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EEC Trade Policies and Latin American Export Performance

A Discussion of Causalities

by Rolf J. Langhammer, Kiel*

Since the beginning of the seventies Latin American exporters have been losing ground to their Asian competitors on the EEC as well as on the world market. While Latin American authorities tend to put the blame on external factors, and among them not least on the allegedly protectionist and discriminating EEC trade policy, Dr. Langhammer shows that internal, "home-made" policy shortcomings have hampered Latin American exports at least to the same extent.

During the last decade the aggregate Latin American balance of payments has been characterized by a persistent and growing deficit in the current account. This gap widened from about US-\$ 4 bn in 1971/73 to an estimated US-\$ 20 bn in 1979. While some determinants of this gap on the import side can be identified rather easily, i. e. the oil price increase, the price inelastic import demand for energy and modern technology and the change in the term structure of external financing from long-term capital towards more short- and medium-term non-concessional and therefore more expensive bank credits, remarks on developments on the export side are sometimes confined to an "inadequate expansion of exports."¹

Declining Market Share

It is evident that the inadequateness of export expansion cannot be measured by postulating an export growth which equals the tremendous oil price-induced growth of imports. However, it cannot be doubted that the Latin American share in world exports in general, and in developing countries' exports of manufactures in particular, steadily declined during the last two decades, and in this respect the Latin American export expansion may indeed be called inadequate. As far as the latter aspect, the exports of manufactures, is concerned the seventies displayed the Latin American dilemma to the full extent: South East Asian countries extraordinarily quickened the pace of both structural changes in the composition of

their exports and their penetration with manufactures in the markets of industrialized countries. Latin America visibly lagged behind though in 1975 it still accounted for about 57 % of total manufactured value added in developing countries against only 30 % of Asian countries. The high degree of domestic (including regional) market orientation of the Latin American industrial production is documented by Table 1 which reveals a Latin American share of only 18 % of developing countries' manufactured exports in 1978 (against 20 % in 1970). The share in the most important sub-market next to the USA, the EEC, was even lower (13 to 15 %)². On the EEC as well as on the world market Latin America lost ground to Asian competitors which covered 70 % of total manufactured exports by LDCs in 1978. Hence the overall competitive pressure of manufactured exports from developing countries which can be derived in Table 1 from their rising share in total manufactured exports to both markets, has been predominantly exerted by Asian suppliers.³

¹ Inter-American Development Bank, Annual Report 1979, citation according to IMF Survey, 21 April 1980.

² This is because the world market includes both the relatively high amount of intra-LAFTA-trade and the traditionally high Latin American trade flows to the US-market and therefore shows an upward bias of Latin American participation compared to the EEC market.

³ A UNIDO constant-market-share-analysis yields the same result. Whereas both regions, Latin America as well as (however, to a lesser extent) Asia, show negative product composition and net market composition effects in their manufactured exports during 1970/71 and 1975/76, the residual, the so-called competitiveness effect, is more than five times higher for Asia compared with the Latin American figure. See UNIDO: World Industry since 1960: Progress and Prospects, New York 1979, p. 163.

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Table 1
Percentage Share of Latin American Manufactured Exports in Total World and LDCs Manufactured Exports 1970 and 1978^a

	Export Markets			
	World		EEC	
	1970	1978	1970	1978
Share of LDCs Manufactured Exports in Total Manufactured Exports to the Export Market	5.2	8.0	2.9	4.8
of which Latin American Exports	20.0	18.4	15.0	13.5
Asian Exports (excluding Middle East and Oceania)	65.8	71.9	60.6	70.3

^aManufactures are defined as SITC-categories 5 + 6 + 7 + 8 - (67 + 68).

Source: Calculated from UN Monthly Bulletin of Statistics, current issues.

