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Export Diversification in Latin America

By Christian Wilhelms, Hamburg

Export diversification—changing the export structure to obtain increasing variety—can have various facets: that of a phenomenon, a necessity, a duty and an economic or development programme. Export diversification does not affect Latin America alone; it is of interest—or should be so—to all developing countries. To the developed or industrial countries it is of interest because for these the necessity of export diversification can become acute. Even the Federal Republic of Germany has a certain diversification problem if we consider the great significance of car exports for our foreign exchange earnings. On the other hand, export diversification is of importance for industrial countries because the effects and counter-effects of diversification in developing countries are felt, at least in part, in these.

Why Export Diversification?

Export diversification is not an end in itself. Its main purpose is to prevent a lop-sided export structure, and to lessen dependence upon foreign exchange earnings from one or just a few products. Instead of one main product, which a country's economic activity is based upon and limited by in practically every field, a variety of exports must contribute to foreign exchange earnings. Two main effects are to be expected from export diversification:

- ☐ increased stability in export earnings and therefore less risk of excessive fluctuations in income and economic activity;
- ☐ increased export earnings and therefore an assured economic growth.

Among the many positive effects of export diversification may be mentioned the "multiplier effect" in the employment sector, its contribution towards financing development programmes and the development of a country's economic potential.

The position of Latin American exports is sufficiently well-known so that it is enough to mention, on the one hand, the still unsolved problems of single products and single crops together with the lack of foreign exchange and, on the other, the demands arising from the process of development. In order to indicate the situation in individual countries it will be sufficient to give some illustrations to point up the problem: Chile's dependency upon copper; the Argentine as exporter of two main products, i.e. wheat and meat; Brazil as a symbol of the coffee problem, in spite of its already "relatively diversified" export trade; Ecuador as exporter of bananas. Naturally these few indications do not give a complete and

individual picture and there are exceptions—deviations and export structures which appear healthy, at least at a first glance. But if, for example, we examine the export structure of a country like Peru, which can boast of considerable success in diversification with its fishing industry, we cannot help wondering whether the original diversification is not turning into a new form of export concentration.

This rapid "tour d'horizon" should have pointed up that export diversification is a necessity, particularly in Latin America, not only in order to maintain the status quo, but also—perhaps more importantly—to promote economic progress and the development of countries on this sub-Continent.

Product Diversification and Market Diversification

Considered as a politico-economic instrument, export diversification is intended to change the export structure, i.e. decrease its lop-sidedness and promote a varied export structure. It applies to both aspects of export structure: products and markets. Consequently it is possible to differentiate between two fields of export diversification: product diversification (or diversification of supply) and market diversification (also called geographical diversification).

Product diversification can be in two directions: horizontal, in order to achieve as broad as possible a scale of products in the same stage of production (for example, limitation of diversification to primary products), or vertical, to exploit various stages of processing (raw materials—semi finished products—finished products); or lateral, to supplement one of the afore-mentioned possibilities by means of "unrelated" or "unconnected" products, that is, products which are not considered to be logical developments from the two directions mentioned above but can yet make a contribution to structure diversification. To mention an extreme example—cars may be exported as well as agricultural primary products. In market diversification, it is necessary to differentiate between three types of markets: industrial countries, socialist state-controlled/planned economies (state trading countries) and developing countries. One may also differentiate further according to geographical position or stage of development, membership of economic or politico-commercial blocs, etc.

In theory, it is possible to break these categories down into ever smaller sub-categories. In reality—apart from the initial position of a country at any given time—it is the concrete aims of economic, com-

mercial or development policy which determine the individual aims and opportunities for export diversification and which define the direction of diversification measures.

Problems of Product Diversification

In Latin America the problems of product diversification, as a subcategory of export diversification, lie on several levels.

To begin with, difficulties in diversifying the export structure may be due to the production structure. If this has not been diversified, it is impossible to expect product diversification in export. Therefore product diversification is dependent upon production diversification. Thus, efforts to diversify exports also help to improve the production structure.

A further problem is raised because most of the new—i.e. mainly industrial—production in Latin America has been created less for export purposes than for import substitution. Production capacities leaving no room for export surpluses, product quality, cost structure and prices are the obstacles confronting export diversification. Prices, of course, can be dealt with by reducing costs on the basis of longer runs—and this can often be done just by making full use of available excess capacity; product quality (in the broadest sense) could often be adapted to the demands of foreign markets.

Further problems arise here however: there is insufficient knowledge of foreign markets, and the situation is complicated by the fact that in order to exhaust the opportunities, three different groups of markets need to be taken into consideration, as mentioned above. Demand structures, sales opportunities, quality requirements and price levels on foreign markets are unknown, so that there are no indications or opportunities to eliminate current difficulties.

A result of Latin America's lack of foreign exchange is that it is not always possible to import the quality of materials necessary to manufacture products for export; the same applies for special machinery. This causes quality fluctuations, unsatisfactory workmanship and production bottlenecks.

A further problem: the smallness of the domestic market which impedes the installation of cost-reducing capacity or may make any investment appear hopeless from the outset. It decreases the possibility of diverting surpluses from existing production to export so as to diversify exports, and therefore new production has to be created specially for the export market. This means that sales risks are particularly high, so that this type of investment can only be made if sales are thought to be assured on the foreign market. However, since competitors cannot be eliminated, it is never possible to answer this question with certainty.

Problems of Market Diversification

Market diversification, aimed at embracing all three groups of markets/countries mentioned, demands a sufficient diversification of the product structure. After all, it must be taken into account that not every product is suitable for every market; the prospects of exporting coffee to a coffee-producing country are probably slight.

