

Korea's Leading Think Tank

Korea's Service Sector and Future Development Directions

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C O N T E N T S



I . Status

II . Structure

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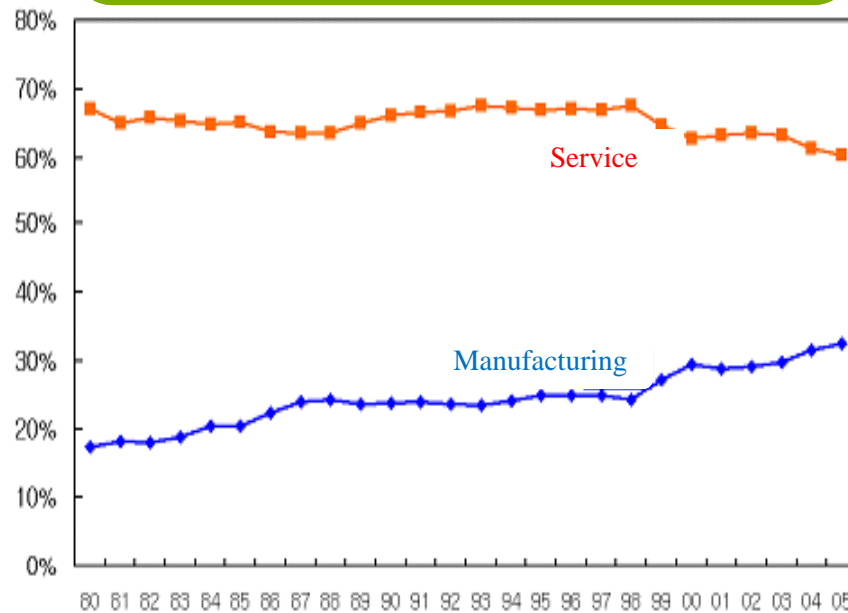
Part-01 | Status of the Service Industry



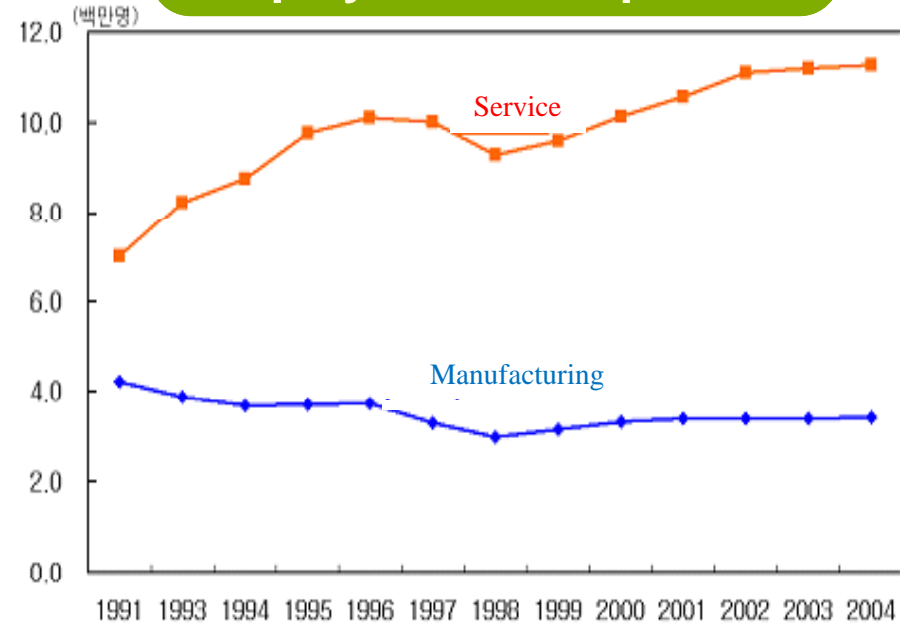
Economic slowdown and service industry (1)

- The growth rate of the value-added and value added ratio of **the service industry** continued to fall after the crisis.
- Successful restructuring transformed the manufacturing industry into technology-intensive industry.

Ratio of value-added- Comparison



Employment- Comparison

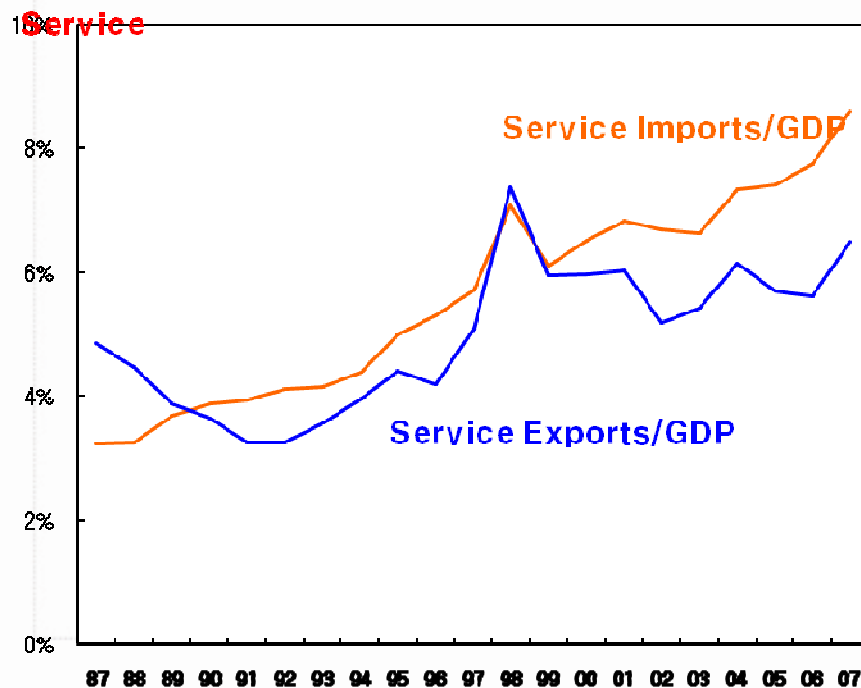


Economic slowdown and service industry (2)

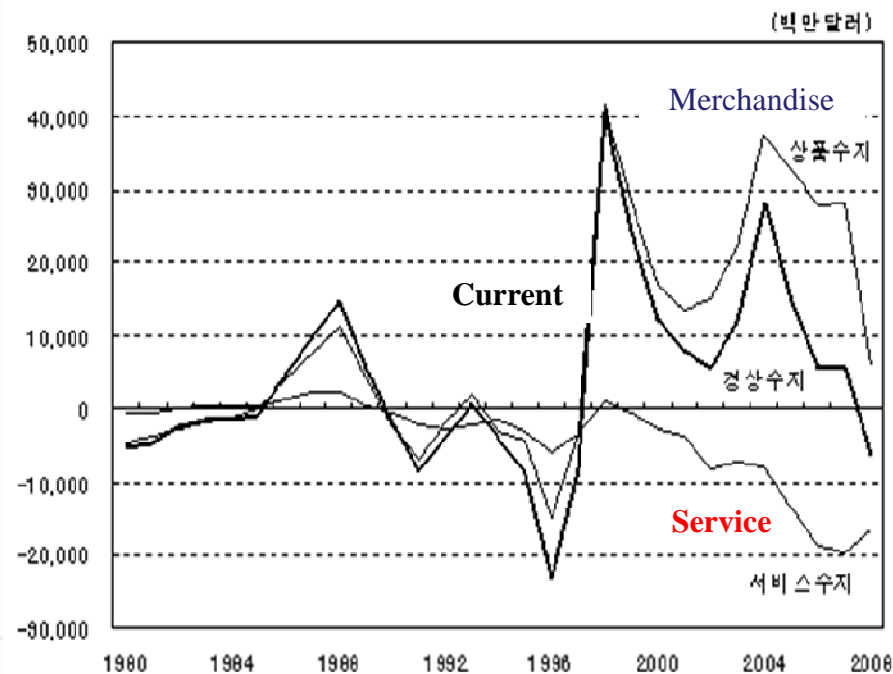
Outflow of the service industry with poor competitiveness through overseas purchase

- With the expansion of economic openness after the crisis, there was an increasing opportunity of buying overseas services.

