

Forging Stronger Ties: The Strategic Imperative of Korea-Central America Cooperation in the New Nearshoring Era



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Mexico has been a key beneficiary of the supply chain reorganization resulting from the U.S.-China conflict. It benefits significantly from nearshoring to advance into North America, and inward foreign direct investment from each country is flocking to Mexico.

What is the reason? With the NAFTA coming into force, a supply chain was formed in the automobile manufacturing sector between the three North American countries, and the USMCA in 2020 and the implementation of the IRA in 2022 further strengthened the supply chain in the three North American countries. Accordingly, there was a noticeable tendency for multinational companies targeting the U.S. market to advance into Mexico. In addition to the already established North American supply chain, this results from lower wages compared to the United States, Canada, and even China, as well as distance proximity to the United States.

Can we count on Mexico to remain an optimal location for nearshoring in the future? In other words, can we expect Mexico to steadfastly maintain its current strengths?

First, because physical distance is constant, Mexico will retain its advantage in transportation costs compared to other continents or countries in Latin America. So what will the wages be like? The current AMLO government is continuously raising the minimum wage, and this trend is expected to be maintained if presidential candidate Sheinbaum, who is likely to win the Mexican presidential election in June, is elected president. In addition, multinational companies' aggressive entry into Mexico due to nearshoring is leading to a surge in demand for production factors such as labor and land, and the costs thereof are rising. Furthermore, we should notice wage increases due to long-term economic growth.

There is also uncertainty about whether the supply chain between the three North American countries will remain the same. In particular, it may change depending on the U.S. presidential election results. While the U.S. trade balance with Mexico is recording a deficit, if Trump is elected, he may pursue trade policies to alleviate the deficit. As a result, the possibility of changes in the supply chain between the three current North American countries cannot be ruled out.

Even if we assume no significant changes in U.S. trade policy toward Mexico in the future, Mexico can pursue policies to enhance added value by changing its current industrial structure. In other words, policy efforts will be made to locate high-value-added processes beyond simple manufacturing and assembly within the country.

As such, factors other than the distance between the United States and Mexico may change over time, potentially weakening Mexico's role as a nearshoring base in the future. Accordingly, in the long term, new countries will emerge or be needed to replace Mexico's current role. Thus it becomes necessary to prepare a strategy to select such countries and strengthen cooperation.

In this regard, it is necessary to pay attention to Central America in the long term, particularly the Dominican Republic and Guatemala. The two countries are closer to the United States and Mexico than other countries in Latin America. Also, they have a comparative advantage because their wage levels are lower than those of Mexico. According to the International Labour Organization (ILO), the average monthly wage in the Dominican Republic is \$457.6 in 2023, and in Guatemala, it is \$384.9, which is lower than Mexico's \$500.6. Considering the rapid increase in the number of multinational companies entering Mexico, the wage gap between these countries may widen.

In addition, the Dominican Republic has FTAs with the United States and Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) through the Dominican Republic-Central America FTA (CAFTA-DR). Guatemala has signed FTAs with the United

States and Mexico. Therefore, once the Dominican Republic and Guatemala establish their manufacturing base to some extent, there is room for them to be incorporated into the North American-centered supply chain, at least for low-value-added processes, by utilizing the already concluded FTA or upgrading the FTA in the future. Participation in the supply chain is what both countries ultimately want under supply chain reorganization.

Since Guatemala and the Dominican Republic may be incorporated into the North American-centered supply chain in the long term, laying the foundation for economic cooperation with these countries is essential. For the first time with a Latin American country, Korea is attempting to accelerate economic cooperation by signing a Trade and Investment Promotion Framework (TIPF) with the Dominican Republic in April 2023. In addition, Guatemala officially signed the Korea-Central America FTA Accession Protocol in January 2024 and is pursuing ratification and entry into force in the second half of 2024. In this way, Korea is laying the foundation for economic cooperation with these two countries, which is likely to become an important foundation for increasing the possibility of utilizing the FTA network for future advancement into North America.

However, the current TIPF with the Dominican Republic is limited to a non-binding MOU, and the FTA with Guatemala has not yet gone into effect. Therefore, the task facing Korea is to conclude a binding agreement with the Dominican Republic and ratify and enter into force an FTA with Guatemala as soon as possible to continue the cooperative relationship.

Although Mexico is receiving tremendous attention at this point, a longer-term perspective should take into consideration the possibilities of Mexico's leading industries to move to high-value-added ones in the supply chain, rising wages, and the expansion of Mexico's trade surplus with the United States. Seen as such, Mexico's current role in the supply chain may be difficult to sustain. In other words, Mexico's comparative advantage to position itself at the simple assembly stage in the supply chain decreases, and it is difficult to rule out the possibility that the United States will additionally incorporate other countries in Latin America into the North American supply chain. Therefore, it is necessary to select a country that can replace Mexico in advance and establish a framework for cooperation with that country.

In many respects, Central American countries deserve continued attention from Korea in the future. In particular, considering the possibility of the future emergence of the Dominican Republic and Guatemala in the North American-centric supply chain, it is necessary to continue to promote cooperation with these countries. **KIEP**