European Union- Latin American Trade: Current Conditions and Perspectives

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Total trade between the European Union, the EU, and the Latin American Counties, the LAC, grew very sluggishly in the last ten years. There are, however factors that could accelerate the expansion of this trade. Among these factors are: the high purchasing power of the wealthiest twenty percent of the LAC, the need that these countries have for the type of capital goods that the EU produces and the supplies of inexpensive labor in the LAC that could be used to develop dynamic manufacturing sectors.

INTRODUCTION

In 2012, total trade between the European Union, the EU, and the19 Latin American Countries, the LAC, reached 223.7 billion euros, its highest level ever. That level of trade represented 6.4% and 15.7%, respectively, of the EU's and the LAC's total trade in 2012. In the following years, the EU-LAC trade declined steadily; thus, by 2016 the total trade between these entities barely reached 195 billion euros (European Commission, 2017, p. 3).

The 2012 to 2016 steady decline of EU-LAC trade was, to a large extent, the result of the reduction of prices of primary goods, which in turn caused the steady decline of the value of the exports of five of the six largest economies of Latin America; namely, the economies of Argentina, Brazil, Chile, Colombia and Peru (Massachusetts Institute of Technology, MIT, 2017). Despite the reduction of the total EU-LAC trade between 2012 and 2016, in 2016 the EU was the third most important trading partner for the LAC; while Latin America was the fourth most important trading partner of the EU (European Commission, 2017, p. 9). This mutual importance suggests that it would be in the economic interest of both entities to put their trade back on the path of growth.

Putting the exports of the LAC on a growing path would, however, require a change in their composition. These exports have been dominated by primary goods; which as is well known, have prices that tend to be quite volatile. Hence, the share of these exports that corresponds to manufactures must increase, while the share corresponding to primary goods must decline. To move in this direction, several Latin nations count with a crucial resource: a relatively large supply of young, cheap and trainable labor. These supplies of labor could combine with foreign investment to form competitive manufacturing sectors; which is what Mexico, the second largest economy of the LAC, did to form its dynamic export-of-manufactures sector (Cañas, Heffner and Herrera, 2017, p. 3).

The exports of the EU to the LAC have been dominated by capital and high-income consumer goods. These exports have the potential for steady growth because there are factors that have facilitated and are likely to continue facilitating the growth of the demands for these types of goods. Salient among these factors are the high purchasing power of the wealthiest twenty percent of the LAC's societies, the growing need that all LAC countries have for capital goods to expand and to modernize their infrastructures, and the macroeconomic stability that the majority of these nations have experienced for several years (Economic Commission for Latin America and the Caribbean, ECLAC, 2016, p.35 and pp.48-49).

Independently of the economic factors favoring the growth of the EU-LAC trade, the fact that the populations of the LAC are relatively young and still growing represents potential markets for all kinds of goods and potential supplies of inexpensive labor. If the EU does not actively increase its presence in the LAC to profit from this demographic fact, China will (Kay and Bacavire-Bacarreza, 2011, pp. 14-19).

The remainder of this paper is organized as follows. Section two provides a brief summary of the existing trade treaties between the EU and the LAC. Section three describes the evolution of the EU-LAC trade between 2006 and 2016. In section four, the discussion deals with the economic and demographic facts that create potentially large markets in the LAC for European capital and consumer goods. Section five discusses factors that may help promote the exports of the LAC to the EU. Finally, section six contains conclusions.

Existing Trade Treaties between the EU and the LAC

The EU has signed and implemented trade agreements with two Latin nations, Mexico and Chile, and with two trading groups from this region, the Central American Nations and the Andean Community. Key features of these treaties are summarized in table one below.

TABLE 1
EXISITING TRADE TREATIES BETWEEN THE EU AND THE LAC

Country or Trading Group	Date of Implementation	Main Objectives of the Treaty from the EU Perspective
Mexico	July 1, 2000	Maintain and gain competitiveness mostly vis-à-vis the U.S.A.
Chile	January 3, 2005	Expand its presence and prevent losses to the U.S.A.
Central America: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.	June 2012	Maintain and gain competitiveness mostly vis-a-vis the U.S.A. and China; as well as to promote regional integration.
Andean Community: Peru, Colombia and Ecuador.	March 2013: Peru August 2013: Colombia December 2014: Ecuador	Maintain and gain competitiveness mostly vis-à-vis the U.S.A. and China; as well as to promote regional integration.
Cariforum: This is a group of 15 Caribbean nations. The Dominican Republic is the only LAC in this group.	October 2008	Expand its presence, prevent losses to the U.S.A and promote economic development and integration.