Service industry's imports and exports ratio of GDP



Trade Imbalances

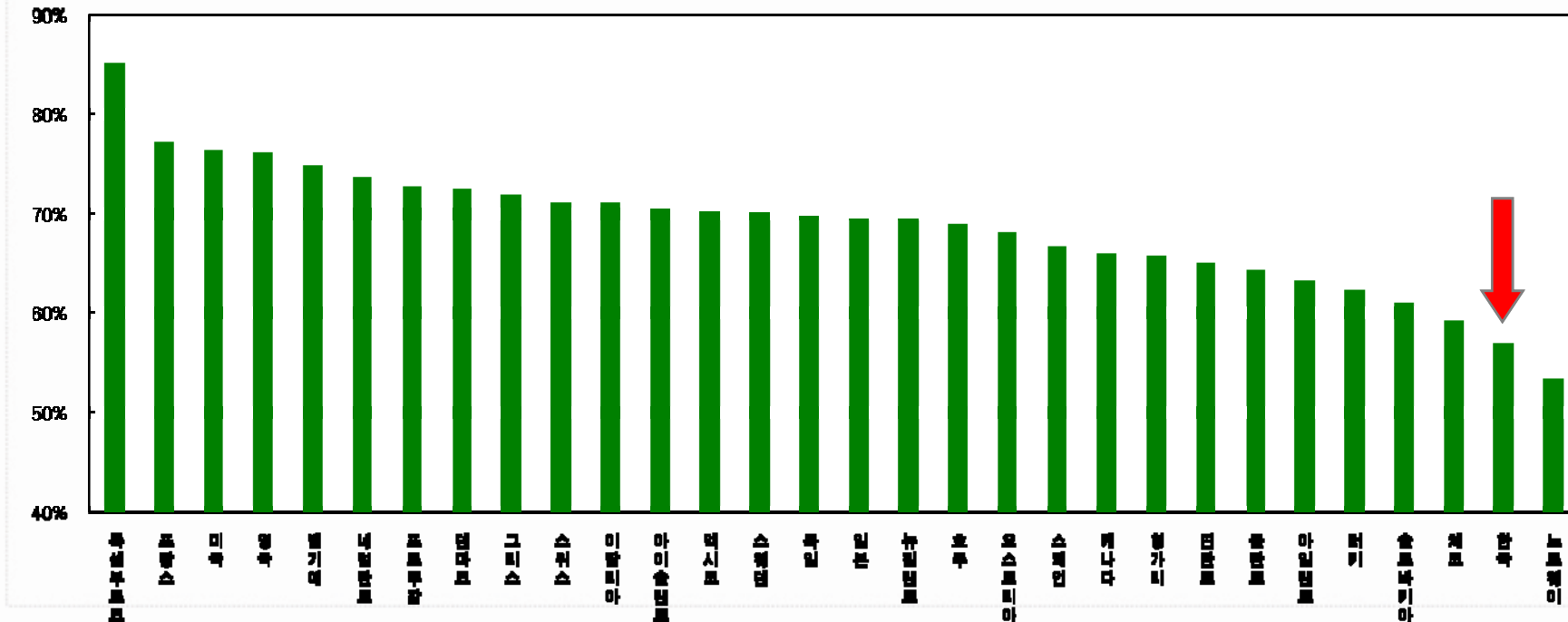


Service industry: International comparison

Korea's service share (service value-added/total value-added) is among **the lowest** in the OECD.

- However, the manufacturing industry ratio of Korea is the highest among the OECD nations with 28.0% as of 2006.

Service Sector's Share of Value-added ('06, OECD)

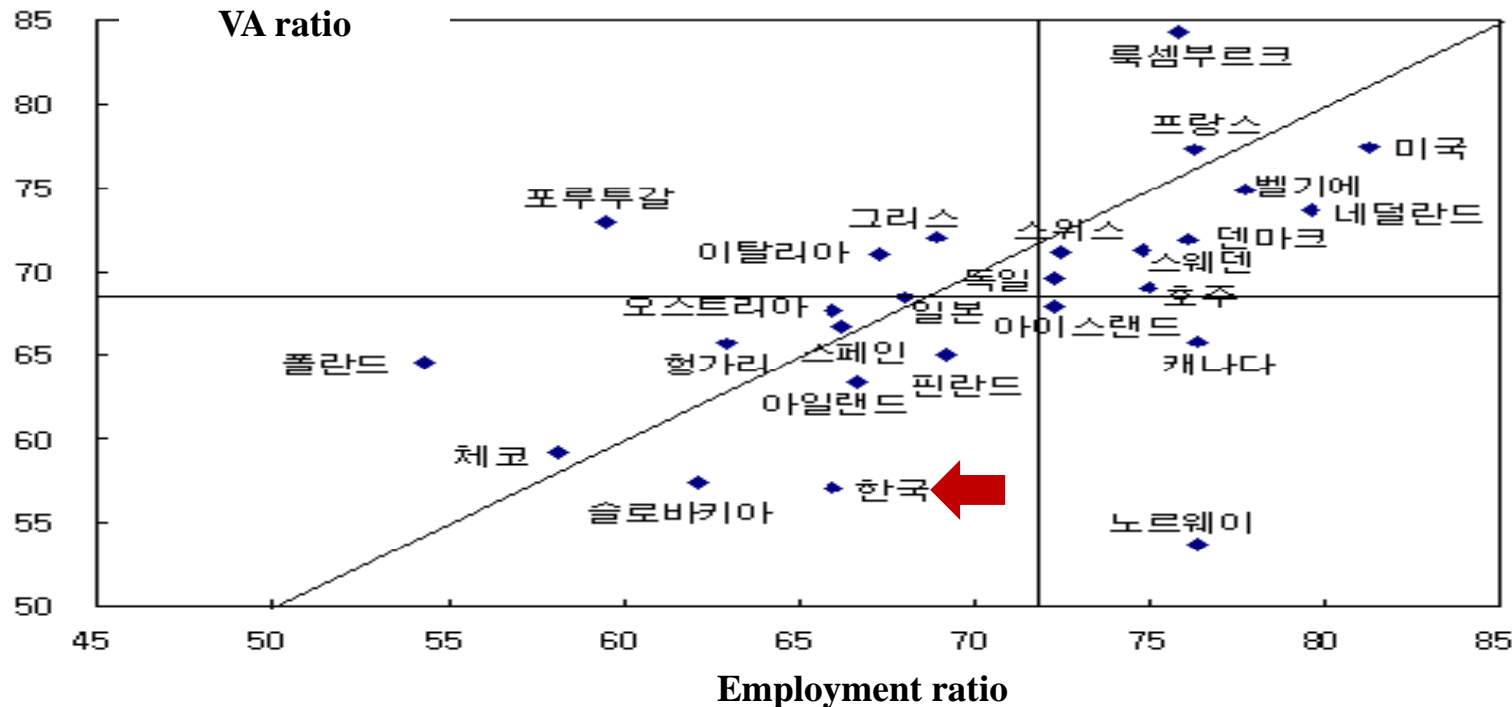


Service industry: International comparison

Overall, service industry in Korea shows relatively lower levels of employment and value added ratio.

- Relative productivity of service industry in Korea has been decreasing since 2004.

Value added and Employment ratio of Service (OECD, '06)

