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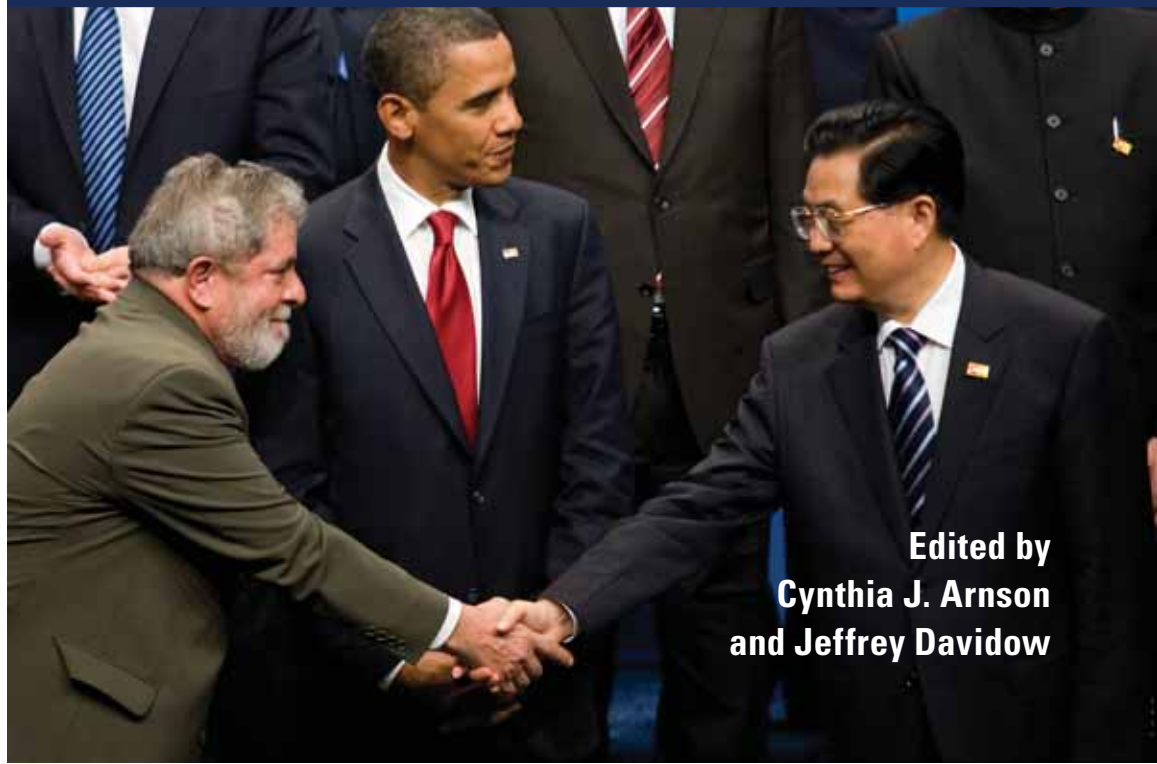


Institute of
the Americas



中国社会科学院
拉丁美洲研究所
INSTITUTO DE AMÉRICA LATINA
ACADEMIA DE CIENCIAS SOCIALES

China, Latin America, and the United States: **THE NEW TRIANGLE**



Edited by
**Cynthia J. Arnson
and Jeffrey Davidow**



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Chinese Academy of Social Sciences



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INTRODUCTION

Cynthia J. Arnson and Jeffrey Davidow

The rise of China as a dominant economic power in the last decade represents one of the most significant changes in the international system since the end of the Cold War and one of the most rapid transformations the world has experienced. Changes in the Chinese economy, the growth of its manufacturing sector, and the country's need for raw materials, energy, and food, have sparked an unprecedented expansion of China's commercial and political relations with countries of the developing world, including but not limited to Latin America. While the political issue of Taiwan remains an important consideration for Chinese foreign policy toward the region, politics no longer appear to be the dominant driver of the relationship with the Western hemisphere. Nor, despite occasional sabre-rattling and appeals to China's historical territorial claims in Asia, China's global ambitions do not yet appear to be principally influenced by traditional, nationalistic military intentions. Rather, the leading edge of China's interest in Latin America, and vice versa, is economic—and on a massive scale.

Consider, for example, China's rates of economic growth over the last decade. Since 2000, China's economy has grown at an average rate of 10.3 percent per year. In 2007, the growth rate soared to 14.2 percent, and in 2009, even while most of the global economy remained mired in recession, China barreled ahead with a growth rate of 9.1 percent.¹

It is hard to exaggerate the sheer size of the Chinese economy or internal market. China's status as one of the so-called BRIC countries obscures the fact that its 2009 GDP—over \$4.98 trillion—is more than three times as large as Brazil's, the next largest of the BRICs. At the same time, China's economy is nearly four times as large as India's and Russia's.² China's population of just over 1.3 billion is the largest in the

¹The figures are from the World Bank. See <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG> and <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?page=1>

²In 2009, China's GDP was \$4.984 trillion. Brazil's GDP that same year was \$1.572 trillion. India's was \$1.310 trillion, and Russia's \$1.231 trillion. *Ibid.*

world. And reductions in poverty since 1981—at a pace and of a scope that the World Bank called “without historical precedent”—have greatly expanded internal demand for foodstuffs, energy, and consumer goods.³