Source: Garcia, M. J., 2016, pp.7-15; and Krakowski, M., 2008, pp. 114-119

As can be seen in table one above, of the 19 LAC, twelve have already established a trade agreement with the EU. Among the seven LAC that have not yet signed a treaty with the EU are the four members of Mercosur: Argentina, Brazil, Paraguay and Uruguay. Mercosur and the EU, however, started to negotiate a treaty in 1999 and, since that year, have had several rounds of negotiations but they have not yet signed a treaty. A major cause for this failure has been the persistent disagreement about trade in agricultural goods such as beef and grains; goods that are quite important for Argentina and Brazil as well as for some members of the EU like France and Ireland (Garcia, 2016, pp. 10-12). Very recently, however, the leaders of Mercosur announced that they are committed to reach an agreement with the EU in the very near future (Euractive, 2017).

Bolivia, Cuba and Venezuela are the other three LAC that have not established a trade treaty with the EU. Bolivia, as a member of the Andean Community, participated between 2003 and 2008 in the negotiations to establish a trade treaty between this community and the EU. Yet, due to disagreements regarding intellectual property rights, Bolivia withdrew from these negotiation in 2008 and has yet to return to the negotiation table like Ecuador did in 2014 (Garcia, 2016, p. 16). Cuba and Venezuela have not participated in any negotiations to establish a trade agreement with the EU. Furthermore, due to the political and economic ideology of their governments, is very unlikely that these two nations will enter, in the foreseeable future, into any kind of negotiations for a trade treaty with the EU or with any other entity.

When the trade agreements with Chile and Mexico were established, the presence of China in the LAC was minimal. Since then, the LAC-China trade has grown enough to make China the first trading partner of Brazil, Peru and Chile, and the second trading partner of Mexico. Thus, the rapidly growing importance of China for the LAC is adding pressure to the government of the EU to finalize the treaty with Mercosur and to improve the treaties that the EU has with other Latin countries (MIT, 2017; and European Commission, 2017, Trade).

Brief Review of the Evolution of the EU-LAC Trade between 2006 and 2016

Between 2006 and 2016, the LAC exports to the EU grew at an annual rate of 1.05%, from 80.4 billion euros in 2006 to 89.3 billion euros in 2016. This growth, besides being small and erratic was drastically interrupted in 2009 when, as result of the world-wide recession, the LAC exports to the EU fell 26.32% (European Commission, 2017, p. 3).

The composition of the LAC's exports helps explain their slow growth during the 2006 to 2016 period. In 2006, the shares of primary and manufactured goods in these exports were, respectively 65.4% and 34.6%. By 2015, the share of these exports that corresponded to primary goods had declined to 57.7% while the share corresponding to manufactured goods had increased to 42.3%. The increase in the share of manufactured goods of the LAC's exports was, however, of little significance since, during this period, at least 82% of the LAC's exports of manufactures came from Mexico and at least 60% of Mexico's exports went to the U.S.A. (MIT, 2016; and Cañas, Heffner and Herrera, 2017, pp. 4-6). Thus, as the prices of primary goods such as grains, petroleum, copper and other minerals steadily declined during these years, the value of the exports of most LAC countries, with the exception of the value of the exports of Mexico, also declined.

In 2009, also as result of the world-wide recession, the exports of the EU to the LAC experienced a 20.9%reduction. Despite this drastic drop, between 2006 and 2016 the exports of the EU to the LAC grew at a yearly rate of 5.34%; from 63.2 billion euros in 2006 to 106.4 billion euros in 2016 (European Commission, 2017, p. 3). This relatively vigorous growth was not the result of vigorous and sustained economic expansion across Latin America; since between 2011 and 2016 the economies of Argentina, Brazil, Chile, Colombia and Peru experienced low rates of growth (ECLAC, 2016, p.35). This suggests that even in times of weak economic growth, the economies of the LAC were still able to generate demands for the kind of goods that dominate the exports of the EU; namely, capital and high-income consumer goods such as machinery, cars and pharmaceuticals.

Factors that Promote the Growth of the EU Exports to the LAC

All the LAC have foreign debts denominated in hard currency; which means that such debts have to be paid with this kind of currency. For the LAC, the most important source of hard currency is exports. Thus, one factor that strongly influences the capacity of the LAC to import is the ratio: foreign debt payments/exports.

In the 1980s, this ratio was too high, which severely limited the capacity of the LAC to import, and thereby, the growth of the LAC's economies. Since then, this ratio has declined to about 3.5 percent by 2015 (ECLAC, 2016, p.36). This ratio may not continue declining, but is not likely to increase either because neither the foreign debts of the LAC nor the interest on these debts are likely to increase. Thus, a very significant share of the hard currency generated by the exports of the LAC are likely to be available for the financing of imports from the EU and from other regions of the world.