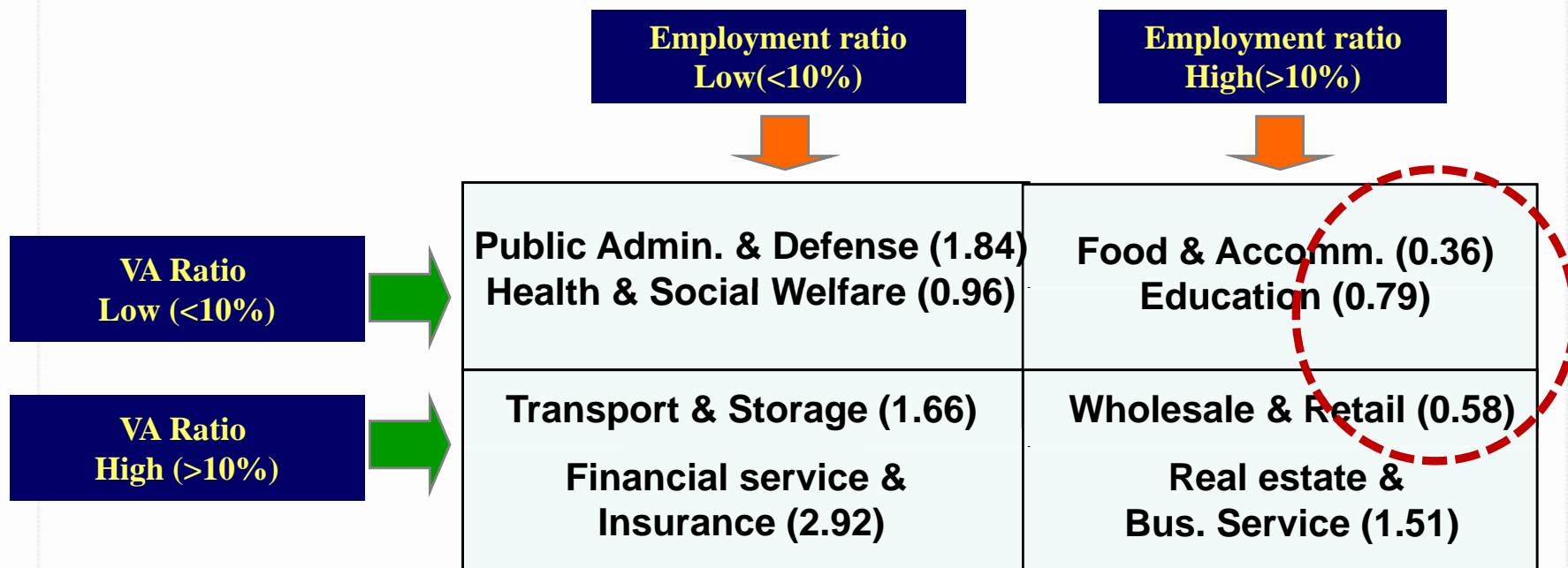


Part-02 | Structure of the Service Industry



Structure of the service industry (1)

Distinctive “Polarization” among sectors in terms of employment ratio and VA ratio



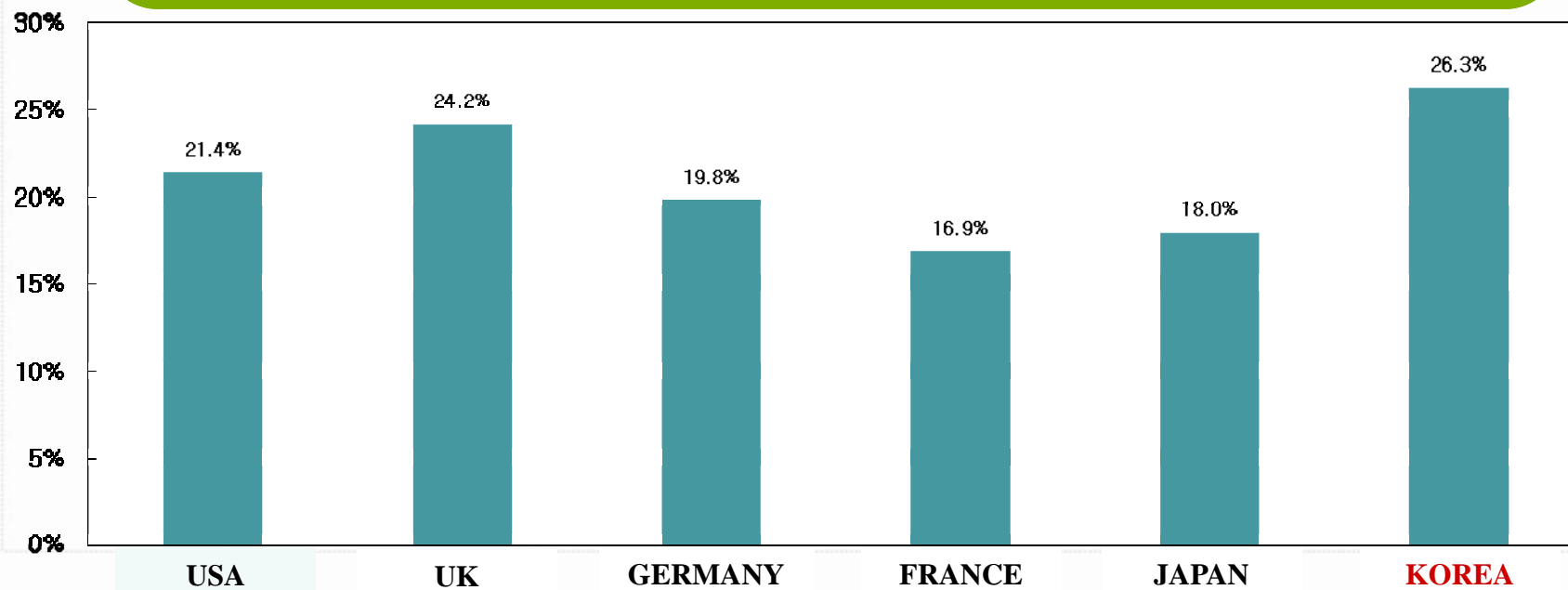
Note : Numbers in parentheses are **relative average productivity (value added share/labor share)**

Structure of the service industry (2)

High labor share of wholesale and retail, hotels and restaurants which have low productivity.

- Ratio of self-employed - **Korea: 26.5%**, the USA: 7.1%, Japan: 10.8%
- # of population per restaurant - **Korea: 79**, the USA: 416, Japan: 140

Major countries' ratio of wholesale and retail, hotels and restaurants (on employment basis, '06)

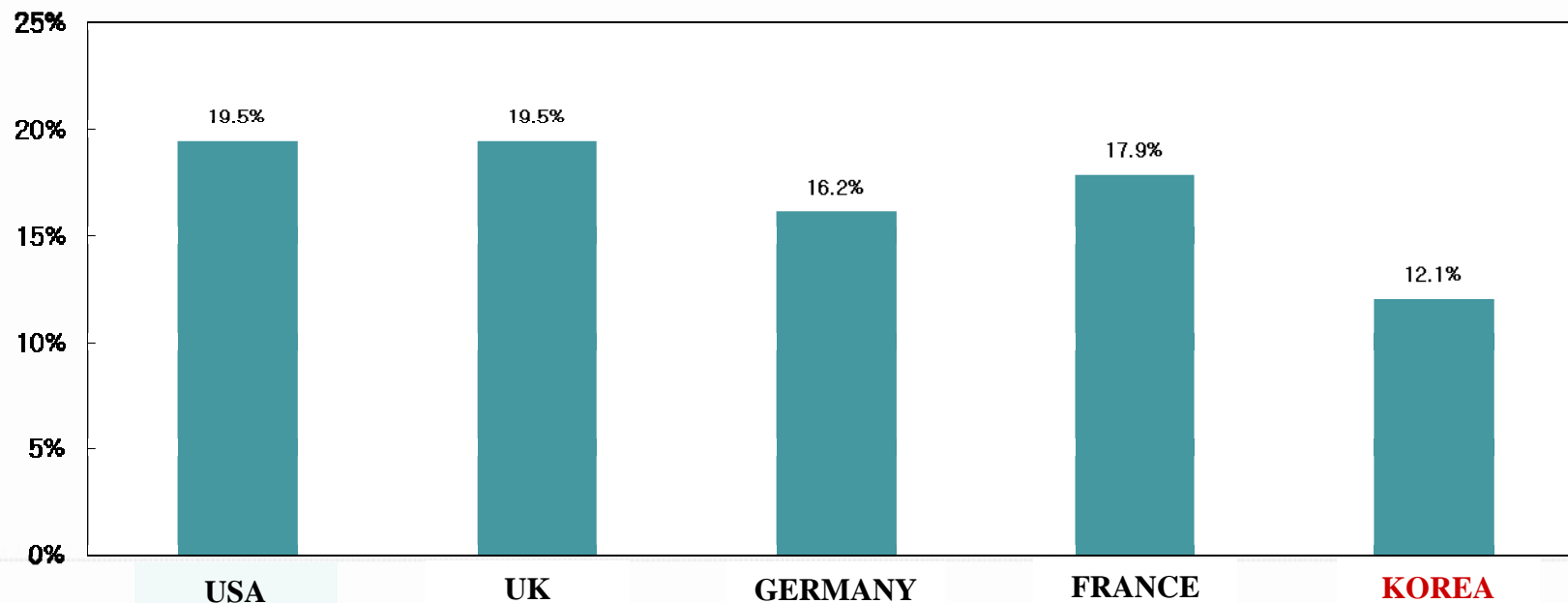


Structure of the service industry (3)

Low proportion of financial and business services which have high productivity

- Low proportion of high-productivity businesses reduces the productivity of the entire service industry.

