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EXPORTS OF MANUFACTURES: PROSPECTS AND PROBLEMS

by

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During the 1960s the Latin American countries experienced an important change with regard to the export of manufactures, not so much in the value of exports that are still modest, but in the new attitude to the problem of the external sector.

Very few people in Latin America still believe that steady development can be achieved by exporting their basic raw materials and not many more still maintain that the answer to the problem is to supplement the economic activity generated by these traditional exports with the industrial activity needed to substitute imports through local production. All those who study the region's economic problems objectively and seriously are now convinced that steady development and living conditions for the people comparable with those in the developed countries can only be achieved by mass exports of industrial products.

In view of this change of attitude in Latin America, and the fact that these notes are addressed to a forum of experts on the problems involved in the export of manufactures, there is no further need to show the importance of the subject.

Prospects

The developed countries started the process of industrialization over one hundred years ago, whereas the Latin American countries took the first steps at the end of the Second World War. Thus they have had only twenty-five years of industrialization and this constitutes the major problem they come up against in expanding their sales of manufactures outside the region.

The industries developed during these years, that are now starting to export, are faced with competition from enterprises that have large financial resources; technical research centres which enable them to put new products on the market all the time, experience in marketing and international prestige built up over many years.

In spite of these differences that are so hard to overcome, the prospects for the export of manufactures are good, and new opportunities for the developing countries continually occur, particularly for those that have managed to establish an import substitution industry, as in the case of several Latin American countries.

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The highly industrialized countries are faced with a growing scarcity of manpower. Sweden, the Federal Republic of Germany and Switzerland remedied this situation a few years ago by incorporating millions of foreign workers. The problems resulting from this mass immigration have led them to search for other solutions.

One partial solution to the problem of lack of manpower is to encourage imports of products that include a high labour value in their cost. Some countries send components to other regions which have abundant and cheap labour for specific industrial processes and the products are then returned to the country of origin. The Swiss watch industry has transferred the manufacture of certain types of watches to developing countries so as to conserve its own specialized manpower and its entrepreneurial capacity for the production of more profitable goods, such as rocket instruments and those used by commercial aeroplanes to avoid collision in flight. Some United States machine tool manufacturing firms are seeking association with firms in the developing countries in order to transfer the manufacture of simpler machines thereby freeing specialized labour needed for the manufacture of more sophisticated machine tools.

There are definite advantages in the division of labour between countries since this encourages specialization and therefore benefits all the countries that trade with each other. However, the benefits received by the countries manufacturing more complex products are greater than those received by the countries that provide raw materials or food. The more sophisticated the industrial production, the more limited the supply of the product, the greater the relative profit obtained by the exporting country. This is why it is not surprising that the industrialized countries that lack manpower use what labour they have to manufacture the goods that sell for the highest prices and try to farm out the manufactures of simpler products.

The production of simple industrial articles enables the Latin American countries to add foreign exchange income to the means of payment already derived from the export of raw materials and food, and furthermore to obtain better terms of trade. Regional or subregional import substitution will help to equip these industries to play an increasingly

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important part in the supply of more complex products using their own technology, thereby overcoming the difficulties arising from the region's late arrival upon the industrial scene.

The problem of the exchange rate

If the Latin American countries are to make the most of the opportunity to export manufactures in sufficient quantity to help appreciably in solving economic growth problems they must first introduce changes in their external sector strategy and secondly perfect measures to support exports in such a way as to put their entrepreneurs at least on an equal footing with their competitors from the developed countries.

The most important problem involved in external sector strategy is the exchange rate. The countries that base their exports on natural products fix the exchange rate for their currency in accordance with the export requirements for those products. For coffee producing countries the rate is generally such as to facilitate coffee sales, other countries base their rates on the requirements for copper, bananas, wheat, wool or petroleum. Once the exchange rate is such as to permit a relation between the cost of the product and the world price, the problem is usually solved.

The traditional Latin American export products have comparative advantages due to natural circumstances and that is why normally the exchange rate that is sufficient to export such products is not suitable for manufactures for which the advantage of cheaper labour is not always equalled by the comparative advantage for natural products.

A slightly undervalued exchange rate is a good incentive to the export of industrial goods and the surplus compensation resulting for traditional export products can be retained by means of taxes on exports, depending on the extent of undervaluation, the nature of the traditional export product and the owner of the concern, which may be state-owned, or run on national or foreign private capital.

Monetary stability in a country is enough to promote the export of industrial products, once an appropriate exchange rate has been fixed, but the adoption of a suitable policy is more complex in countries that suffer from persistent inflation, because an overvalued exchange rate causes a rapid rise in domestic prices and the advantage is therefore lost.