Latin American trade authorities are fully aware of these deficiencies in the export performance but tend to stress the responsibility of external factors including protectionist policies of the industrialized countries rather than of internal policy shortcomings and delays.⁴

Criticism of EEC Trade Policy

In this respect it is especially the EEC trade policy which has frequently been accused by the Latin American authorities of being protectionist and discriminating. This direction of Latin American criticism of developed countries is not amazing, since as a customs union the EEC in any case inherently discriminates against non-members, but especially in a sector where Latin American countries have vested interests, the agricultural sector. The complaint of being discriminated, however, has another aspect, that of differential treatment of non-members, either from less developed countries or from developed ones. From the beginning of the EEC, Latin America attacked the preferential access of either francophone African countries (Yaoundé-agreements) or some Mediterranean countries (Israel, UAR, etc.) to the EEC-market as being incompatible with the GATT-article XXIV. This article makes the formation of free trade areas and customs unions, or at least an explicit intention to do so, a binding prerequisite for deviating from most-favoured-nation (MFN) treatment. Neither in the African nor in the Mediterranean cases the EEC ever envisaged such integration processes. The Latin American concern culminated in 1974/75, a period of severe and world-wide recession as well as of an extraordinary increase of Latin American external indebtedness. The EEC imposed a meat embargo, transformed (and regionally enlarged) the former

reciprocal Yaoundé-agreements into the non-reciprocal ACP-preferences, and delayed improvements of the product coverage and of the quota limitations of the Generalized System of Preferences. Furthermore – and in spite of three MFN-trade agreements (with Argentina, Brazil and Uruguay) and one trade and cooperation agreement with Mexico – Latin America complains about the neglect of a European-Latin American dialogue and apprehensively observes the intensification of EEC trade relations with other developing areas such as the Mediterranean region or ASEAN. Whether this “external” bias of Latin American argumentation can be supported by empirical evidence, will be discussed in the following.

Impact of the CAP

Doubtless the variable levy system of CAP for temperate agricultural commodities such as beef, maize, wheat, etc., represents the hard core of EEC protection in favour of domestic producers. The variable levy equals the (normally positive) difference between the domestic EEC prices and the world market price and hence safeguards the internal price and production supports against external countervailing forces. According to UNCTAD calculations for 1974⁵ more than 50 % of EEC-imports from Argentina were subjected to variable levies. Probably the same or an even higher rate could be assessed for imports from Uruguay, whereas the Brazilian rate amounted to only about 8 %. The amount of additional Latin American export earnings due to a hypothetical removal of the EEC agricultural protection for the three most important Latin American CAP-products can only roughly be assessed by making assumptions on the consumer price effect of an elimination of protection as well as on the price elasticity of demand. An UNCTAD/FAO model⁶ estimated such an average decline of consumer prices in the EEC for wheat and beef at 40 and 47 %, respectively, whereas elasticity estimates in various studies differ widely between zero and -1.25⁷ for beef.

⁴ See for this “external bias” in discussing causalities UN/CEPAL: The Economic and Social Development and External Relations of Latin America, E/CEPAL/1024/Rev. 1, 77-3-617, 14 June 1977, p. 171 f.

⁵ UNCTAD Handbook of Trade and Development Statistics 1976, Supplement 1977, New York 1978. Special Statistic 7.3.

⁶ UNCTAD: Agricultural Protection and the Food Economy, Research Memo No. 46, Geneva 1972, cited in: Alexander Yeats: Trade Barriers facing Developing Countries, London 1979, p. 138.

⁷ Rolf J. Langhammer: Die Bundesrepublik als Exportmarkt Lateinamerikas (The Federal Republic of Germany as an export market for Latin America). Eine handelspolitische Analyse, Kieler Studie No. 159, Tübingen 1979, p. 74, footnote 1.

By assuming a consumer price decline by 40 % after a removal of protection, an elasticity of import demand of -1.0, an infinite elasticity of supply, and starting from the 1971/73 EEC basic import level for Latin American beef, wheat and maize of about US-\$ 800 mn, the additional Latin American export flows to the EEC – as measured by the static trade creation effect – may roughly be appraised at about US-\$ 230 mn. This estimate is downward biased since it neglects dynamic secondary effects on trade flows. But even if the figure would be quadruplicated the additional trade in agriculture would be less than the absolute increase of Latin American manufactured exports to the EEC between 1970 and 1978, which amounted to about US-\$ 1.3 bn.

Hence although trade liberalization for temperate agricultural commodities could substantially improve the Latin American export prospects, other at least equivalent options of access to the EEC-market are available and probably less difficult to be negotiated. The latter point has been demonstrated by the relatively meagre results regarding dairy products and bovine meat of the Tokyo-Round as well as by better results on tariff cuts for industrial products.

