develop a long term perspective that involves the creation of a more diversified economy. China's past growth relied heavily on investment in manufacturing. Its non manufacturing, primarily its service sectors did not receive commensurate attention by planners. During period from 2001 through 2008, net exports and investment predominantly linked to building capacity in export based sectors accounted for more than 60 percent of China's growth, up from 40 percent in the 1990s. This is much larger than the 2001–08 average of the G7 (16 percent) and Euro area (30 percent). The service industries in China now only accounts for 40% of GDP (2008), (Note 5) which is much lower than that of any other economy in its size class. However, this statistic does a considerable potential for growth in service sectors in China which can be a crucial resource for China's sustainable growth.

## **2. The Features of Service Programs**

A service refers to the non-material equivalent of a good. Service provision is defined as an economic activity that does not result in ownership, and this is what differentiates it from physical goods. It is claimed to be a process that creates benefits by facilitating either, a change in customers, a change in their physical possessions, or a change in their intangible assets. Service output is a component of the nominal gross domestic product of a nation. Service sectors such as gigantic supermarkets, luxury showrooms and business services and offices, which are typically peculiar features of advanced economies. The tertiary sector of industry, also called the service sector or the service industry, is one of the three industrial categories of an economy, the others being the secondary industry (manufacturing and primary goods production such as agriculture), and primary industry (extraction such as mining and fishing). Much of this so-called tertiary sector is more capital-and knowledge-intensive than either the primary sector (agriculture, mining, forestry, and fisheries) or the secondary sector (manufacturing and construction).

Service sector programs consist of such functions as translation, tourism, communication, building, insurance, finance, advertising, culture, education, law, medicine, as typical examples.

Since service industries' products are intangible, they contain considerably less cost in solid raw materials, and typically have a considerably smaller environmental footprint than do the primary secondary sectors. A developed service sector also provides a mature or maturing economy with an invaluable hedge against swings in the business or trade cycle. Many services are actually counter cyclical and tend to have a relatively more stable employment and revenue base which translates into small over all swings in the level of business activity, lower unemployment turnover and a more steady flow of tax revenues.

## **3. The Service Situation of Both the US and China**

The service sector is the largest and most significant part of the American economy. It represents about 80 percent of U.S. economic activity. Services are also an increasingly more important component of U.S. trade and accounts for much of the growth in U.S. exports.

The US economy tends to run larger and larger trade deficit (table 1), however, thanks to service contribution, the deficit has a much smaller impact on the total US economy than it otherwise would have been.

<Insert Table 1 here>

In contrast, China has a great advantage over most major exporting countries, especially when compared to that of the US economy (table 2). China's historical reliance on labor-intensive industries, enhanced by the expanding tendency of the US to outsource almost all of its manufacturing capacity, has rendered China as a leading world manufacturing center. China continues to export ever more manufactured goods to the US accounting for 21-32% of the US total goods trade deficit during the 2002 to 2008 period. However, despite the US advantage over China in services industries output (table 2), its service trade surplus with China accounted for less than 4.1% of its total service trade surplus prior to 2008. The US trade deficit to China alone, accounted for 37.7% of its total deficit to the world in 2008 (table 3).

Most experts think that to achieve a decrease in the US trace deficit to China, China must decrease goods export to the US. It is our position that Chinese manufactured export to the US is determined by comparative advantage principles of the market and ongoing deficit balances might best approached by increasing the export of US services to China.

<Insert Table 2 here>

<Insert Table 3 here>

## **4. The Benefits of Cooperation on Service Programs of Both Countries**

China and the US must recognize an unalterable reality surrounding the increasingly fast pace of globalization coupled with the equally rapid growth in technology which, when viewed together, create an entirely new set of opportunities for the service sector in both countries. Progressive economies can, indeed must, fall back on the time tested hypothesis that they are best advised to focus on that which they have a natural comparative advantage in terms of production if they are to successfully compete in the rapidly shrinking geography of world markets.

Capital and innovation intensive economies need to use that advantage as an export resource. That utilization involves not only exploiting its output and capacity to seek new and innovated ways through which they can best expand their markets in nations that lack those same sectors. In addition, Capital and innovative intensive economies such as the United States must implement the most contemporary educational and delivery systems possible to insure and maintain its leadership in this sector. Education becomes more than an output to stable growth. Current technological growth has made education at all levels an invaluable input to virtually all sectors of a modern capital, innovative and technology driven economy.

