Impact of Trade Agreements with the European Union on Wine Exports from the New-New World

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Economic theory holds that greater openness to trade generates a welfare gain. However, it remains unclear whether this effect holds in the case of bilateral negotiations. This is due to the fact that when the openness is bilateral, there are two possible effects: trade creation and trade diversion (Viner 1950). According to this theory, a reduced tariff through the free trade agreement does not necessarily lead to a welfare improvement. The net effect will depend on the magnitude of trade creation (welfare gain), defined by the replacement of domestic production by cheaper imports from a trading partner, and trade diversion (welfare loss), defined by the replacement of imports from the rest of the world by imports from countries that are members of the agreement but at higher costs and in an inefficient way. In this context, it is interesting to analyze how trade agreements affect exports.

In this paper I focus particularly on the wine sector, analyzing exports from Argentina, Chile and South Africa, which in 2010 accounted for 96.6% of wine exports from the New-New World. To measure the impact on wine exports I consider the free trade agreement signed between Chile and the EU in 2003 and the agreement between South Africa and the EU in 2000. Besides, I then make a comparison with Argentina, in order to control for the performance of other countries that have no agreement with European Union.

To measure the effect of the agreement, this paper uses the Gravity Equation (Tinbergen 1962; Anderson 1979). The dependent variable is the value of wine exports in dollars from Argentina, Chile and South Africa to all destinations. Independent variables include the exporter GDP and importer's GDP, the population of each country, the bilateral real exchange rate and wine production in the exporting country. It also includes the geographic distance between each pair of countries as a proxy for transportation costs and two dummies that identify whether countries share a common language or have common border. It also includes a trend, a dummy indicating the years of the agreement with the European Union and a dummy indicating the existence of other trade agreements outside the EU.

As expected, I find that wine exports from Chile and South Africa to the EU increased considerably after the agreement. However, estimations show that wine exports to the rest of the world also increased considerably. In turn, exports in countries like Argentina that have no agreement with EU, also grew significantly, both to the EU and to other destinations. However, in this case, exports to the rest of the world increased more than exports to the UE, unlike what happens in Chile and South Africa.

Therefore, this paper estimates a model that, on the one hand, takes as a control group "other destinations" to compare with exports to EU and, on the other hand, takes Argentina as another control group. As a result, I find that Chilean exports recorded a significant increase in the period post agreement, although the impact is smaller when controlled by the observed increase in exports to other destinations. Finally, the positive effect of the agreement also decreases when it is controlled by the good performance of countries without agreement like Argentina. After this controls, I obtain the estimation for the net effect of the agreement.

It should be noted that in the case of South Africa, the comparison with Argentina is not that accurate due to the differences in the composition of wine exports. However, the model estimates a positive net effect for wine exports from Chile and South Africa, indicating that there exist benefits from trade liberalization and particularly from trade agreements with the EU. This means that Argentina would probably benefit with this type of agreements and following an openness strategy as Chile has. However, Argentina’s trade negotiations through Mercosur are not that wide and currently show little dynamism. Although actually there are some negotiations with the EU, the implementation of an agreement between both blocks does not seem close enough.

1 New-New World: Argentina, Chile, Hungary, Lebanon, South Africa.