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The worst effort of a lack of continuity in the relation between the exchange rate and the level of domestic prices is that frequently sales of industrial products are initiated with foreign countries while the exchange rate is still undervalued, and then have to be interrupted as soon as the level of domestic prices exceeds parity. The entrepreneurs who make the effort to open markets for manufactures therefore lose not only what they have invested in this operation, but also their prestige since they disappoint their new clients. This loss of entrepreneurial prestige of necessity reflects upon the country as a whole.

Certain countries suffering from persistent inflation have adopted small scale and frequent devaluations as a solution that allows them to maintain a constant relation between domestic prices and the exchange rate. However, this policy is only useful to support exports of industrial products when the constant relation between the variable exchange rate and the rising level of domestic prices is such that the exchange rate is continuously undervalued to a specific extent. Unfortunately this does not always happen, and the small and frequent devaluations are often behind the rise in domestic price levels, with the result that the exchange rate only serves to support traditional exports.

These problems arise, particularly when countries have not yet reached the point where they can export manufactures for significant values - this is why it is a problem that affects the developing countries. The fixing of an exchange rate is influenced by interests in exports, and, when these are mainly traditional, the exchange rate will normally be favourable to traditional export interests and not to those of exporters of manufactures, which are much less important and do not have sufficient unity to carry any weight in government decisions. In the developed countries, by contrast, the importance of industrial exports is such that the exchange rate always meets their requirements in one way or another.

When the currency is overvalued by, for example, 20 per cent, this percentage must be added to the normal tariff protection received by the national industry, but if on the other hand the currency is undervalued by 20 per cent, the normal tariff protection can be reduced by the same amount. These differences of 40 per cent between the level of undervaluation

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and overvaluation are very frequent in countries that suffer from inflation, and they have a marked effect on the real protection needs of the industry, because, if there is no continuity in the relation between the exchange rate and the level of domestic prices, since tariff modifications are of necessity slow, the tendency in such cases is to establish tariffs that are higher than normal, with all the resulting problems.

Excessive tariff protection not only affects the competitive capacity of the entrepreneur, it also hinders export possibilities because it hampers the correct functioning of instruments such as the drawback and temporary imports.

As is well known, the drawback, in customs terms, is the refund of import taxes paid on the inputs used in manufacturing, when the product is subsequently exported. Temporary importing avoids the refund by not charging the tax, as long as the product is exported in accordance with certain predetermined conditions.

When a country has reached a certain level of industrial integration, efforts are made to ensure that the export product includes the largest possible volume of local inputs, in this way the net inflow of foreign currency into the country is increased. Thus in many cases it is better to refuse the drawback for inputs manufactured locally.

While the prices of national inputs are reasonably higher than prices on the world market, this policy can easily be applied, but if this is not the case, the negative incidence on the price of the final product may hinder its export.

In such cases the manufacturer of the final product, or the government, can ask the manufacturer of the input to reduce the price for the volume of inputs to be included in the export product. If this cannot be arranged, the only other alternative open to the government is to authorize the drawback and then export a product with a smaller national input content or to lose the chance of exporting altogether.

There is a relation between the possibility of making a profit and the risk of fraud in exporting and importing. In the developed countries with low import tariffs for industrial products, fewer cases of fraud are registered than in the countries with high import tariffs. One reason is

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the temptation to obtain a concession while avoiding total or partial payment of a 20 per cent import charge and another is if the tax reaches 100 per cent. The European Economic Community has experience on this subject, but with regard to the trading of agricultural products from a temperate climate, since exporters from the Community sometimes ship products that are not covered by subsidies and forge the declaration so as to obtain subsidies, which in some cases reach 100 per cent of the world price.

A very high tariff on imports of industrial inputs has similar effects, and this is why temporary imports of highly taxed goods must frequently be subjected to such controls so as to avoid undue diversion into the domestic market which in the end makes the measure impractical.

As in the case of establishing an import substitution industry in the region, the government must create the conditions needed to export manufactures. Once interest has been aroused in such exports, the pressure brought to bear by this interest will probably be sufficient to maintain and perfect the policy, but there can be no doubt that, unless the necessary incentives are created, even though no one demands them, there will be no private interest to take the place of state action spontaneously.

Conclusions

When, at the end of the Second World War, several Latin American countries adopted an import substitution policy, they enforced a series of economic policy measures to facilitate the creation of industry. They covered aspects such as short- and long-term credit, preferential exchange rates for imports of raw materials and machinery, tariff protection to promote the development of new activities and investment advantages to bring about import substitution. It was thanks to the combination of all these factors that the desired objective was attained.