Preferences for ACP-Countries

Besides the EEC-protection in favour of domestic agricultural producers Latin America's second point of concern refers to the ACP-tariff treatment which is considered to be detrimental mainly to competing tropical agricultural commodities from Latin America (trade diversion effects)⁸. This argument is ruled by two implicit assumptions. First that ACP-products enjoy a

preference margin which is high enough to overcome the inertia of traditional trade connections, in this case with Latin America. That means that small price changes due to a small trade concession for ACP-countries would be neglected because the costs of diverting trade from Latin America to the ACP-countries would exceed the preference margin.

Second that the substitution elasticities between ACP- and Latin American products are high, i. e. that products from different regions are homogenous.

Table 2, which records the products in which ACP-countries and Latin America could theoretically compete, yields two principal results:

First, of the sample covering more than 80 % of ACP-exports to the EEC in 1977 nearly 60 % (48 % of total exports) would not be dutiable in any case, i. e. duty-free under MFN-conditions. This percentage heavily varies along with fluctuating copper-, oil- and coffee prices. In 1974 for example, coffee prices were low and copper prices high (the reverse case compared to 1977). So dutiable coffee covered only 5.0 % of total ACP-exports instead of 16.1 % in 1977, whereas non-dutiable copper covered more than 14 % in 1974 instead of only 7.0 % in 1977. Hence the non-dutiable share of ACP-exports mainly depends on the price of non-dutiable mineral commodities such as copper, uranium, manganese, etc. In 1974 this share amounted to 71.2 %. In this case the discrimination argument of Latin America would be valid only for less than a third of ACP-exports. Among these dutiable products, coffee and cocoa (including its processing) together with some other tropical products predominate.

Here the second aspect comes to the fore: The preference margin was already rather low before the

⁸ Within the ACP-Latin America complex, the STABEX system is – apart from preferential tariff treatment – another aspect of conflict. Since STABEX is equivalent to an additional official resource transfer at non-market terms, but does not distort price relations between ACP- and Latin American commodities, it has no direct trade effect and will therefore be not discussed here. Cf. for a discussion Rolf J. Langhammer, op. cit., p. 96 ff. For a defense of the trade diversion argument cf. Albrecht von Gleich: *The Economic Relations between Germany and Latin America and the Significance of the European Community*, in: Joseph Grunwald (ed.): *Latin America and World Economy: A Changing International Order*, Beverly Hills 1978, pp. 99-120.

⁹ In analogy to Krause's investigations of the effects of the Tokyo-Round one may argue that a preference margin of less than 10 % is not very restrictive so that the growth of imports from Latin America depends upon the growth of final demand without giving much rise to inter-country substitution, i. e. trade diversion. See Lawrence B. Krause: *United States Imports and the Tariff*, in: *The American Economic Review, Papers and Proceedings*, Menasha/Wisc., Vol. 49 (1959), pp. 542-551.

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Table 2

EEC Major Imports from ACP- and Latin American Countries in 1977 and Tariff Treatment before and after the Tokyo-Round

CCT Statistical Number	Product	Percentage of total EEC imports from ACP	Percentage of total EEC imports from Latin America	EEC Pre-Tokyo-Round	EEC Past-Tokyo-Round
				MFN-tariff-rate	MFN-tariff-rate
0201	Beef	0.3	2.1	L ^a	L ^a
0801 B	Bananas	0.9	4.2	20.0 ^c	20.0 ^c
0901 A.1 a)	Coffee, unroasted	16.1	20.7	7.0	5.0
1005 B	Maize	0	2.3	L	L
1201 B	Oil seeds	1.4	3.6	0	0
1507 D II a) 1.	Palm oil-crude	0.5	0	6.0	6.0
1507 D II b) 2,aa	Solid crude oil	1.7	0.3	10.0	10.0
1701 B II	Raw sugar	3.1	0.7	L ^a , G ^b	L ^a , G ^b
1801	Cocoa, beans	8.2	1.1	5.4	3.0
1803, 1804	Cocoa paste, butter	1.9	0.7	15.0 resp. 12.0	15.0 resp. 12.0
2301 B	Fish meal	0	0.5	2.0	2.0
2304	Oil-cakes (ground-nuts)	1.1	6.7(soja)	0	0
2510	Natural calcium phosphate	0.7	0	0	0
2601 A II	Iron ore	2.4	4.4	0	0
2601 B - E	Other ores	3.9	2.9	0	0
2709	Crude petroleum	25.8	2.6	0	0
2820	Aluminium oxide	0.8	0	8.8	8.4
4403 B	Wood in the rough	3.8	0	0	0
4405 C	Wood sawn lengthwise	0.7	0.5	0	0
5501	Raw cotton	1.6	1.6	0	0
7401	Unwrought copper	7.0	4.6	0	0
Total		81.9	59.5		