Major countries' ratio of financial and business service (on employment basis, '06)

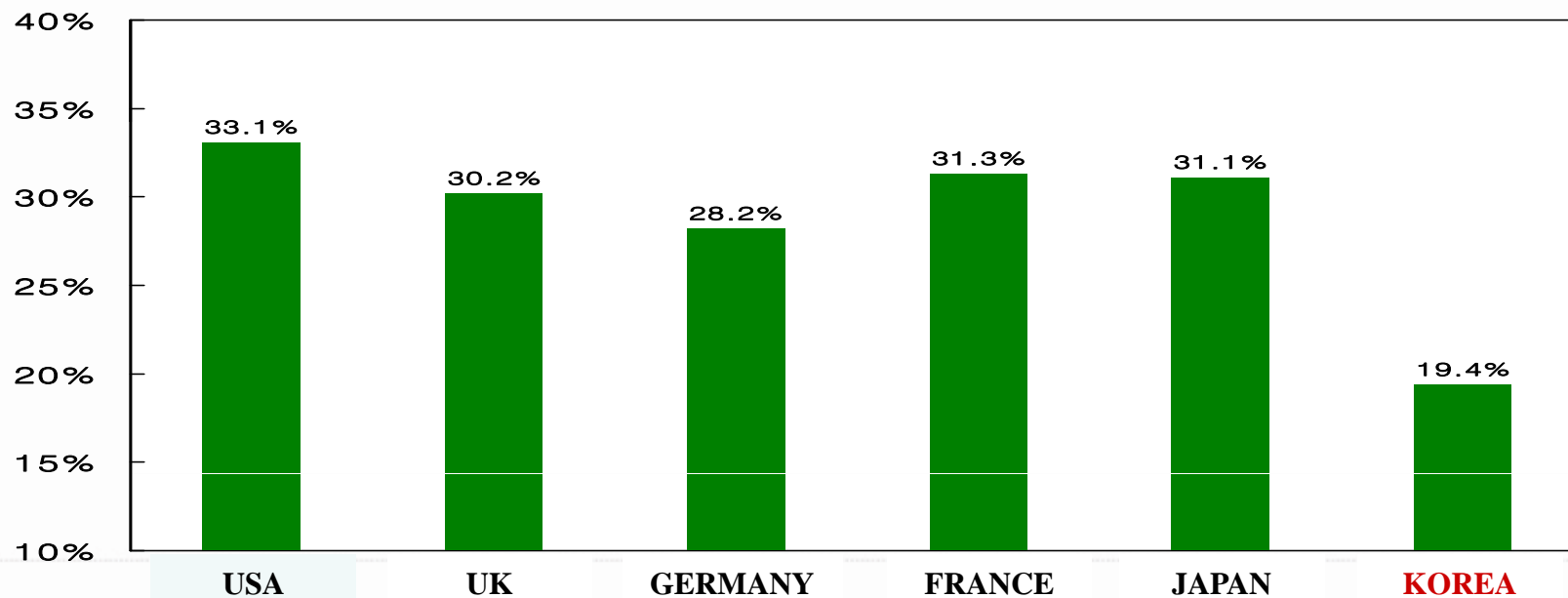


Structure of the service industry (4)

Low proportion of social service sector as a result of the weakness in social welfare system

- Korea's low proportion of social service sector is the most striking difference compared to developed countries.

Ratio of public admin. and social work (on employment basis, '06)

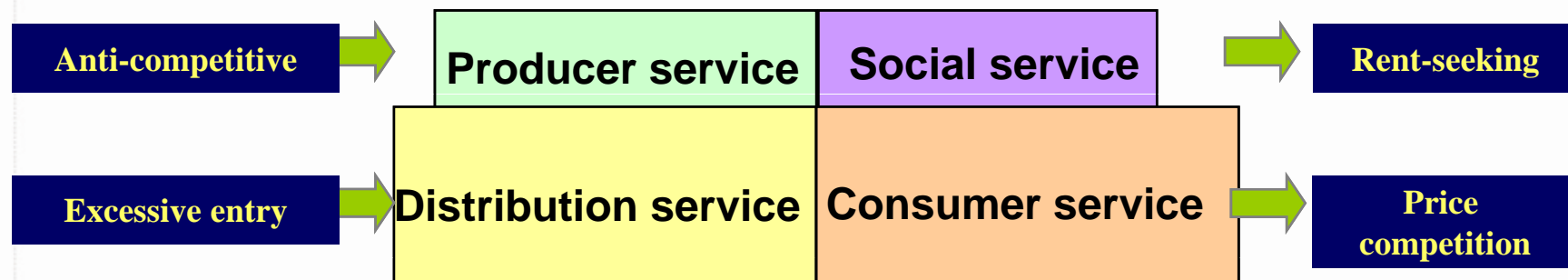


Dual structure of the service industry

Dual structure of **anti-competitive** knowledge-based service and **over-competitive** labor-intensive service

- High return to the knowledge-based industry is the result more of realizing the anti-competitive rents than of innovation.
- Low entry barrier to the labor-intensive service industry causes excessive competition and deters industrial development.

Inherent nature of Korea's service industry



Dual structure of the service industry

Excessive Competition in Distribution service in Korea?



Part-03 | Problems of the Service Industry

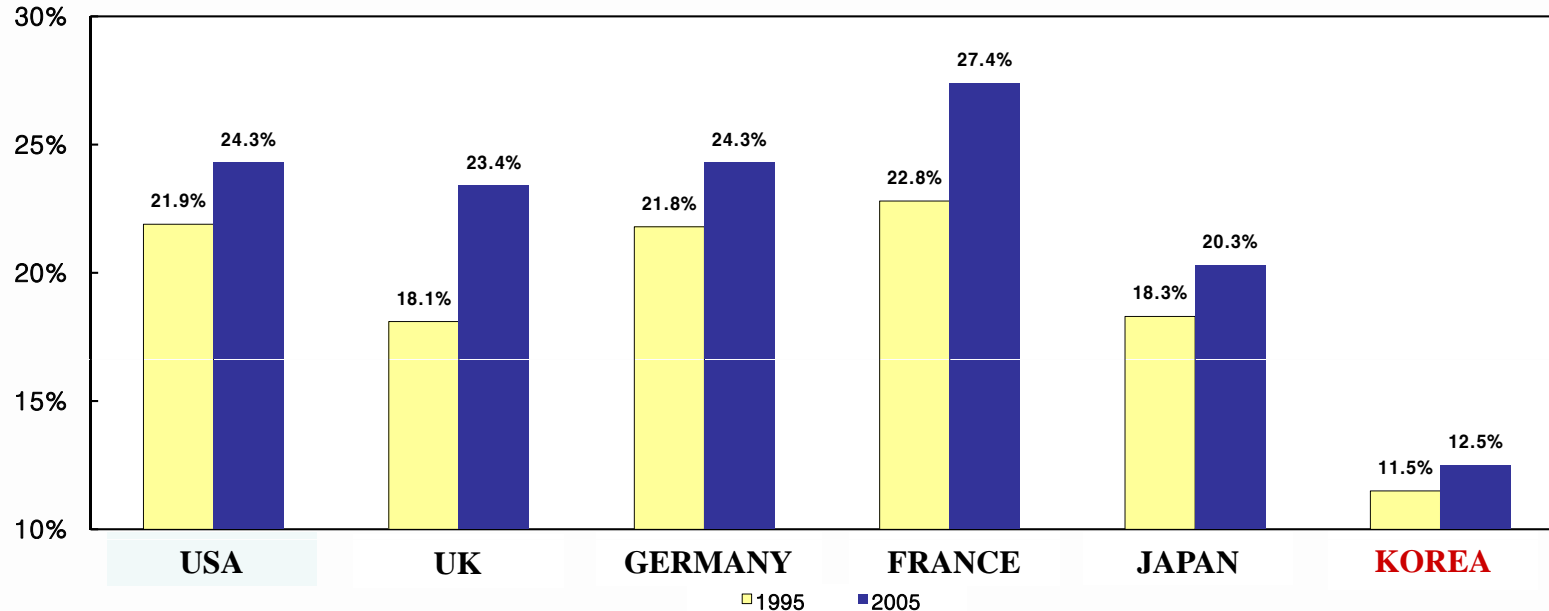


Systemic problems: (1) Entry regulation

Entry barrier by certification system has restrained the growth of the knowledge-based service industry.