Countries that decide to export manufactures must adopt a similar policy if they wish to be successful. An exchange policy geared to the increase of industrial exports is essential, but unless it is accompanied by preferential credit for industries that channel some of their production to external markets, by support for imports of machinery for the same purpose, by the promotion of investment in these fields, in other words,

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without the adoption of a different strategy for the external sector aimed mainly at the export of manufactures and unless the policy measures are concentrated towards this objective the desired success could not be achieved.

Exporters must be able to rely at least on similar support in the export of manufactures as that granted to exporters in the developed countries. For this purpose they will need the drawback and temporary imports, prefinancing and postfinancing credit insurance against political and commercial risks, foreign service backing for export activity, aid to attend fairs and exhibitions, tariff preferences in regional or subregional systems or in the developed countries and efficient communications and transport.

The difficulty in making the policy for the export of manufactures a success lies in the fact that it is not enough for a country to have an industry that supplies the domestic market for it to be able to project that industry into world markets. It must also have an adequate exchange rate, although to begin with this may not be justified by trade trends or promoted by any pressure group, if it is to initiate and strengthen exports of manufactures. It is also necessary to create financial and other systems to support exports that are non-existent to begin with, it is essential to modernize and perfect the existing systems for support, avoiding very frequent changes that confuse those they are meant to benefit and hamper the work of the organizations implementing them, and lastly it is imperative that a national mystique on the subject be created. Only when these objectives are fully understood and backed by the entire population of the country can there be any likelihood of success.

ANNEX I

ARGENTINE EXPORTS CLASSIFIED ACCORDING TO THE DEGREE OF PROCESSING
AND THE EXTENT TO WHICH THEY ARE TRADITIONAL

The Ministry of Foreign Trade of the Republic of Argentina has drawn up statistics with a view to showing the new exports of manufactures registered in the last few years. For the purpose of this survey products are considered to be new if they do not figure in Argentina's export statistics before 1960, or if they were not relevant during the 1960s. The products were classified as industrial or primary on the basis of the classification used in surveys made by the United Nations in the Standard International Trade Classification (SITC) according to the degree of processing.

The following table shows the statistics for the last few years:

TOTAL ARGENTINE EXPORTS CLASSIFIED ACCORDING TO DEGREE OF
PROCESSING AND EXTENT TO WHICH THEY ARE TRADITIONAL

(Millions of dollars)

	1966	1967	1968	1969
New industrial products	95.0	108.1	157.3	209.3
Traditional industrial products	310.5	353.5	337.1	360.2
Primary products	1 187.7	1 002.9	873.5	1 042.6
<u>Total</u>	<u>1 593.2</u>	<u>1 464.5</u>	<u>1 367.9</u>	<u>1 612.1</u>

Source: Ministry of Foreign Trade, Republic of Argentina.

As can be seen, exports of new industrial products exceeded 95.0 million dollars in 1966 and 209.3 million in 1969. In relative terms these products accounted for 5.8 per cent of total sales abroad in 1966, rising to 13 per cent in 1969.

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The following table shows the exports of new manufactures classified according to main destinations.

ARGENTINE EXPORTS OF NEW MANUFACTURES CLASSIFIED
ACCORDING TO DESTINATION

(Millions of dollars)

Destination	1966	1967	1968	1969
ALAIC	52.0	63.5	84.4	118.5
United States	21.0	23.3	38.7	36.2
European Economic Community	9.0	7.7	15.3	31.6
United Kingdom	3.4	3.0	3.6	3.2
Other countries	9.6	10.6	15.3	19.8
<u>Total</u>	<u>95.0</u>	<u>108.1</u>	<u>157.3</u>	<u>209.3</u>

Source: Ministry of Foreign Trade, Republic of Argentina.

As can be seen 56.6 per cent of exports of new manufactures in 1969 went to ALAIC countries, 17.3 per cent to the United States, 15.1 per cent to the countries of the European Economic Community, 1.5 per cent to the United Kingdom and 9.5 per cent to other countries.

The most important new manufactures exported in 1969 were books, adding machines, steel products, car covers, punched card machines for statistics and processed foods.

ANNEX II

EXPORT INCENTIVES AUTHORIZED BY THE GOVERNMENT OF ARGENTINA

The following is a brief summary of the principal measures to support exports at present enforced by the Argentine Government.

DRAWBACK

Exporters can obtain the refund of import duties and the duties and charges allocated to the "Fondo de Contribución al Desarrollo del Plan Siderúrgico" and the "Fondo Forestal" on imports of inputs used in the processing of goods for export.

The rules governing these concessions are contained in decrees 8051/62, 7567/63 and 9249/63.