^aL = Variable levy. ACP-countries enjoyed partial preferential treatment according to Regulation 706/76, i.e. a reduced variable levy for maize and duty-free treatment for a pre-fixed maximum amount of beef imports. - ^bG = eligible for a guaranteed price in the EEC. - ^cThe EEC-tariff for bananas principally refers to imports of the Benelux-countries, Ireland and Denmark. The major consumer countries either admitted duty-free import quotas for banana imports from their former colonies in the ACP-region (i.e. France, United Kingdom, Italy) or are allowed to maintain traditional duty-free imports from Latin America (West Germany according to the banana protocol in the Rome-treaty).

Sources: Calculated from: Eurostat, Analytical Tables of Foreign Trade, NIMEXE-1977. Eurostat, Monthly External Trade Bulletin, Special Number 1958-1977, June 1978. - UNCTAD, Trade and Development Board, Special Committee on Preferences, Eighth Session, Geneva, 27 June 1977, TD/B/C.5/49/Add. 1. - Official Journal of the EEC, current issues. - GATT, The Contracting Parties to the General Agreement on Tariffs and Trade, Vol. 4, Geneva 1979.

Tokyo-Round and has been further reduced⁹ as a result of the multinational tariff negotiations from which also the Latin American non-GATT-member Mexico benefits because of the MFN non-preferential trade agreement between the EEC and the country. In addition most of the processing is done in the consumer countries so that import prices have only a limited impact on consumer price changes. It seems rather likely that the above-mentioned inertia argument may be applied to the coffee and cocoa trade flows due to the low and – on the consumer price level – perhaps negligible preference margin unless consumer tastes shift to Latin American arabica or West African robusta sorts. The latter can be observed as a long-term trend since World War II but has nothing to do with short-term preference margins in tariffs. For bananas where the preference margin seems to be high, this margin does not matter anyway since trade flows are determined by quotas (see footnote c in

Table 2) giving an advantage to Latin America on the West German market. The banana case also illustrates that preference margins are totally ineffective if they are outweighed by Latin American production cost and quality advantages: In spite of a 20 % preference margin no African bananas are exported to the quota-free Benelux-market.

Since the ACP-region – with one exception¹⁰ – does not compete with major Latin American CAP-products and since various preference margins have been either reduced by the Tokyo-Round negotiations or by the GSP-regulations discussed below, the core of discrimination shrinks to the sugar-protocol annexed to the ACP-agreement. Due to this EEC-import obligation at guaranteed prices the EEC-imports of raw cane sugar from Latin America decreased from about US-\$ 270 mn in 1974 to about US-\$ 50 mn in 1977/78. Though countries like the Dominican Republic, Guatemala or El Salvador may severely suffer from the ACP-induced loss of export earnings, the total Latin American trade balance is not seriously influenced by the sugar agreement only, but by the combination

¹⁰ The exception refers to the traditional beef exports of Botswana and Swaziland to the UK. This partial preferential treatment, however, only continues the intra-Commonwealth preferences and therefore cannot be interpreted as trade diversion due to the ACP-agreement.

between CAP-protection in favour of EEC domestic suppliers and the preferential treatment of the ACP states. The low share of extra-EEC sugar imports in apparent consumption (domestic production plus imports minus exports) which in 1978 only amounted to 4 % reveals that Latin American sugar exports are much more hampered by the CAP-protection than by the ACP-discrimination.