- Entry barrier on a third of 543 service businesses('08 OECD)

Business service share against GDP ('95~'05)

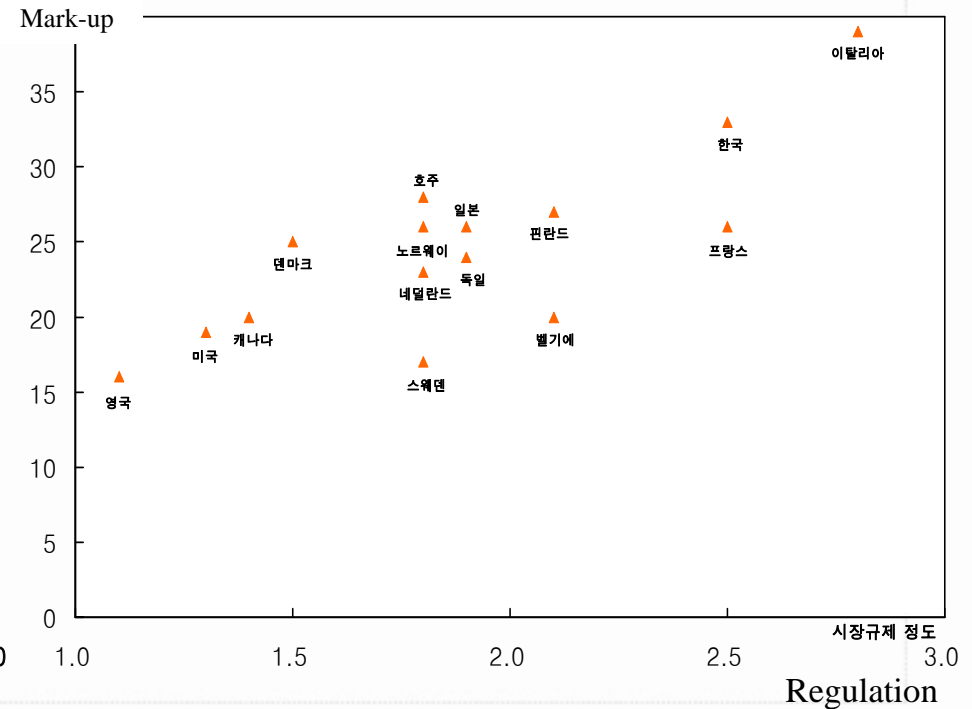
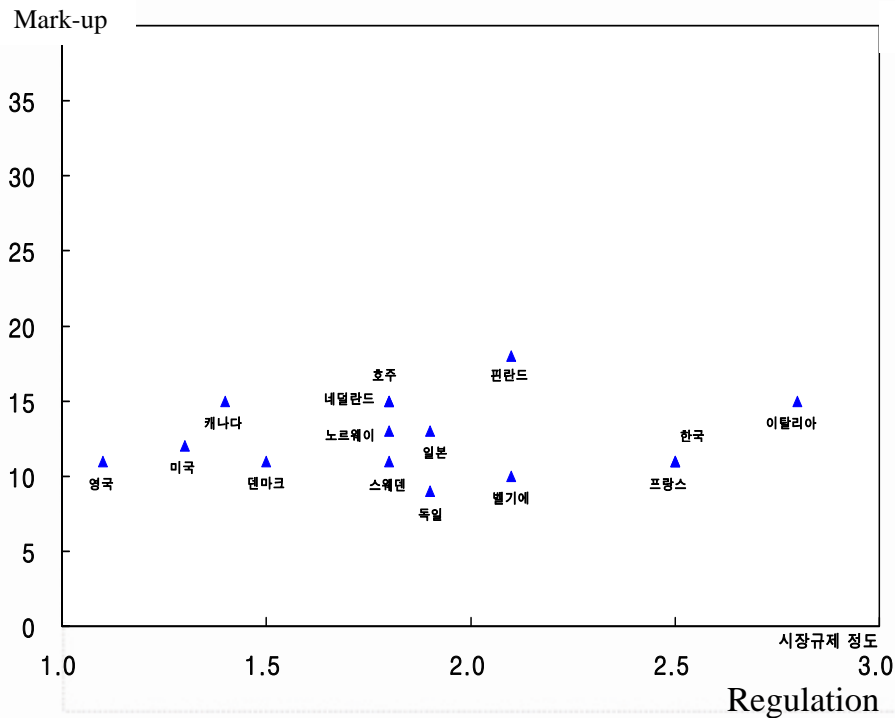


Systemic problems: (2) Regulation

Regulations tend to encourage more **rent-seeking behaviors** than innovation in the service industry.

Regulations and markups in the manufacturing industry

Regulations and markups in the non-manufacturing industry



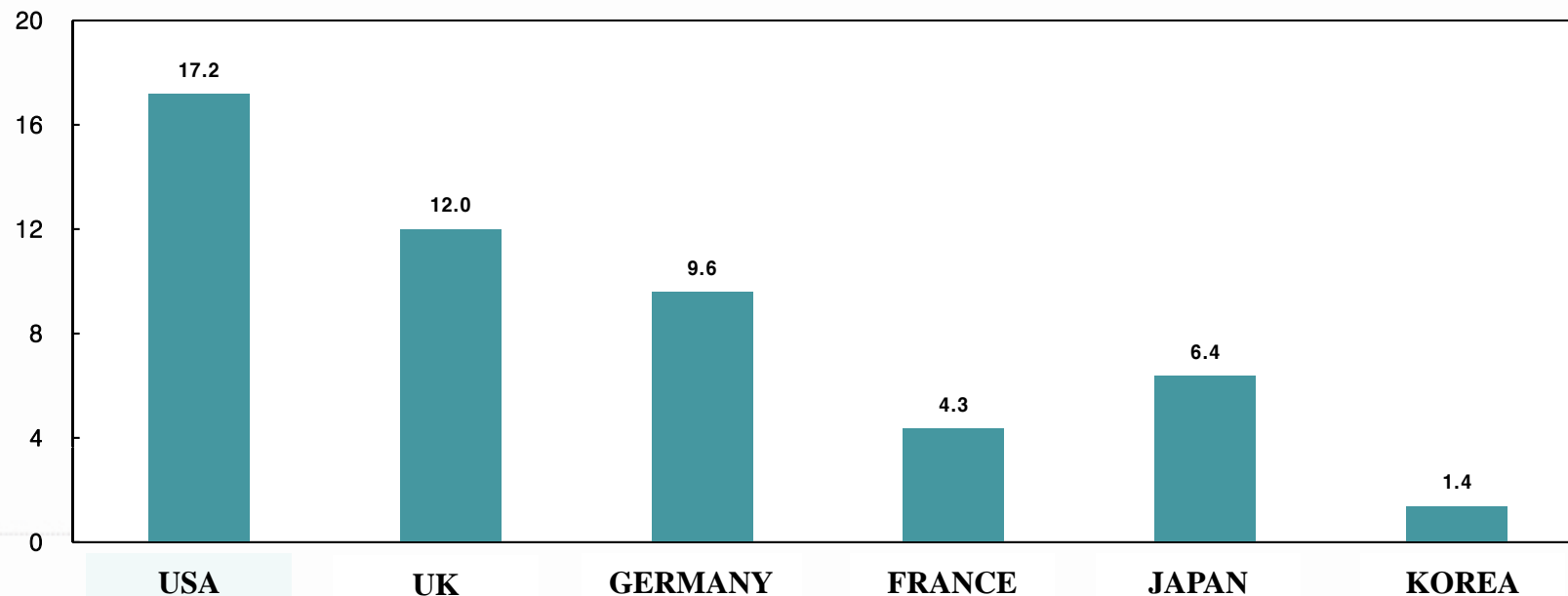
Source: OECD, 2008

Systemic problems: (3) Company scale

Growth of service companies has lagged as they face difficulties in **capital inflow**.

- Mortgage-focused financial practices cause difficulties in funding service companies which are mostly based on **intangible assets**.
 - This is the main factor behind Korea's overly high self-employment rate.