They are calculated by product by means of a "drawback standardization" carried out by the Ministry of Foreign Trade. These "drawback standardizations" are requested by the exporters who provide information on the composition of the product to be "standardized" and on the marketing of the product. In this way thousands of different products have been "standardized".

Once the drawback standardization for a product has been carried out, it is approved by a resolution and each exporter subsequently exporting a similar product has the right to receive the refund mentioned above.

TAX REFUND

Exporters of unused manufactured goods have the right to a refund of the taxes levied, whether national, provincial or municipal.

According to the appropriate authorities the ruling on this matter in Argentina is about to be modified, therefore the ruling still in force is not included here.

EXEMPTION FROM SALES TAX

All goods that are exported are exempt from sales tax according to decree 3696/60 with certain exceptions mentioned in the decree.

/TAX DEDUCTION

TAX DEDUCTION

According to the Law 17.529, exporters can deduct 10 per cent of the f.o.b. value of exported goods listed in the annexes to Decrees 9610/67, 5787/68 and 7251/69 from their income tax.

TEMPORARY ADMISSION

Exporters can bring in raw materials and semi-processed products temporarily free of import duties and charges, with the exception of tax rates on services.

Decree No. 5343/63, governing this ruling, states that for temporary admission to be granted the raw materials and semi-processed goods imported must be re-exported after improvement processing or transformation in the country and, prior to customs despatch of the products, the importer must give the National Customs Authority a guarantee for the sum of all the duties and charges that he would be liable to pay in the case of normal importing, plus 25 per cent. The guarantee must be maintained for a period of eight months. Within the 180 days following customs despatch, the importer must export the goods. This period can be extended only once and for a period not exceeding sixty days.

CERTIFICATE OF DECLARED QUALITY

Exporters can obtain a certificate for the quality and other specifications of their goods to facilitate sales operations abroad.

INTERNATIONAL FAIRS AND EXHIBITIONS

The Ministry of Foreign Trade has a hand in the preparation of Argentinian exporters for participation in international fairs and exhibitions, paying some of the expenses incurred, such as the cost of the space they are to occupy, building the pavillion, decorating the stands and functional expenses.

EXPORT AWARDS

The Ministry of Foreign Trade has established a system of export awards that are given annually to enterprises that have done particularly well in increasing exports and selling new products abroad.

BULLETIN OF TRADE OPPORTUNITIES

The Ministry of Foreign Trade publishes a weekly bulletin informing readers of trade opportunities abroad.

FINANCING OF EXPORTS

The Central Bank of the Republic of Argentina laid down the rules governing export financing in Circular B 689 (RC 378), and these are applied directly by local banks.

The goods that are subject to such financing are listed in the circular and must be unused and of Argentine origin, freight and insurance of exported goods are also included as long as they are carried out by Argentine firms. This financing can also be requested for technical services, research and studies sold abroad, and repairs and adjustments to transport and equipment temporarily imported into the country.

The financing can cover 85 per cent of the f.o.b. value in the case of capital goods, freight and insurance and repairs or adjustments to machines and transport equipment imported temporarily. Other goods exported can be financed up to 80 per cent of their f.o.b. value. For technical services, research and surveys the financing may cover up to 90 per cent of the value.

The terms for loans are eight and a half years for capital goods; three years for durables and up to one and a half years for other products. In other cases the terms will be granted by the Central Bank, following special consultations.

Operations exceeding 50,000 dollars per firm in all banks must be covered by credit insurance for export against ordinary commercial risks or guaranteed by a recognized solvent foreign bank.

The Central Bank has established that the commercial banks cannot charge more than 6 per cent annually for these operations.

The Central Bank also established a system to back exporting firms in Circular B 502 consisting in a non-renewable 180 day loan for a maximum of the equivalent of 30 per cent of the value of goods exported, as long as these are covered by the tax refund. The interest rate on this loan to exporter cannot exceed 11 per cent per year.

In Circular B 777, the Central Bank established a system of prior financing of exports of non-traditional products that is applied directly by local banks and gives credit facilities of up to one year prior to the export of the goods.

CREDIT INSURANCE FOR EXPORT

Credit insurance for export against extraordinary risks is administered by the Ministry of Foreign Trade and covers inability to pay for unavoidable reasons such as civil or international war, revolution, moratorium declared by the buying country, rules or provisions passed by the importing country blocking the transference of funds paid by the buyer. It also covers incomplete payment of a debt owed by a public body of the importing country.

The application of this insurance is the responsibility of a private firm that has signed a contract with the Ministry of Foreign Trade and now receives proposals for coverage and issues the appropriate policy.