This does not mean that the US should abandon its ability to produce manufactured good, any more than should China relegate its service sector to nations with a comparative advantage over them in those sectors. What it does mean is that each nation must undertake a full sector due diligence designed to seek a proper and optimal balance between that which it can do best and that which best utilizes its scarce resources and all inputs to production.

Our objective with this more classical approach to economic development is to not only insure the best balance of factor inputs but to also build an economic development policy that encourages the advantages of each trading partner to the advantage of both the exporting and importing nation. The natural output from this approach that should be realized by both nations will be the creation of a more productive labor force which invariably spills over into the creation of a more robust middle class, a vital component of every successful economy.

Another by product of our call for a better balance between a production and service sector economy for China is that it offers an efficient and important path towards a more responsible environmental conservation policy, a deficiency aimed at China by many of its trading partners. China's environmental problems are among the worst in the world, and are likely to only get worse. These environmental issues are a big problem for China because they have real socio-economic implications for the Chinese people and China's economy. China is known by many as the 'world's factory' and this term is quite accurate. China is an export juggernaut in everything from T-shirts to TVs. China is the world's largest producer of steel, cement, aquaculture food and television sets, and is the second-largest producer of electricity and synthetic textiles. Unfortunately, being the 'World's Factory' often means exporting goods while at the same time, leaving unacceptable levels of pollutants behind on China's factory floor.

China has recently been labeled as both the world's biggest polluter and among the world's most progressive developer and installer of renewable energy, particularly solar. Clearly, China wants to attain a positive impact in tackling its pollution problems. To do so it must not only upgrade the existing traditional manufacturing sectors, but also enhance its service sector output. A vibrant service sector will help China both relieve its pollution problems and provide a better overall output balance so that its economy can continue to prosper throughout this next century.

## **5. How to Develop Cooperation on Service Programs**

The market for services in China has significant growth potential in both the short and long term. However, both the US and China have imposed some restrictions in certain service sectors that prevent or discourage each other from gaining or further expanding market access. Of course, these barriers are gradually being removed now, and we think that the following service sectors which have little impacts on both countries' politics should be expanded at a larger scale presently.

### *5.1 Education*

It has historically been difficult for geographically distant nations to find economically, environmentally, and in some cases politically efficient ways in which the exchange of information can flow between them. Distance alone has made it difficult for joint production and shared exchanges throughout almost all service sector enterprises for China and America. Such fields as education, medicine, business services as well as the cultural and the arts sectors have had to rely on traditionally expensive and time consuming travel costs to create a mutually satisfying exchange.

Clearly, a large number of Chinese students, scholars and doctors are eager to learn from America, but to do so, they must spend a considerable amount of money, time and energy to both apply for and implement the journey. Ever more American students and scholars are also seeking intellectual, cultural and informational exchange with Chinese counterparts. However, to date, there are only 160,000 Chinese students studying in America and a mere 20,000 American students studying in China. Although President Obama declared in Shanghai on November 16, 2009, that American government would plan to enlarge the number of American students studying in China to 100,000 and that his administration would simplify the visa procedures for Chinese students to go studying in America, these policies will not come close to meeting the demand for these programs on the part of Chinese students. China has more than 18,600,000 college students in 2008. If a more streamlined and efficient policy and application systems existed on both sides of the Pacific, numerous Chinese students would leap at the opportunity to study or visit America. The same enthusiasm exists on the part of many American students for study in China.

