Producer services and urbanization in China: trends and challenges

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(With thanks to Yang Xiaolan and Ni Pengfei, CASS, Beijing; and Yang Renfa, Anhui University)
• Urbanization proceeding apace, but largely localized population and spread between 600+ cities, many below efficient size threshold for many economic activities.
• Successful urbanization crucial – producer services thrive on key agglomeration economies in cities.
• Various policy adjustments post-1978; recent intention to upgrade the industrial structure from low-value to high-value added production.
• For this to happen producer services (especially knowledge-intensive services) are strategically important sector.
• Role of manufacturing in economy changes over time – its share of GDP peaks at 20-35 percent - thereafter share begins to fall, job creation shifts to services.
• Manufacturing companies increasingly rely on diverse service providers - upstream and downstream - design, IT services, logistics, telecommunications, consultants of all kinds, commercial legal services etc.
• Services also create demand for manufactured goods - a McKinsey study (2012) suggests that in China manufacturing creates $500 bill. in services demand, and services demand $600 bill. a year in manufactured goods.
China: trends in services GDP and employment, 1978-2011

Extracted from *China Yearbook of Statistics* (2012)
China: KIS employment and growth, 2004-2010

KIS defined as: financial services; information and communication services; science and technical services; business services (after Wei et al, 2006)

Source: China Statistical Yearbook of the Tertiary Industry, 2011
China: KIS value-added (bill. yuan), 2004-2010

Source: China Statistical Yearbooks, 2005-2012

Source: China Statistical Yearbook of Tertiary Industry, 2011
Services (GVA) in Provinces and Selected Cities, 2004-2009

• More than 40% of total GVA of 37 leading cities was accounted for by all service activities – still lower than European cities (>70%)
• Cities in the west generally perform less well than the leading cities in the coastal provinces.
• Beijing only city with services GVA (75.5%) higher than the European average; Guangzhou and Shanghai still some way behind at around 60%.
• Financial intermediation and transport, storage, and postal services account for the largest share of producer services GVA. Beijing (13.2%), Hangzhou (10.2%) and Shenzhen (13.5%) prominent in financial intermediation.

• Computer services and software are major contributors to total producer services GVA in Shanghai (12%) and Beijing (8.8%).

• Leasing and business services contribute a limited share of GVA, even less than computer services etc.

• Many of these are knowledge-intensive market services crucial to the necessary local and national economic adjustments, but remain relatively underdeveloped in all but a very small number of Chinese cities.

• Exceptions are the cities at the apex of the hierarchy, notably Shanghai, Beijing and Guangzhou, but even here the absolute values of leasing and business services GVA are not much higher than those for scientific research, technical services and geologic prospecting.
City size and annual change in producer service employment (2004-2010)
Growth of Producer Services (GVA) in Provinces and Selected Cities, 2004-2009

- Relationship between city size, total GVA and share of producer services. GVA accords with similar research on European and North American cities (see also Yang and Yeh 2013b).
- **BUT** overall level and diversity of producer service activity remains lower than in the cities in the advanced economies.
Cities with more than 100,000 employed in producer services in 2009 consistently demonstrate positive average annual growth since 2004.

Irrespective of population size, almost all of the capital cities of the provinces show higher annual rates of producer services employment growth than even the prefecture-level cities.

Pattern less consistent in cities with fewer than 100,000 producer service jobs; approximately one-third recorded negative average annual growth rates, while others recorded rates at or above those typical of cities with larger producer service clusters.

Reasons include: city location (coastal, central, western provinces); proximity to larger, competing city; structure of economic activity; administrative role of city; presence or absence of foreign-invested firms.
Even over the relatively short 2004-2009 period, hegemony of cities such as Shanghai and Guangzhou for producer services employment is being challenged by some dispersal, albeit slowly, to the provincial capital cities – replicating the dominance of these cities at provincial level in the way that Beijing and Shanghai dominate at national level.

Reflecting the evidence from GVA data, employment change in knowledge-intensive activities, notably leasing, and especially, business services lags behind financial intermediation etc.

Cities, irrespective of population size, that have accumulated a significant cluster of producer services (by volume or diversity) tend to attract further rounds of growth and investment that reinforces their initial advantage.

This conforms with experience of similar processes in the European city system.
Firm level survey of producer firms: Shanghai

- Telephone survey of 8000+ sample of producer service firms with an address in Shanghai (September 2013).
- 100 respondents broadly representative of the survey population.
- More than one third of the firms serviced clients within 10 miles of their location, in the rest of the PRD or East China.
- Local and national shares of total revenue from clients significantly higher than those typical of producer service firms in European cities.
- Even firms in second tier European cities will generate more than the average of 4 per cent of Shanghai firms’ revenue from clients in the rest of Pacific Asia and beyond.
Firm level survey of producer firms: Shanghai

- Firms asked to identify their strengths and weaknesses taking account of their existing characteristics and business objectives.
- Most often cited reputation as their primary strength - well known that a good reputation for client service, support, or ‘product’ quality enables firms to charge higher fees, attract the best personnel and attract new commissions simply through referrals from existing clients, partners or even suppliers.
- Next comes innovation/R&D, then cost/price advantages, and the overall service provided to clients, most of which are located within Shanghai or the wider YRD (35 per cent).
- Principal weaknesses derive from the shortage and range of available expertise, lack of flexibility, and marketing/promotion challenges.
- **Note:** Recent projections suggest that China is likely to struggle to close a large and widening gap in the supply of university and vocational graduates – will impact on producer services.
Going forward, opportunities for Shanghai producer service firms arise from:

- potential for further development of an extended regional market,
- diversification of economy of China more generally, further opening up of domestic and international markets
- establishment of the Shanghai Pilot Free Trade Zone.

Weaknesses and threats to Shanghai’s position as a leading centre for producer services (as well as its ambition to be a world city) include:

- high living costs,
- congested infrastructure,
- competition from expansion of corporate complexes elsewhere in the YRD and more widely in the PRD,
- erosion of its headquarters base primarily, but not exclusively, as a result of competition with Beijing.
Given:

- the limited findings of the research on producer services undertaken as part of WP2 and —-----

- the fact that research focused on producer services focus remains limited in scope and contribution to properly understanding how to effectively incorporate them in city, regional and national economic development policies

There are **TWO** principal recommendations:
RECOMMENDATION 1

1. Construct, publish, and regularly update consistent and comparable national datasets (time-series) on employment, GVA, input-output (disaggregated down to appropriate administrative units and establishments) for producer services using international classifications such as the ISIC Rev.4.

(Wherever possible these datasets should be readily accessible to domestic and to overseas researchers)
2. Commission a national-level research programme on producer services (operating in prescriptive and responsive mode).

**Purpose:** To provide rigorous and systematic insights (include regular monitoring where appropriate) on a number of issues that include:

- development trajectories for the various categories of producer services, especially KIS, and how and why these vary by city size, industry structure etc.
- awareness (micro-enterprises to SOEs and TNCs) of the actual and potential role of producer services in corporate business strategies, goals and competitiveness;
- determinants of inclusion/exclusion of producer services in city/province plans and policies for economic development
- relationship between the physical infrastructure provision and the development of producer service firms;
- the hard and soft impediments to the growth and performance of producer services, especially at the interface between them and manufacturing firms (knowledge acquisition and transfer, innovation, product enhancement, logistics, marketing etc.);
- how to tailor policies and initiatives for education, training and skills to include provision for outputs that will better match the human resource requirements of a growing and diversifying portfolio of producer services, including firms from outside China.