

Service Market Opening in Latin America and Its Effect on the Region's Manufacturing GVCs

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I. Introduction

Due to the accelerating digital transformation in the post-COVID-19 world, the share of service trade in the economies of major countries worldwide is expected to increase further. Services and participation in the global value chain (GVC) are closely related. This relevance is because services serve as a significant input factor in the manufacturing sector, where the GVC is the most complex and diverse, facilitating the upstream and downstream production process in the value chain. The recent movement to open the service market in Latin American countries has an inherent policy goal of improving the competitiveness of the service sector in these countries, as well as enhancing participation in the GVC centered on the manufacturing industry by facilitating the introduction of services within and outside the region in product trade.

Korea's exports are still concentrated on the trade of manufacturing-centered products, and improving competitiveness in the service sector is a challenge. This phenomenon is also evident in Korea's exports to Latin America. Korea's exports to Latin America are focused on manufacturing-oriented product trade, and trade and cooperation in the service sector between Korea and Latin American countries remain low. In a situation where Korea's exports to the world are sluggish due to the spread of protectionism and delayed global economic recovery, the Korean government and companies need to move away from the traditional Korea-Latin America cooperation model that was focused on manufacturing-oriented product trade. In addition, they need to expand service trade and create new solutions in the service sector.

Although the expansion of global services trade and the movement to open service markets in Latin American countries provide Korea with opportunities to create trade and cooperate with Latin American countries in the service sector, few studies provide information on the level of service industry openness in Latin America. Additionally, research that can provide logic for trade expansion in the service sector and cooperation efforts with Latin America is sparse. While the opening of the service markets in Latin American countries is expected to ultimately lead to increased participation in the GVC through increased input of services within and outside the region in product trade, the Korean government needs to look ahead to future changes in the structure of GVC participation, following the movement of countries in the region to open service markets.

Therefore, against this background, it is essential to understand the level of service market openness in major Latin American countries, provide information to governments and companies, and provide the logic for economic cooperation between Korea and Latin America in the service sector.

II. Status of Service Market Opening in Major Countries in Latin America

As a result of reviewing the domestic laws of MERCOSUR and the Pacific Alliance in Latin America, the level of regulation on investment

in the service sector has been lowered due to the past active policy of attracting foreign direct investment. Except for some exceptional cases, there is no discrimination between Koreans and foreigners regarding investment in most service sectors, and there are few areas where investment is prohibited or restricted.

In some fields, there are restrictions on investment in services. In fields such as coastal transportation, maritime transportation, air transportation, road transportation, and banking services, all eight countries restrict foreign investment. In the business service field, there are cases where qualification or association registration requirements are imposed, focusing on some professional service fields such as legal, accounting, and architectural services. In summary, the level of investment liberalization in business, construction, and distribution services, excluding transportation services, is high.

However, the level of service concessions in these countries was significantly lower than the level of investment liberalization based on domestic law. According to the WTO service concession table, seven countries, excluding Uruguay, have low concession levels in the computer and related services field. However, in the DDA service concession plan, only Mexico, Chile, and Peru show significant concession improvement in these fields. Looking at the level of commitment to the opening of the best FTAs that the countries concluded, Mexico, Peru, and Colombia gave unrestricted market

access to all fields of computer and related services, but other countries showed no significant changes in concessions.

If we look at the changes in the concession contents of the best FTAs concluded by these countries, compared to the WTO service concession table and focusing on the business service sector, we find the characteristic of a significant expansion of the openness promises of Pacific Alliance countries. In general, it is confirmed that much improvement has been made in concessions in other business, real estate, and rental/lease services. Among professional services, concession improvements have progressed across legal services, accounting and tax services, and architecture and engineering-related services. On the other hand, although partial concession improvements in business services are being made in MERCOSUR member countries, the level is shallow. In the case of transportation and logistics services, although the level of concessions is gradually improving, it is still shallow compared to other service fields, and my assessment is that it will not be easy to expect significant improvements in terms of concessions in the future.

When a country commits to openness through multilateral or bilateral trade negotiations, it must maintain that level of openness and is liable for compensation if actions are taken to retreat from the level of openness commitments. For this reason, to improve the stability and predictability of service market opening, foreign service providers may request that such

measures be conceded through a trade agreement along with the service market or investment opening under the domestic laws of the target country. Therefore, for Latin American countries to attract more foreign service companies through service market opening and to enable domestic industries to be incorporated into GVCs, there is a need to promote concession improvements that enhance the stability and predictability of service market opening.

III. Service Market Opening and Manufacturing GVCs

As the introduction mentions, services are essential in building a GVC in the manufacturing industry. In this chapter, I present the results of an empirical analysis of whether the conclusion of services trade agreements with Latin American countries has changed these countries' forward and backward linkages. In addition, I would like to mention the results of an additional empirical analysis using data including OECD member countries and some non-member countries to determine which areas of service industry regulation significantly impacted the construction of GVCs in the country.

As a result of the empirical analysis, I found that when Latin American countries signed a bilateral service trade agreement with a Global North country, the agreement significantly strengthened the backward linkages of Latin American exporting countries. Among Latin American countries, when a country in the Global North concluded a service trade agreement with a Global North country, forward

linkages of Latin American exporting countries also increased. It is possible that the signing of service trade agreements with Latin American and advanced countries has made it easier for competitive service companies to enter Latin America or that offshoring has increased as connectivity between the service industry and manufacturing has improved, further strengthening forward linkages. This strengthening of forward linkages was only meaningful in signing service trade agreements between advanced countries and some Latin American countries that belong to the Global North and thus have a certain level of industrial base.