Average business scale of wholesale and retail (2005)

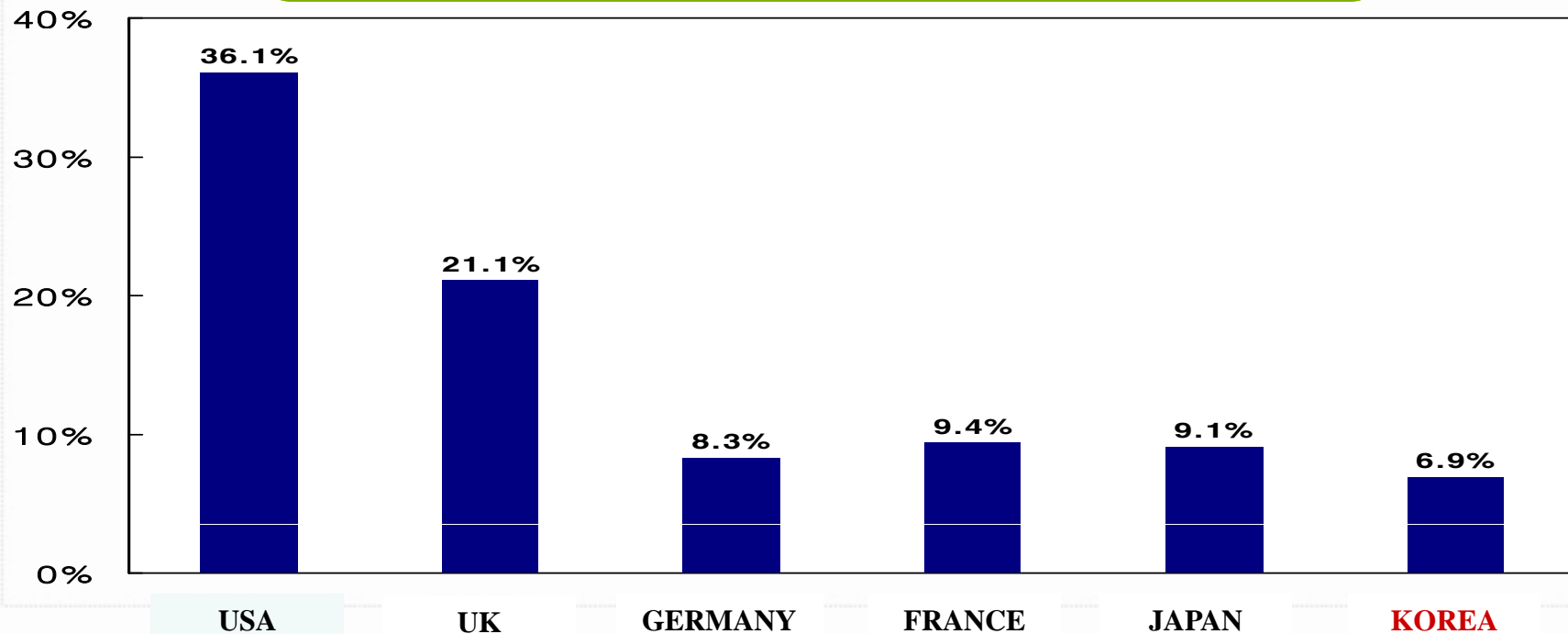


Problems of knowledge base: (1) R&D

Most of R&D are conducted by the manufacturing industry while **only 7% by the service industry.**

- Moreover, **90%** of R&D expenditure in the service industry are involved in **communications and IT-related service.**

Service industry's share in R&D expenditure (2005)



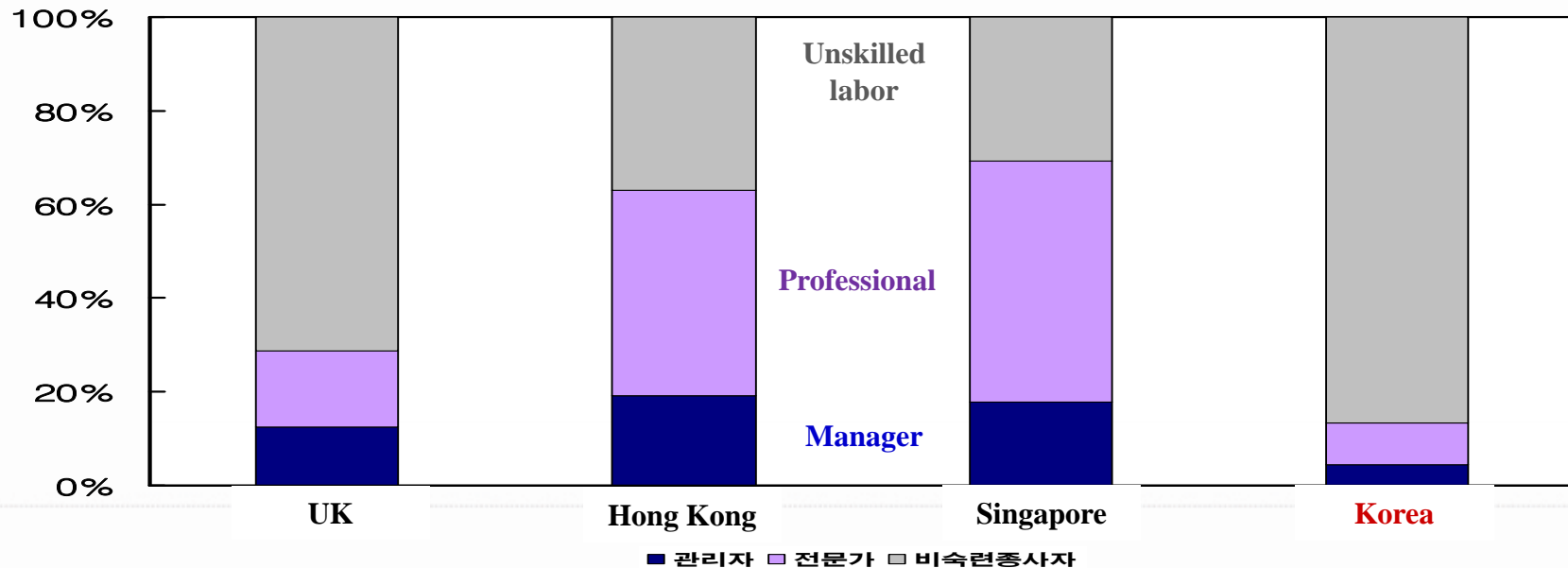
Problems of knowledge base: (2) Human resource



Service suppliers compete with price not with innovation due to its low **knowledge-based capacity**

- Innovative power of the service industry depends on the accumulation of **human resources**: different from the technology innovation of the manufacturing industry

Human resource composition in the financial industry (2006)

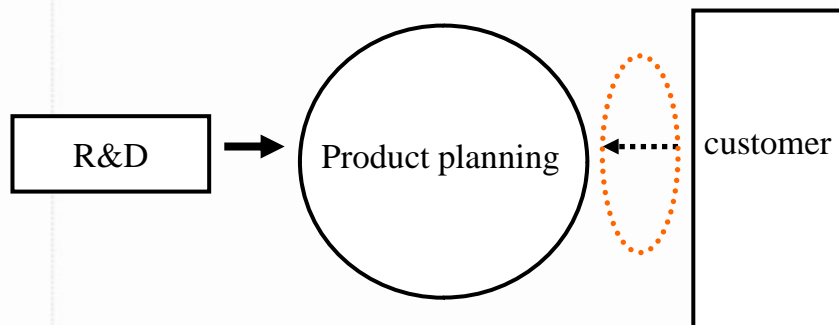


Problems of knowledge base: (3) Innovation capacity **KDI**⁷

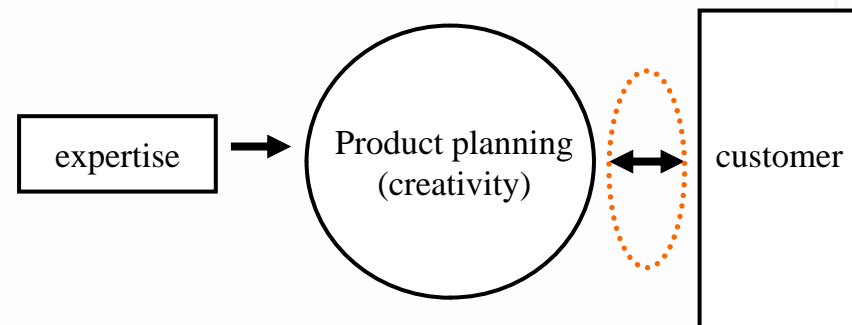
Lack of educational system to foster **creative manpower** required for the service industry

- Competitiveness of the service industry: identifying **customer demand** on site, then individualizing and providing it
 - Manufacturing: technology development in mind of mass production
 - Service: **profession** and **creativity** of the employees contacting customers directly

Innovation concept map of the manufacturing industry



Innovation concept map of the service industry



Problems in creating the demand

Excessive restrictions on public interest could hinder the expansion of the demand by limiting **consumer choices.**

- **Blocking consumers' access** to the information on service products has restrained the expansion of the market.
 - (ex.) Ban on the advertisements of medical and legal industries

Purchase of **external business service by SMEs remains stagnant due to their low profitability.**

- Vice versa, the low outsourcing rate in business service results in the reduced productivity of SMEs.