Key demographic characteristics of the LAC's societies form a second factor that helps promote the demand for high-income goods, such as imported processed foods, imported clothing and cars. These demographic characteristics are: a young population with a median age of 28.9 years, a declining fertility rate that currently stands at 2 children per woman, an average of 3.7 people per household and a rapidly growing number of households where there are two wage earners (ECLAC, 2016, pp.13-15).

A third factor that could significantly promote the growth of the EU exports to the LAC is the purchasing power of the wealthiest twenty percent of the Latin societies. This can be appreciated in table two below, where the income of six EU countries are compared with the income of the wealthiest twenty percent of six LAC.

TABLE 2
COMPARISON OF SIX EU NATIONS WITH THE WEALTHIEST 20% OF SIX LAC

	Population Millions	**Total GDP Billions**	**Income per Head**
Argentina Hungary	8.574 9.9	\$260.33 ≈ 243.3€ \$121.7 ≈113.7€	\$30,363 ≈ 28,377€ \$12,363 ≈11,554€
Brazil Spain	41.192 46.42	\$1,341.8 ≈ 1,254.02€ \$1,199 ≈1,120.6€	\$32,574 ≈ 30,443€ \$25,832 ≈ 24,142€
Chile Croatia	3.579 4.224	\$147.1 ≈ 137.48€ \$48.73 ≈ 45.54€	\$41,100 ≈ 38,411€ \$11,536 ≈ 10,781€
Colombia Portugal	9.558 10.35	\$218.7 ≈ 204.39€ \$198.9≈ 186€	\$22,881 ≈ 21,384€ \$19,222 ≈17,965€
Costa Rica Estonia	0.954 1.312	\$26.7 ≈ 24.95€ \$22.46 ≈ 21 €	\$27,987 ≈26,156€ \$17,119 ≈15,999€
Mexico Poland	24.595 37.99	\$700.43 ≈ 654.61€ \$477 ≈ 446€	\$28,478 ≈ 26,614€ \$12,554≈ 11,733€

Source: ECLAC, 2016; and The World Bank, 2017.

The six EU countries selected are certainly not among the most prosperous of Europe; nonetheless all of them are still considered wealthy next to developing nations. However, as can be seen in each one of these six comparisons, the wealthiest twenty percent of the LAC has a significantly higher purchasing power than the corresponding EU nations.

A fourth factor favoring the growth of the exports of the EU to the LAC is the need that these nations have of improving and modernizing their infrastructures. This include the construction of public transportation systems like railroads; as well as the equipping of health care facilities, and industrial plants with high tech machinery.

Factors that Promote the Growth of Exports of the LAC to the EU

As mentioned above, the fact that the exports of the LAC are dominated by primary goods, makes the sustained growth of these exports quite difficult, since the international prices of this type of goods are quite volatile. Thus, to overcome this difficulty, as was also mentioned before, the LAC will have to develop manufacturing sectors that are capable of exporting.

This is something that Mexico did as result of the North American Free Trade Agreement, the NAFTA. Mexico's export-of-manufactures sector has been successful enough to have generated between 20% and 25% of the country's GDP for the last 15 years and to generate, at least in the last three years, no less than 82% of the LAC's exports of manufactured goods to the EU (Cañas, *et.al*., 2017, pp. 3-4; and MIT, 2017).

To form these sectors, the LAC will have to implement policies to attract manufacturing companies that are looking for places where labor is inexpensive and trainable. Among the LAC that have this type of labor are: Brazil, Colombia, Peru, all the Central American nations, and the Dominican Republic.

Some of the LAC face constraints that are very likely to obstruct the formation of a dynamic manufacturing sector where most of the producers are foreign companies. Among these countries are Argentina, Bolivia, Cuba, Ecuador and Venezuela. In the case of Argentina, perhaps two of the most visible of these constraints are the country's persistent macroeconomic instability and inflexible labor regulations. In the case of the other four nations, hostility towards foreign direct investment, which goes from severe in Cuba and Venezuela to mild in Ecuador is probably the most visible limitation to formation of even a modest manufacturing sector capable of exporting.

CONCLUSION

The trade between the LAC and the EU is quite important for both entities. Yet, due to structural problems like the dominance of primary goods in the exports of the LAC, this trade has been growing at low rates. To deal with this obstacle, most of the LAC need to implement policies that would lead to the formation of manufacturing sectors where the LAC supply the labor and foreign manufactures supply the technology.

As the population of Europe, Japan, and the U.S.A. continue to age rapidly; the corporations from the EU will need to search for non-saturated markets. The relative youth of the still growing populations of the LAC combined with the high purchasing power of the wealthiest segments of the LAC's populations, could help to generate some of these non-saturated markets.

For Colombia, Mexico, the Dominican Republic and the six Central American nations the U.S.A. has been their most important trading partner for many decades. The current xenophobic and antimigrant political discourse in the U.S.A. represents an opportunity for the EU to gain markets and presence in these countries.

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