Generalized System of Preferences

In mid 1971 the EEC established – as the first industrialized country or area – the non-reciprocal Generalized System of Preferences (GSP) and thereby formally fulfilled the decisions of the second UNCTAD-conference 1968 in New Delhi on a preferential tariff treatment of semi-manufactures and manufactures from developing countries.¹¹

Till 1976 the sectoral pattern of actual GSP-exports to the EEC changed in so far as food products (CCCN 1-24), though initially being of minor importance among the GSP-covered products, ranked first among the GSP-exports (about 24 % in 1976). Next to food products came mineral oil processing and textile goods. In 1976 the share of GSP-trade in total manufactured exports¹² of developing countries to the EEC was still rather low (about 20 %).

The Latin American share in total EEC-GSP imports varied between 21 % in 1973 and 27.6 % in 1975 (25.3 % in 1976) and mainly depended upon the export performance of Brazil (46 % of the Latin American GSP-exports in 1976), Mexico (9.6 %), Argentina (9.5 %) and Chile (4.7 %).

A comparison of Chile and Peru with the generally more important exporter of manufactured goods, Colombia (2.0 %), illustrates two major shortcomings of the EEC-GSP scheme. The GSP-exports of Chile and Peru nearly exclusively consist of a single semi-processed agricultural commodity (fish meal), the EEC-imports of which are subjected only to a MFN-tariff of 2 %. Hence the preference margin of 2 % does not eliminate a serious trade obstacle. Such trade would have occurred without preferences anyway so that the GSP does not stimulate *additional* trade. There are a lot of other examples for a low preference margin, a low price elasticity of demand (because the

products are complements to rather than substitutes for the EEC domestic supply) and hence a negligible trade creation effect. The other shortcoming is that substitutes for domestic production ("sensitive" products) are subjected to restrictive ceilings (so-called maximum amount limitations for a single developing country as well as tariff quotas among EEC-member countries) or to "voluntary export restraints"¹³ (world textile agreement). Consequently, for a country like Colombia which exports "sensitive" textiles under the GSP, the ceilings are so restrictive that expanded trade faces MFN- rather than GSP-treatment.

In 1977 the Colombian GSP-exports in the sensitive textile tariff items 5505 and 5509 for example amounted to less than 1 % of total Colombian exports to West Germany in these items. Under these conditions the above-mentioned low share of Colombian participation in the Latin American GSP-exports to the EEC cannot surprise. However, in general Latin America exports far less "sensitive" or "quasi-sensitive" goods, that means substitutes for EEC-domestic production, than the average of all GSP-beneficiaries. In 1979 only about 15 % of total GSP-exports from Latin America to West Germany were "sensitive" or "quasi-sensitive" goods against 40 % for all beneficiaries. This reflects the relatively high share of agricultural products in the Latin American GSP-supply (about one third against only 20 % for all beneficiaries) and particularly the relatively low share of manufactures with high substitution elasticities compared with South East Asian competitors.¹⁴

Little Scope for Trade Creation

Once again the statistical evidence reveals that the Latin American export supply – dominated by the Brazilian figures – is much more a complement to than a substitute for EEC domestic production and thus does not allow for significant trade creation. Here the at the first glance paradoxical situation emerges that, though the Latin American GSP-export supply is not faced with such restrictive ceilings as it is the case with the Asian supply, Latin America could not shift the relation between its GSP-exports and those of Asian countries upwards. This is because the share of exports subjected to ceilings is an indicator for the

¹¹ For details on the EEC-GSP scheme see Axel Borrmann et al.: Das allgemeine Zollpräferenzsystem der EG (The Generalized System of Preferences of the EC), Hamburg 1979. Tracy Murray: Trade Preferences for Developing Countries, London 1977. Its impact on Latin American trade flows to West Germany is discussed in Rolf J. Langhammer, op. cit., pp. 57-89.

¹² For the definition see Table 1.

¹³ Only those developing countries which made agreements on "voluntary export restraints" with the EEC in 1977, received GSP-treatment for certain textiles in 1980.

