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# Trade in services in Latin America and the Caribbean: an analysis of recent trends

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# Abstract

This paper compares the dynamism of the Latin American and Caribbean region's services trade with that of Asia, evaluates the determinants of these trade flows, and proposes measures for improving the region's performance. The focus of this study is on "other services", which includes all services except transport and travel services (mainly tourism). "Other services" include many modern service inputs (including communications, financial and information technology services and business services), that play an increasingly vital role in determining many businesses' levels of competitiveness and productivity. Latin America exports of "other services" grew by less than that of the world and Asian averages between 1985 and 2005. As a result, the share of Latin America and the Caribbean in world's "other services" trade diminished from between 1995 and 2005, although the performance varies greatly among subregions, with Argentina, Brazil, Costa Rica and Honduras being the most successful. The region's lack of dynamism relative to that of China and India is also reflected in the drop of the region's share in imports of the United States and European Union.

Three key determinants are analyzed to understand the region's poor performance: national regulatory systems, human capital, and information and communication technologies (ICTs). The incidence of regulation contributes little to the understanding of the differences in export performance, as services in countries in Latin America and the Caribbean tend to be less heavily regulated than those in Asia. Together with the privatization of many state enterprises, Latin America attracted larger inflows of foreign capital as a share of GDP between 1995 and 2004. However, most of this investment was

motivated by serving local markets rather than creating an export base of services. The quality and cost of human capital provide a better explanation of the superior Asian performance. China, India and the ASEAN countries have an advantage over Latin America and the Caribbean because they have a large number of highly skilled workers (including information technology experts) who are paid competitive salaries. Another factor favoring the Asian countries is that workers have a good grasp of mathematics, an area where the region lags far behind. Third, although the quality of the ICT infrastructure is comparable between the two regions, the cost seems somewhat higher in Latin America and the Caribbean. One factor that raises the cost of access to ICTs in the region is that, by contrast with Asia, only a few countries are signatories to the WTO Information Technology Agreement.

To boost trade in these services in the region, both public and private sectors need to make an effort to produce better-quality, competitively priced services. These efforts should target the main obstacles to the sector's development. First, a greater liberalization of services trade, combined with increased mutual recognition and gradual convergence of different countries' regulatory frameworks. The timid approach taken to liberalization in WTO, subregional agreements (Mercosur and Andean Community), and the bilateral agreements with countries outside the region has done no more than maintain the regulatory status quo without achieving any genuine liberalization of trade in services. Second, upgrading human capital is probably the most important task for Latin America and the Caribbean. The public and private sectors should work together to establish ICT university courses and training programmes, especially for small and medium-sized enterprises. Third, an important step in opening up access to modern technologies such as telecommunications is to improve regulatory and competition policy with a view to stimulating investment and ensuring that high-quality services are provided at the lowest possible cost. Greater broadband Internet penetration makes it easier to sell more complex electronic services internationally. Broadband access can also boost companies' competitiveness and productivity. Another measure to encourage service exports is quality certification that enhances international credibility for service delivery.

# Introduction

The growing importance of services in the economy, employment and trade is a trend common to both advanced and developing countries. Services are essential inputs for many activities, and play a crucial role in increasing economic growth and productivity by improving financial intermediation, infrastructure, the use of information and communication technologies (ICT), education, health and the State apparatus. They currently represent approximately two thirds of the gross domestic product (GDP) of rich countries, and close to half that of developing countries, even though a clear difference exists between the types of services prevailing in each group. In terms of employment, the services sector accounts for 70% of workers in developed countries, but only one third of workers in emerging economies. Latin America and the Caribbean are positioned between the two groups. Cross-border trade in services has tripled since 1990, while foreign direct investment has quadrupled. Emerging economies have expanded their service exports at a rate exceeding that of developed countries (UNCTAD, 2004, 2005).

Business services play a strategic role in the overall arena of services. They are becoming increasingly knowledge-intensive (for example, advisory services, services related to information technology, engineering services and research and development services), and have become strategic inputs that increase the productivity and competitiveness of businesses. Moreover, thanks to advances in ICT, firms can now outsource many services to suppliers offering the best price-quality ratio, anywhere in the world. This process has played a key role in the explosive growth of trade in services provided to businesses, as well as the internationalization of such trade. Developing countries such as India and China, as well as certain nuclei in Latin America, have shown a strong capacity to attract a considerable share of this dynamic component of global trade.

This study will compare the trends of trade in services (save for transportation and travel) in Latin America and the Caribbean, China, Hong Kong Special Administrative Region of China, India and the countries that comprise the Association of Southeast Asian Nations (ASEAN). It will also assess the main determining factors of such trade, and propose measures to improve international insertion in this sector. To that end, the dynamics of service exports over the last decade will be examined. The relative diversification of service exports will also be analysed and compared to the pattern of concentration found in more traditional services (transportation and tourism). The varying performance of the countries of the region in this field will then be examined —particularly with regard to the factors that have influenced trends in service exports, the progress made by regional and bilateral trade and investment agreements and the differing levels of regulation to which the sector has been subjected. Finally, policies will be proposed to improve the region's performance in terms of service exports.

These questions will be addressed in four sections. The first section deals with the strategic role of services, and sets forth the main trends in global trade. The second section compares the performance of the region in terms of trade in services with that of a group of Asian countries, both at a global level and in the main markets of the United States and the European Union. It also discusses the success of certain Latin American transnationals in this sector. The third section analyses certain factors that play a determining role in export performance, taking into account issues such as regulation, human capital and the progress achieved by countries in the field of information and communication technologies. The fourth section analyses policies that may improve the region's competitiveness in this regard by harmonizing regulatory frameworks among countries. This would be accomplished by establishing trade agreements, improving workforce quality and increasing the adoption of cutting-edge technologies.

This study covers all market services, with the exception of transportation and travel.[1] The annex at the end of this paper contains a list of sectors based on balance of payments and World Trade Organisation (WTO) classifications. This paper will address not only auditing, computer, engineering and legal services provided to companies, but also construction, financial, insurance and communication services. Transportation and travel have been excluded for a variety of reasons.[2] The term "services" will hereinafter be understood to apply to all services, except for transportation and travel.