There are many benefits for the exchange of both countries' students and scholars. First and foremost is the chance to open closer communications and to get to know each country better, all of which would bring both countries more closely together in many ways. Another benefit through enhanced exchange will be economic in that as we all learn more about

each others nation we open numerous doors for all to help promote each economic as well as cultural development. A third benefit will be realized by helping Chinese students master English as well as opening educational opportunities for American students to study Chinese. Both languages are very different from each other, further complicating the process of learning for American as well as Chinese students. The more we can each provide efficient and knowledgeable teachers to help we can begin to reduce the time it takes to learn each others language which then spills very quickly into how we can then better create business, cultural, and artistic opportunities that can only help both nations better achieve economic stability and growth

Identically, besides communication face to face, meeting on line is the best substitute than any other way for education between both countries. It not only save time and energy, but also save money, so many people who could not afford to study or visit abroad before can realize their ideals. For example, online meeting with Dimdim.com, Glance or other videoconferencing software, represent an easy way to see and talk with many people at any time, regardless of where they're located. At present, there are many software companies that have developed very advanced technology to enhance international communications and conferencing. They support Web meetings with up to 100 attendees, regardless of whether they are and do it on either Mac or Windows based machines. Attendees can see the contents of host's computer screen on their own computer screens. They can talk with the host conveniently and clearly. Therefore, even if students or scholars don't go abroad, they could be taught or met by teachers or scholars in another country. We believe that if Chinese students are taught English among a host of subject, by American teachers. In this way, they are sure to master English language well and fast. And do so at a much reduced cost and smaller environmental footprint. Additionally other courses, seminars, lectures, forums, speeches and reports can be taught or transmitted with these technologies. The number of internet user in China has hit a estimated 253 million, ranking China the No.1 internet user in the world. America has the most advanced technology in internet uses. Therefore, it is the time for China and America recognize the comparative advantage of each and begin to both develop and expand it commitment to on line virtual education.

### *5.2 Medicine*

Meeting on line can also play an important role in the field of medicine for both countries. Not only can professional medical providers from both countries' more efficiently communicate and discuss difficult diseases, and procedure almost as though they were in the same room, they can also hold a joint consultation to decide how to best deal with some cures, surgical approaches, and diagnosis on a patient regardless of where they are by watching the x-ray, electrocardiograph and laboratory data as obtained.

Before it was a maxim that a patient must come to doctor and be observed by the doctor before being diagnosed. In modern times, this type of observation can be almost entirely replaced by more accurate and discriminating clinical laboratory tests results which can then be transmitted to other countries or localities instantly. It means that doctors or experts outside of the countries who have not themselves examined the patient can participate in identifying the illness afflicting a person. America has been a dominant force in western medical skills and advanced medical equipment. It has long been recognized that China has many unique medical skills, very different that those practiced in the west. The combination of both skills would surely represent a scientific strength to deal with many illnesses. It is most crucial to diagnose the cause of an illness as quickly as possible. Before the advent of these new communication technologies, doctors and experts were forced to either fly to a country themselves or have the patient flown in so as to collaborate with local doctors and experts. Now, meeting on line can win much valuable diagnosis and curing time.

### *5.3 Technology*

Technology trade accounts cover transactions of intangible assets, including patents, trade secrets, and other proprietary rights—that are used in connection with the production of goods, copyrights, trademarks, franchises, rights to broadcast live events, software licensing fees, and other intellectual property rights.

America takes huge advantage in these services and China desire to own these service products in order to enhance its service ability. However, China often complains that America sets many barriers to limit exporting high technology products to China and claims that it is one of the reasons for the unbalance trade between both countries. In contrast, America often complains that China lacks of effective intellectual property rights (IPR) enforcement, which remains a major challenge, as counterfeiting and piracy in China remain at unacceptably high levels and cause serious economic harm to American stakeholders across the economy, so American industries hesitate to market leading edge technology in China due to the high probability of piracy.

At the time of its accession to the WTO in 2001, China was in the process of modifying the full range of IPR laws, regulations, and implementing rules, including those relating to patents, trademarks, and copyrights. China had completed amendments to its Patent Law, Trademark Law, and Copyright Law, along with regulations for the Patent Law. Within several months after its accession, China issued regulations for the Trademark Law and the Copyright Law, followed by implementing rules. China also issued regulations and implementing rules covering specific subject areas, such as integrated circuits, computer software, and pharmaceuticals.

In 2008, China announced an updated Action Plan for revising its legal regime in order to better protect IPR. Among other things, this Action Plan sets out China's intentions for revising various laws and other measures, including the Patent Law, which passed the National People's Congress in December 2008, the Trademark Law, and related measures. China has also been working on other proposed legal measures that could have significant implications for the intellectual property rights of foreign right holders. In particular, China issued an Anti-monopoly Law in August 2007, which became effective in August 2008, and under this law is considering issuing rules relating to the treatment of IPR by standards setting organizations.