¹⁴ For details in this respect cf. Rolf J. Langhammer, op. cit., tables 17 and A14.

trade creation – and hence for the growth potential of the export supply, that is the degree of substitutability between imports and domestic production. This degree is higher for the Asian export supply than for the Latin American supply. Furthermore Asian suppliers proved to be more flexible in diversifying their supply structure towards manufactures which were classified as “non-sensitive” than did Latin American suppliers. In this respect the close cooperation between export-oriented investors from EEC-countries in South East Asia and experienced importers of manufactures (such as European mail order houses) has surely favoured this flexibility and the high utilization rate of the GSP-options in the South East Asian countries (i. e. Malaysia, Thailand, Singapore, Hongkong, Philippines, etc.)¹⁵. Since foreign investments in Latin American manufacturing are predominantly domestic market-oriented¹⁶ Latin America faces a perhaps decisive disadvantage in this respect.

Conclusions and Outlook

The EEC – Latin American dialogue on trade relations has just been reactivated. In May 1980 ministers for foreign affairs of the Andean Pact countries agreed with the EEC to start negotiations on a trade and cooperation agreement between the two regional groupings. The agreement will be a copy of the ASEAN-EEC agreement of March 1980. The same target has been envisaged by negotiations between the EEC and Brazil in March 1980. Both agreements will be arranged on a non-preferential MFN-basis and hence be only of a formal advantage for those Latin American countries which either are not contracting parties to the GATT (Ecuador, Bolivia, Venezuela) or till now acceded only provisionally to GATT (Colombia). The aspect of cooperation in technological affairs as well as the intensification of capital flows from the EEC will provoke more attention than the trade aspects. Politically important is that the Andean Pact will formally be put on a par with the ASEAN group, because both groups will then enjoy the same “integration bonus”, i. e. cumulative origin rules under the GSP and the formal acknowledgement as a regional partner of the EEC. However, there are various reasons why too much hope for further Latin American export expansion induced by the new agreements should not accompany this reactivated dialogue:

□ The experience with consultation prior to certain protectionist measures – this consultation was a key element of the three EEC-trade agreements with the

beef-exporting countries Argentina, Brazil and Uruguay – is not encouraging, as has been demonstrated by the meat embargo in 1974.

□ MFN-agreements cannot compensate for lacking improvements in the GSP anyhow, and here the preferences will even be eroded by the Tokyo-Round-results as well as by the intention of the EEC to reorganize the GSP in 1981 and to concentrate the benefits more on least developed countries by restricting the GSP-exports of relatively advanced countries like Brazil, Argentina and Mexico. In accordance with the past experiences it seems to be rather unlikely that small Latin American countries can benefit from guaranteed GSP-quotas, since their supply in manufactures will probably not be competitive outside the LAFTA-market.

□ There is a strong resistance within the EEC to copy the tobacco-example and to include other CAP-products in the GSP.

□ The second enlargement of the EEC, be it now or in the second half of the eighties, will result in the loss of some traditional Latin American exports to Spain and Portugal, since both countries will then be supplied by intra-EEC-imports under the CAP. It may also be possible that the new members will compete successfully with Latin American suppliers on the old EEC-market, for example in some oil seeds or in rice, so that Latin American exports would be reduced.¹⁷

□ Most importantly, some Latin American countries heavily suffer from balance of payments pressures and tend to follow a new strategy of import substitution, which inherently discriminates against exports. This, however, would aggravate the existing supply bottlenecks in manufactured exports and would further enlarge the competitiveness gap between Latin America and Asia on the world markets for manufactures. Any dialogue between Latin America and the EEC should be aware of the empirically well-founded hypothesis that such internal “home made” obstacles to manufactured exports from Latin America have proved to be at least as (negatively) effective as the EEC-protectionism in CAP-products.

¹⁵ The share of ASEAN-GSP exports in total GSP-exports to West Germany for example increased from 7.6 % in 1973 to 16.4 % in 1979.

¹⁶ Cf. for data on US-investments in Latin America, William K. Chung: Sales by Majority-Owned Foreign Affiliates of U. S. Companies, in: U. S. Department of Commerce, Survey of Current Business, Vol. 55, Washington 1975, No. 8, pp. 22-39, Vol. 57 (1977), No. 1, pp. 29-39.

¹⁷ However, there is also the possibility that in products where the new members are net importers (cereals) the degree of autarky within the enlarged EEC decreases and opens the way for some export expansion from Latin America.