Inactive **overseas expansion of the service industry despite the small size of the domestic service market**

- Insufficient training programs to educate experts who fully understand the local markets

Part-04 | Policy Agendas

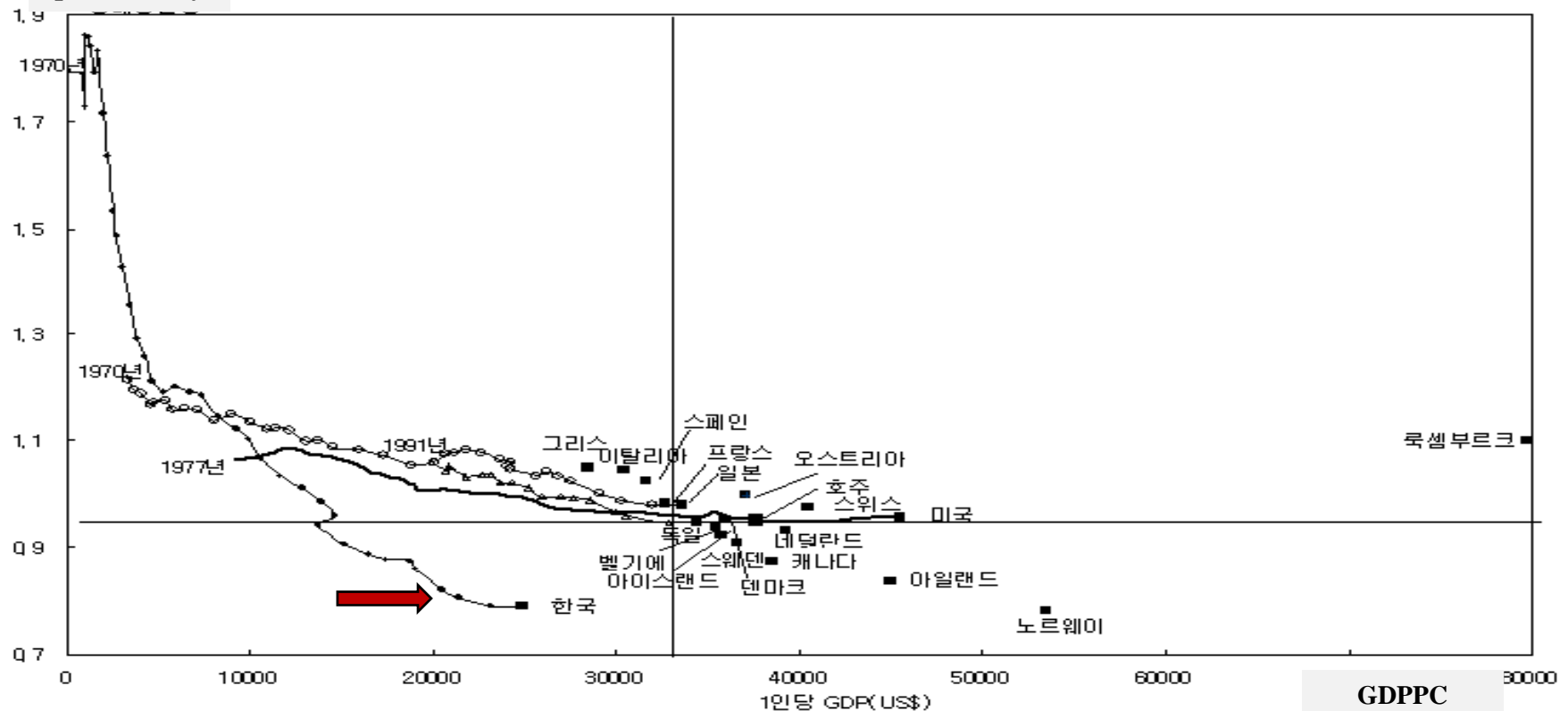
KDI

Policy Agenda – How to Improve Productivity

Korea's service sector has one of the lowest levels of productivity in OECD.

Relative productivity

Relative productivity in service sector (OECD, '07)

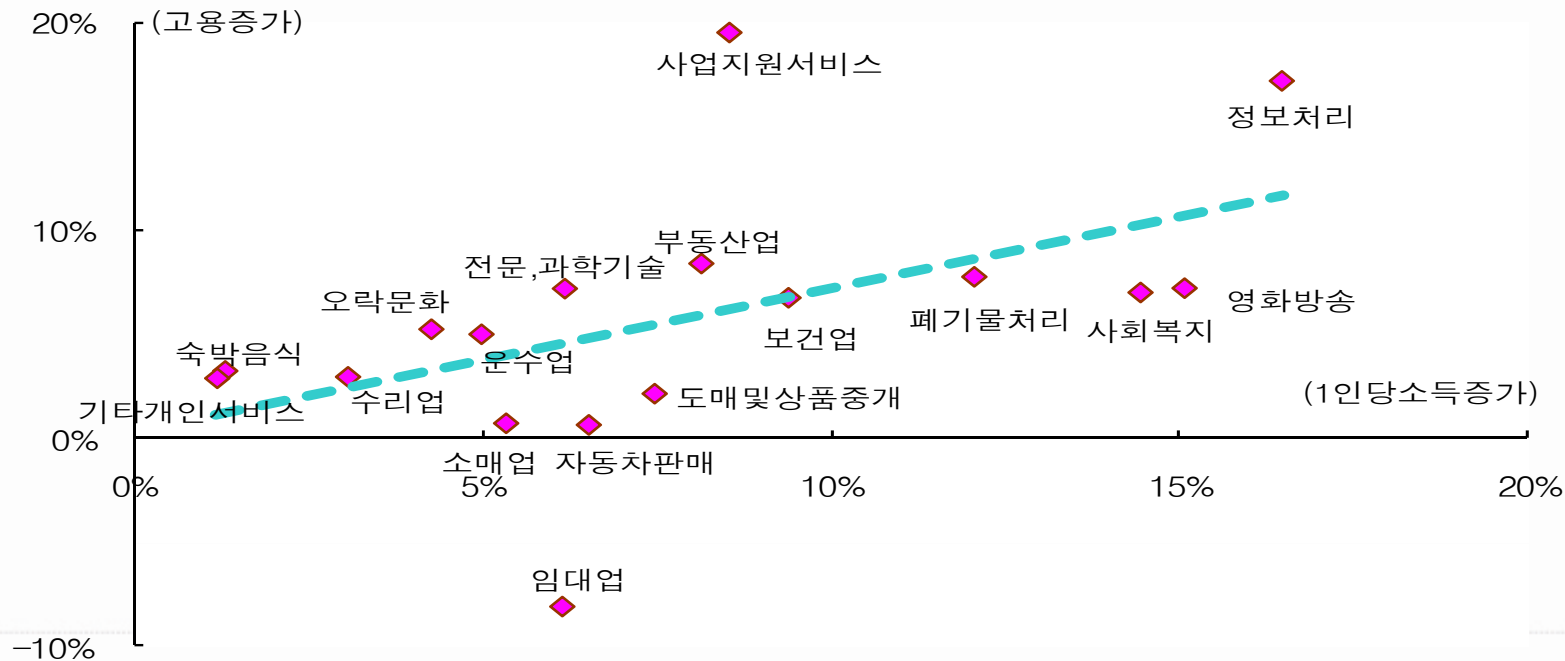


Service industry: New growth engine

Service industry is a major tool to provide more quality jobs and enhance growth potential.