In 2008, China also issued its long-awaited National IP Strategy, a policy document intended to encourage and facilitate the effective creation, development, and management of intellectual property in China. The document addresses strengthening IPR protection, preventing IPR abuses, and fostering a culture of IPR in China. The strategy also identifies key sectors in which China seeks to obtain foreign patents and technology standards. Other goals include improving patent quality and improving protection for geographical indications, genetic resources, traditional knowledge, folklore, and layout-designs of integrated circuits. Notably, the document mentions that China will explore the establishment of courts of appeal for IP cases. (Note 6)

Although China's central government displayed strong leadership in modifying the full range of China's IPR laws and regulations in an effort to implement China's WTO obligations, effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem in China. IPR enforcement is hampered by a lack of coordination among Chinese government ministries and agencies, and between sub-national authorities and the central government, a lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.

Therefore, on the one hand, Chinese regulatory authorities must initially make improvements in technology services enforcement. They must make sure that American providers' IPR must be protected efficiently. On the other hand, America must remove definite technology export limitations to China according to ongoing bilateral dialogues or negotiations. The more China is pushing to accelerate its transformation into a more market-based economy, the more America should decrease the limitations to exporting its technology service products to China.

#### *5.4 Producer service*

The producer services industry covers logistics, technology, finance, information, commerce, and so on, which facilitate manufacturing industry. It is a generally accepted view that advanced manufacturing industry could not exist without the presence of advanced producer service. Subsequently, it is much more difficult for manufacturing industry to maintain comparable and competitive advantages. Therefore, to enhance the producer services strength will definitely become China's concentration in the near future. Meanwhile, every producer service industry in China has donated a huge prosperous market.

For example, the Chinese logistics reached a value of \$81.4 billion, accounting for 40.5% of revenues generated for the Asia-Pacific region, and 13.8% of the revenues generated globally. The Chinese share of the global market is predicted to continue to increase, rising to 19.8% by 2010; this is mirrored regionally, as China is predicted to increase its share of the Asia-Pacific region to 51.9% (table 4)

<Insert Table 4 here>

China's civil logistics market is difficult to penetrate, but its international logistics market is also a lucrative channel that can be easier to exploit. In March 2006, FedEx announced that it was introducing three new flights to China, taking FedEx's weekly total up to 26 flights; now FedEx has the highest number of weekly flights into China of any US-based logistics company.

The Chinese biotechnology market grew by 13.3% in 2008 to reach a value of \$6.3 billion. In 2013, the Chinese biotechnology market is forecast to have a value of \$12.3 billion, an increase of 95.4% since 2008.

The Chinese hotels and motels industry generated total revenues of \$28.4 billion in 2008, representing a compound annual growth rate (CAGR) of 15.6% for the period spanning 2004-2008. The performance of the industry is forecast to decelerate, with an anticipated CAGR of 12.3% for the five-year period 2008-2013, which is expected to drive the industry to a value of \$50.7 billion by the end of 2012.

The Chinese insurance market grew by 23% in 2007 to reach a value of \$98.4 billion. In 2012, the Chinese insurance market is forecast to have a value of \$201.8 billion, an increase of 105.1% since 2007.

There are many other service data demonstrating the huge potential of China producer service sectors, and just above limited data has shown that if America takes the chance, it will definitely expand the service sector trade with China and gain much more service trade surplus with China.

## 6. Summary

Relationship between the US and China has worked to the advantage of American economic interests. As a member of the WTO and the world's fastest-growing market, China service sector is being opened more and more to the US. The services sector accounts for most of the jobs and economic activity in the United States, and offers the best prospects for growth in U.S exports. The service sector trade means decrease of trade unbalance degree between the US and China. Besides, the service sector trade is beneficial to China's sustainable development.