Apart from this requirement of sufficient product diversification, there again arises the problem already mentioned of insufficient knowledge of the distribution markets. A comprehensive knowledge of market conditions in general, as well as of the conditions for definite types of goods, is a condition of market diversification. The Latin American countries are faced with problems arising from the multiplicity of countries which can be considered in any way as distribution markets: industrial countries as purchasers of raw materials, foodstuffs, semi-finished and finished goods; developing countries, mainly as markets for foodstuffs and finished products, although the special relationships in intra-regional exchange between the countries of Latin America also need to be taken into consideration here; Eastern bloc or socialist countries with planned economies as purchasers or compensation partners, for Latin American raw materials in particular. A further problem is that of market entry, which is determined by tariffs, the competitive position, demand structure, economic plans, availability of foreign exchange and similar factors. In case of exports to developing countries, and to Latin American countries in particular, the degree of "programme identity" between trading partners is an additional factor in deciding sales opportunities; only product diversification can lead to market diversification in this sector.

One characteristic of commercial relations with Eastern bloc/socialist planned-economy countries is the need to find suitable exchange goods. This does not apply to the export production of the relevant Latin American country alone.

One of the special problems of market diversification for Latin American countries is the lack of an efficient foreign trade organisation: except for traditional exports, foreign trade is mainly import-oriented. In export, therefore, firms do not yet have the adaptability and market knowledge necessary to make new contacts, although these are peculiarly essential for export diversification and in particular for market diversification.

Certain other difficulties must be mentioned briefly: regular deliveries cannot always be guaranteed—although this is vital for efficient market diversification, if it is not limited to single "ad hoc" deals; the poor financing of many new firms and unwillingness of many old-established firms to undertake the expenditure which is unavoidable for market diversification, i.e. the cost of market research, pro-

motion and the outlay for making new contacts. The geographical location of Latin America makes all these difficulties more acute, since, even when it is only a matter of travelling to "neighbouring" countries in Latin America, the cost involved is not small because of the distances.

Not without influence on the possible degree of market diversification is the preponderance of certain traditional main purchasers of Latin American products; the USA, for instance. Not infrequently, such purchasers take a country's entire production of a certain item so that sales are always guaranteed and there appears to be no incentive—or even any opportunity—to sell to other countries. However, such a situation can become critical when—as with Ecuador's export of bananas to Japan—the main buyer, on whose requirements practically the whole production was based, turns to other producers.

General Problems of Export Diversification in Latin America

The general problems are those which concern everyone who is engaged in any way with the promotion of exports for countries in Latin America. For instance, a list of obstacles to exporting could be a long one; it would include categories such as the following: lack of interest in exporting; lack of market knowledge and contacts; difficulties of communication; deliberate or unintentional restraints upon exports—often only indirectly, but none the less effective for that; lack of competitiveness due to high costs.

In exporting non-traditional products, certain Latin American countries find the phenomena of inflation an extremely serious problem, as well as the resultant problem of establishing an exchange rate ratio which, even if its effect is not directly to promote exports, is at least not detrimental. Latin American exporters' complaints about "unrealistic" rates are well-known. However, the effects of such rates are not restricted to the actual difficulties of calculation for export: the exchange rate problem is a favourite pretext for justifying a lack of essential "export-mindedness". It is often overlooked that protected domestic markets, where there is almost no competition and buyers are uncritical and inured to inflation, offer much easier selling conditions than does a very competitive foreign market. In Latin American countries, the conflict between private and public sectors and the preference given to short-term private profits over the long-term general economic advantage is a problem not to be underestimated in this respect.

Latin America's balance-of-payments problems give rise to other difficulties of a general nature. Export diversification is expected to contribute to their elimination. However, a lack of foreign exchange is prejudicial also to the investment re-

quired, particularly that for new production, and to the availability of foreign exchange for market analyses, foreign travel, participation in foreign trade fairs. There is also the matter of a sufficient store of export experience relating to non-traditional products, the calibre of businessmen and experts employed in the various fields of exporting, to say nothing of the "infrastructure" in the sense of a balanced banking organisation and effective means of transport and communication.

Last, but not least, it should be mentioned how vital it is that the need for export diversification should be recognised within the framework of an economic and development policy. Even if it is too much to expect that there should always be systematic diversification programmes in every area, the basic necessity of promoting export diversification in the interests of both commercial and development policy should not go unrecognised. It is the attitude of those sectors concerned exclusively with traditional products that does not yet appear to be in line with this requirement.

Opportunities and Indications for Export Diversification in Latin America

An attempt has been made to outline the problems obstructing efforts to diversify exports from Latin America. However, the outlook is not always as poor as appearances might suggest when these problems are summed up. There are gratifying exceptions. Nevertheless the essential condition for changing the export structure of Latin America—which is, after all, the purpose of diversification—is that these numerous obstacles be removed. No one will expect this to be done all at once or over-night. But the prejudicial effects exercised upon export diversification by the problems discussed must at least be recognised so that a first step may be taken towards changing the position.

What are the opportunities here? They are probably just as numerous as the problems. To mention some of the most important: the elimination, as far as possible, of obstacles to exporting, as is being done increasingly, for instance, in Brazil; the creation of suitable institutions to work out ideas for export diversification, diversification programmes and projects; the preparation of market analyses and product studies to elicit the opportunities on specific markets and for specific products, and the publication of the results of such investigations. Of no less importance is public relations work aimed at overcoming traditional lines of thought and lethargy and at creating export-mindedness with a diversification slant. Thus export diversification becomes a subject for both material and functional export promotion in the broadest sense. Of at least equal importance with the elimination of tariff restrictions in importing countries is the Latin American countries' technical mastery of marketing matters, of cost competitiveness and the efficiency of their foreign trade apparatus.