- The **matured** manufacturing industry and global competition: productivity tends to grow when the employment growth is low.

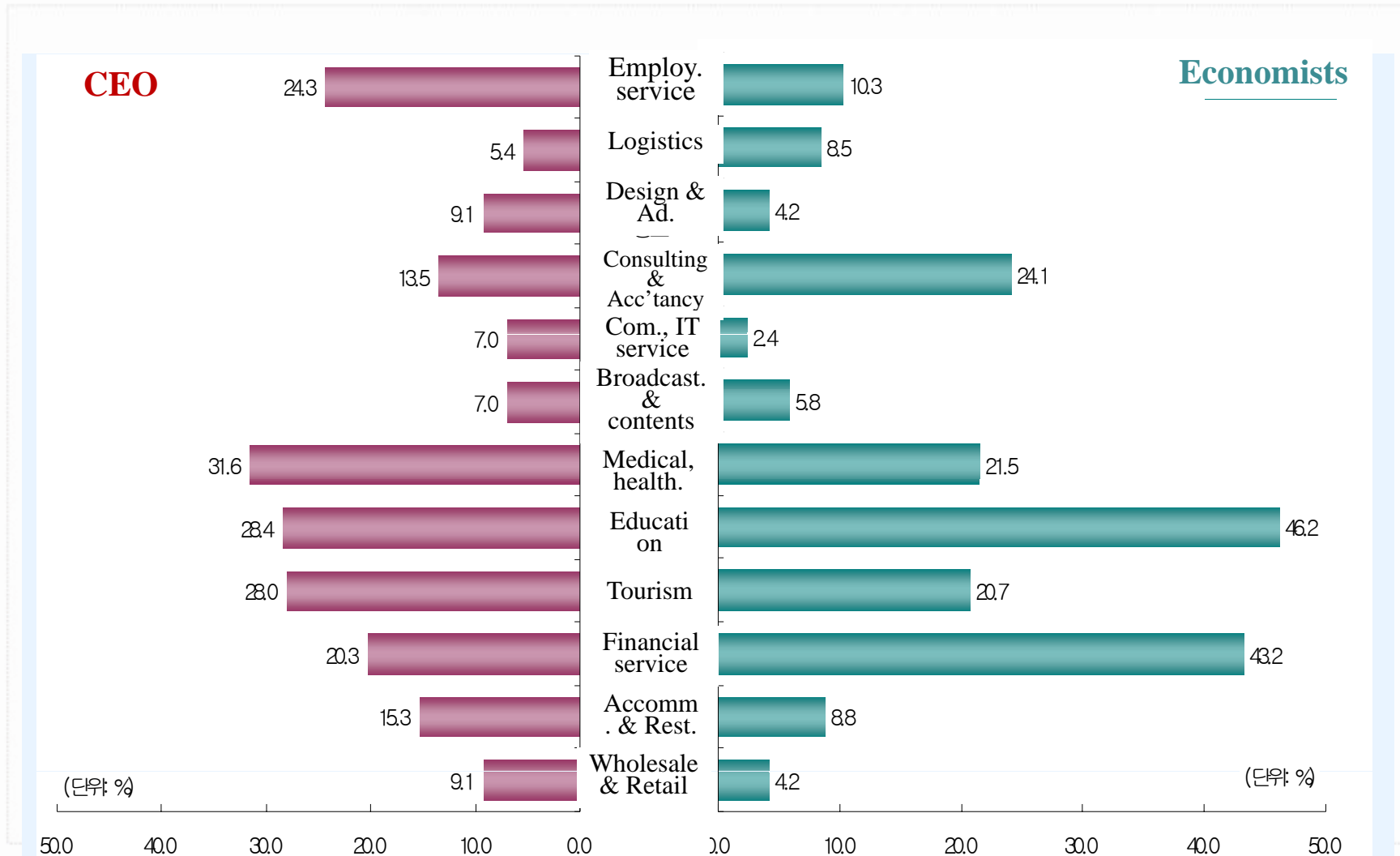
Relationship between employment and productivity (service)



What to Do List: OECD recommendation and Korea's special circumstance

- Provision of manpower and capital
- Regulation reform (No discrimination)
- R&D
 - + Convergence with IT Innovation
 - + Balancing between Public Interest and Industrial Development
- More openness

Which Service Industries to Enhance?



Strengthening the competitiveness of the service industry (1) - Capital and Labor



Inducing **capital provision** into the service industry

- Upgrading the related systems for attracting capitals and, say, non-medical CEOs to **medical institutions**
- Exploring methods to improve the loan process for service companies

Value-added of Service Sector (Currency, GDP ratio)

year	한국 (1 trillion Won)	Japan (100 billion Yen)	USA (100 million Dollars)	UK (100 million pound)
2000	11.8 (2.0%)	–	546.2 (5.6%)	415.5 (4.9)
2006	25.2 (3.2%)	260.2 (5.1%)	822.8 (6.3%)	57.4 (5.5%)

Strengthening the competitiveness of the service industry (1) - Capital and Labor



Training manpower that can fulfill the demand of the on-site business

- **Professionalism, Creativity, Convergence**
 - Professional school system and upgrading the quality of education by attracting **professors with practical experience**
 - Respecting the university's autonomy in establishing educational facilities and revamping the curriculums
 - Establishing the competition system among universities; rigorously implementing the tenure system of professors; releasing to the public the information of universities including graduates' career development; encouraging interdisciplinary studies
- **More flexible labor market**

Strengthening the competitiveness of the service industry (2) – Institutional reform



Implementing **regulation reform** so as to improve industrial foundations

- Eliminating legal, medical, welfare service regulations which pursue the political perspective for the reason of public interest
- Reviewing various **certification tests** which deliberately limit the manpower provision in the service industry.
- Preparing institutional improvement measures to stop collective selfishness.

Legal Service – International Comparison

	USA (2008)	UK (2008)	Germany (2008)	Japan (2007)	Canada (2004)	Aust. (2002)	Korea (2007)
# of Lawyers	1,162,124 ¹⁾	155,323 ²⁾	146,910 ²⁾	24,302 ³⁾	–	–	8,174 ⁴⁾
Pop. per Lawyer	268	394	560	5,238	447 ⁶⁾	558 ⁶⁾	5,891
Rel. ratio to Korea (%)	5	7	10	89	8	9	100

Strengthening the competitiveness of the service industry (2) – Institutional reform



Eliminating **discrimination against manufacturing**

- Some differences innate
 - Manufacturing higher facility investment, larger scales, more export-oriented, tangible assets, more IT related works
- Correcting high **utility rates** for service industry
- Reviewing **definition** of SMEs - Revised
 - Manufacturing: < 300 workers/8b won
 - Service: < 50~300 workers/5~30b won
- Correcting different **value-added ratio**
 - Manufacturing: 20%
 - Service: 30~40%
- Reviewing **discriminatory tax system**
 - Special Tax Reduction for SMEs for manufacturing + selected service only (wholesale and retail, car service, tourism)
- Revising **target industries for government supports**
 - Subsidizing Production Environment Innovation Technology
 - Industry clustering vitalization/ Supporting factory establishment

Strengthening the competitiveness of the service industry (3) - Outsourcing and R&D



Preparing policy support measures to precipitate the **outsourcing** of the business service

- Increasing **the public sector's** purchase of private service through limiting the launch of affiliates by government-owned companies
- Expanding the outsourcing of the business service through **improving the productivity of SMEs**
- Preventing the practice of imposing **unfair price & conditions** on SME service companies through a stronger fair trade policy

Expanding the government support on service **R&D**

- Expanding the subject of **the national R&D program**, currently confined to the manufacturing industry, to the service industry
- Activating the basis study of **consumer analysis**, which could be used widely by broadcasting, advertisement, and design.

Strengthening the competitiveness of the service industry (4) – Export promotion



Transforming the service industry from domestic to **export industry**

- Supporting service companies to **become larger** so that overseas expansion will be activated
- Actively training **experts** with sufficient understanding of foreign language and international trade, and using foreign manpower
- Upgrading the national image: improving the dignity of politics, labor movements, social orders.

Actively participating in globalization by **more opening up**

- Higher productivity through more competition
- Wisely utilizing foreign services to improve competitiveness of industries using them as inputs and enhancing consumers welfare
- Attracting more FDI in service industries

THANK YOU