However, despite the benefits of trade between the US and China, there remain many and varied sources of friction in this relationship. In the US, a company can generally engage in any lawful business and may expand the scope or markets of interest in which it pursues business. In China, however, a company can only engage in an approved scope of business. The scope of business that is ultimately approved for a company in China is under the direction and control of the governmental approving authority at the time of the company's registration. The ability of a company in China to expand thereafter beyond its original scope of business cannot occur unless it first obtains approval from the authority. As a result, a Chinese company's business is quite specific and limited. Therefore, the US service transferor should investigate and assure itself that the transferee-to-be will not violate the provisions of its business license, articles of association or other organizational documents.

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## Notes

- Note 1. 2008 list by the CIA world fact book.
- Note 2. Note 6. Note 8. Note 9. Ministry of Commerce of the People's Republic of China Comprehensive Department
- Note 3. WTO: China surpasses Germany as world's NO.1 exporter for first time, China daily, August 26, 2009

Note 4. Zhongshan: China will possibly surpass Germany as world's NO.1 exporter in 2009. <http://stock.sohu.com/20091228/n269251643.shtml>

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Note 6. U.S. Census Bureau, U.S. Bureau of Economic Analysis news, U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES, Annual Revision for 2008 U.S. Department of Commerce • Washington, D.C. 20230

Note 7. The same as ii

Note 8. The same as ii

Note 9. The same as ii

Table 1. U.S. International Trade in Goods and Services (Note 7) In millions of dollars, details may not equal totals due to seasonal adjustment and rounding.

Period	Balance			Export			Import		
	Total	Goods	Services	Total	Goods	Services	Total	Goods	Services
2002	-421,603	-482,829	61,226	977,469	685,171	292,298	1,399,074	1,168,002	231,072
2003	-495,042	-549,012	53,970	1,020,186	715,848	304,338	1,515,228	1,264,860	250,368
2004	-609,990	-671,834	61,844	1,159,230	806,161	353,069	1,769,219	1,477,994	291,225
2005	-715,273	-790,851	75,578	1,281,457	892,338	389,119	1,996,729	1,683,188	313,541
2006	-760,359	-847,260	86,901	1,451,685	1,015,812	435,873	2,212,044	1,863,072	348,972
2007	-701,423	-830,992	129,569	1,643,168	1,138,384	504,784	2,344,590	1,969,375	375,215
2008	-695,937	-840,252	144,315	1,826,596	1,276,994	549,602	2,522,532	2,117,245	405,287

Note: Data presented on a Balance of Payments (BOP) basis.

Table 2. U.S. International Trade with China in Goods and Services (Note 8) In millions of dollars, Details may not equal totals due to seasonal adjustment and rounding.

Period	Balance			Export			Import		
	Total	Goods(1)	Services	Total	Goods(1)	Services	Total	Goods(1)	Services
2002	-101,187	-103,115	1,928	28,101	22,053	6,048	129,288	125,168	4,120
2003	-121,998	-124,068	2,070	34,378	28,368	6,010	156,376	152,436	3,940
2004	-159,370	-161,938	1,624	41,983	34,744	7,239	202,297	196,682	5,615
2005	-199,105	-201,673	2,568	50,904	41,799	9,105	250,009	243,472	6,537
2006	-231,079	-234,101	3,022	63,673	53,673	10,000	294,752	287,774	6,978
2007	-254,106	-259,506	5,400	77,136	62,936	14,200	330,242	321,442	8,800
2008	-262,158	-268,040	5,882	85,602	69,732	15,870	347,760	337,772	Less than 9,988

Table 3. The degree of deficit and surplus of American good trade and service trade to China (Note 9)

Period	Deficit to China/Total deficit	Goods trade deficit to China/Good trade deficit	services trade surplus to China/services trade surplus
2002	24%	21%	3%
2003	25%	22.6%	3.8%
2004	26%	24%	2.6%
2005	28%	25.5%	3.4%
2006	30%	27.6%	3.5%
2007	36%	31%	4.2%
2008	37.7%	32%	4.1%

Table 4. China logistics market value forecast: \$billion, 2005-2010

Year	\$billion	RMB yuan (billion)	%Growth
2005	81.4	667.9	24%
2006	96.3	789.7	18.20%
2007	107.7	883.4	11.90%
2008	119.1	977.3	10.60%
2009	130.0	1,066.5	9.10%
2010	143.3	1,175.7	10.20%
CAGR, 2005-2010			12.0%

Source: Datamonitor, USA, 2008