According to the results estimated under the hypothesis that the effect of GVC strengthening may vary depending on the service sector, backward linkages increased in the country's textile and clothing industry as regulations in the telecommunication, logistics, and transportation service sectors were relaxed. In the crude oil, chemical, and non-metal industries, the relaxation of rules in the logistics service sector strengthened the country's backward linkages in these industries.

In the textile and clothing industries, forward linkages decreased as the regulation level of telecommunication services was relaxed, and in the crude oil, chemicals, and non-metal industries, forward linkages decreased as the regulation level of professional services was relaxed. Additional analysis will be needed in the future to determine why this result occurred, especially in the crude oil, chemicals, and non-metal industries.

Infer that professional services such as engineering services occupy a more critical role in this industry than in other industrial sectors, so the substitution effect due to service opening may have been more significant, and the use of competitive professional services in this technology-intensive industry as exported goods move closer to the downstream sector of the value chain, as well as the tendency to process them directly into final goods and consume them in the importing country may have increased.

IV. Policy Implications

The movement to liberalize the service market in Latin American countries needs to be interpreted as a policy effort to improve competitiveness in the service sector and expand participation in the GVC. In a global trend where service input is increasing at various stages of product production within the GVC, introducing qualified services enhances the overall productivity of major industries, smoothing the production process both forward and backward in the value chain to which Latin American countries belong.

Furthermore, the influx of quality services could increase foreign direct investment in Latin America by making it easier for other sectors, such as manufacturing, to enter the region. It is necessary to fully understand the context in which the opening of the service market in Latin American countries aims to increase the competitiveness of the manufacturing industry in Latin America and increase participation in

GVCs by strengthening the linkage between the service and manufacturing industries.

In the case of Latin American countries, the conclusion of a product trade agreement alone may not significantly increase GVC linkages. The trade structure in which Korea exports finished manufacturing products to Latin American countries and Latin American countries export primary products to Korea has long been established. Due to this trade structure, Korea's competition with other countries in Latin America, including China, is intensifying, and Korea's manufacturing exports to Latin America are continuing to be stagnant.

Awareness of this problem calls for a new economic cooperation model between Korea and Latin America. Among these, advancing into the Latin American national service markets could be a win-win cooperation model that can promote Korea's exports to Latin American countries and the national task of Latin American countries to strengthen participation in GVCs. There is a need to discover areas where Korea can cooperate with Latin America in service areas where Korean companies have a comparative advantage, such as construction services, distribution services, logistics services, business services, and transportation services required for various stages of product production. This is because such cooperation can contribute not only to the expansion of Korean companies' service exports but also to increasing the efficiency of specific industries in Latin American countries where services are imported and growing participation in GVCs.

While major countries in Latin America need help creating added value in the manufacturing sector, the entry of Korean service companies can positively impact the competitiveness of Latin American manufacturing companies and their participation in the global supply chain.

Empirical analysis shows that opening communication, logistics, and transportation services strengthens exporting countries' participation in GVCs in the textile and clothing sectors. This fact has implications for some countries in Latin America. The textile and clothing sector is a core industry in low- and middle-income countries in Latin America, and enhancing GVC participation in the textile and clothing industry is essential in creating quality jobs and reducing income inequality. The role of Latin American countries in the textile and clothing supply chain varies from importing fabric and auxiliary materials and exporting them after simple sewing processes, to exporting a significant portion of the clothing production process while minimizing the import of fabric and auxiliary materials. The supply chain with the U.S. is already closely established, taking advantage of skilled human resources with relatively low wages as a comparative advantage.

Middle- and low-income countries in Latin America face the challenge of establishing a smoother textile and clothing supply chain. In this sector, the influence of global buyers is more significant in the textile and clothing industry than in the value chains of other sectors because producing countries are likely to be left

out of the value chain if they do not immediately respond to global buyers' demands for increased efficiency within the supply chain. For the countries to enhance the efficiency required by international buyers, providing quality services to improve the production process is crucial. Due to the traditional characteristics of the Latin American textile and clothing industry, in which both the number of items produced and the number of deliveries is high, and most of the products are exported, the importance of logistics services, transportation services, and communication services used throughout the production process is increasing. The increase in service demand in Latin America's textile and clothing industry could serve as an opportunity for Korean service companies.

Moreover, there is room for further increase in investment opportunities in Latin America; thus, continuous monitoring is necessary. According to the empirical analysis results of this study, the opening of the service market in Latin America or the conclusion of a service trade agreement strengthened the GVC in the direction of strengthening only backward linkages in the Latin American manufacturing industry. In other words, the agreement did not significantly impact forward linkage. This result may be due to the reality that although the opening of the service market reduced the cost of offshoring to Latin America, it did not lead to offshoring. One of the main causes could be the poor human and material infrastructure environment in Latin America, which has been consistently pointed out in the past. Despite in-

creased opportunities for offshoring, participation in global value chains remains lower than expected due to infrastructure that has not been improved for a long time.

If Latin American countries share this critical awareness, they likely perceive improving human and material infrastructure as a more important task than ever. Solving these tasks is even more important when interest in Latin America is increasing in the ongoing GVC reorganization process. Therefore, future investment opportunities in Latin America can be expected in areas such as education, construction, and communications, and monitoring of this is more necessary than ever. **KIEP**