China’s growth has had a profound impact on the countries of Latin America and the Caribbean (LAC). The impact has been most positive for net exporters of energy, raw materials, and agricultural products, and most negative for those countries whose manufactured exports have been undermined by Chinese competition in such major markets as the United States. Between 2000 and 2009, for example, LAC exports to China expanded nine-fold: in only four years, the region’s exports to China nearly doubled, from \$22.3 billion in 2006 to \$41.3 billion in 2009, representing a pace far greater than the region’s overall export growth.⁴ In the midst of the international financial crisis, 2009 LAC exports to the United States and the European Union fell by 26 percent and 28 percent respectively. That same year, however, exports to China grew by 5 percent, contributing to South America’s resilience in the face of global recession.⁵ All told, China’s trade deficit with Latin America totaled some \$8.9 billion in 2009, largely due to raw materials exports from Brazil and Chile.⁶

To understand the nature and implications of the enormous expansion of Chinese-Latin American relations over the last decade, the Latin American Program of the Woodrow Wilson International Center for Scholars, the Institute of the Americas of La Jolla, California, and the Institute for Latin American Studies of the Chinese Academy of Social Sciences of Beijing convened a May 26, 2010, seminar engaging scholars and analysts from China, the United States, and several countries

³According to the World Bank, the absolute number of poor people fell from 652 million in 1981 to 135 million in 2004, a decline of over half a billion people. The percentage of the population below the poverty rate fell from 65 percent to 10 percent. See World Bank, Poverty Reduction and Economic Management Department, East Asia and Pacific Region, *From poor areas to poor people: China’s evolving poverty reduction agenda* (Washington, D.C.: March 2009), p. iii.

⁴Figures are from Kevin Gallagher and Roberto Porzecanski, *The Dragon in the Room: China and the Future of Latin American Industrialization* (Palo Alto, CA: Stanford University Press, 2010).

⁵CEPAL, *La República Popular de China y América Latina y el Caribe: hacia una relación estratégica* (Santiago: Abril de 2010), p. 11.

⁶Joachim Bamrud, “China’s Latin America Deficit Jumps Fourfold,” *Latin Business Chronicle*, September 1, 2010.

of the Western hemisphere. Participants from Brazil, China, Mexico, Peru, the Andean Development Corporation, the Inter-American Development Bank and others addressed what China's growth meant for particular countries and for the region as a whole, the degree of partnership or competition with China, and the impact of China's demand for energy on the decisions about and development of energy industries in the hemisphere.

An overview of basic statistics helps to illustrate the transformative impact of China's growth on the region. According to the U.N. Economic Commission for Latin America and the Caribbean (CEPAL), by 2008 China was the single largest export destination for Brazil as well as Chile (absorbing 7 percent and 13 percent of exports, respectively), and the second largest export destination for Argentina, Costa Rica, Peru, and Cuba. By mid-2010, shortly after signing a free trade agreement with China, Peru's Vice Minister for Foreign Trade Eduardo Ferreyros indicated that China had also become Peru's principal export destination, displacing the United States.⁷ By the middle of this decade, CEPAL estimates that China could displace the European Union as the second largest export destination for countries of the region, after the United States.⁸

The changes in China and its global economic projection mirror important changes in Latin America as well. At the same time that China has expanded its aggressive search for overseas markets and sources of basic inputs, South American countries in particular have enjoyed a decade of macroeconomic stability and dynamic growth. They have looked, economically as well as politically, to diversify their international trading patterns beyond traditional partners in the United States and Europe.

Nonetheless, the trade relationship is not unproblematic. Chinese exports to LAC consist primarily of manufactured goods, while Latin America's exports to China consist mainly of primary commodities. Critics have charged that trade patterns resemble those of the 17th and 18th century, and that China discriminates against products with greater value added. For example, between 2006 and 2008, soy and soybean oil comprised almost 80 percent of Argentina's exports to China;

⁷Mercedes Aráoz y Luis Giampietri, "Perú es el principal destino de las inversiones chinas en América Latina," *Infolatam*, 22 de abril de 2010.

⁸*Ibid.*, pp. 15–18, 25.

in April 2010, China suspended imports of processed oil in apparent protest of Argentina's filing of a formal anti-dumping complaint against Chinese exporters.⁹ Brazil's exports between 2006 and 2008 consisted of iron ore (44 percent of the total) and soy (23 percent). For Chile, copper and copper ore comprised 81 percent of exports to China. While the destination of commodity exports from the region has changed in recent years, the role of commodities as a portion of total exports has changed less dramatically in Latin America than in other parts of the developing world; indeed, 75 percent of the exports of Chile, Peru, and Venezuela still consist of commodities.¹⁰ This underscores ongoing problems of diversification in Latin American economies, and, critics maintain, magnifies the region's vulnerability to external shocks.

At the same time, Latin American imports from China have grown increasingly contentious since the onset of the global recession. According to CEPAL, some 60 percent of the anti-dumping complaints by countries of the region have been leveled against China alone, for such goods as steel, textiles, footwear, consumer electronics, and tires. Argentina and Brazil have initiated the highest number of investigations.¹¹ IDB economist Maurico Mesquita Moreira, a contributor to this report, has called China "the biggest threat" to industrial expansion in Brazil, as the two countries produce similar goods.¹²

Chinese investments in Latin America have also been concentrated in the extractive sector, particularly oil. In May 2010, China and Brazil signed a ten-year credit-for-oil agreement in which Petrobras agreed to send oil to China for 10 years in exchange for a \$10 billion loan from the China Development Bank.¹³ One month earlier, China reached a similar

⁹Oxford Analytica, "Argentina: Agribusiness Drives Economic Recovery," October 13, 2010.

¹⁰See Emily Sinnott, John Nash, and Augusto de la Torre, *Natural Resources in Latin America and the Caribbean: Beyond Booms and Busts?* (Washington, D.C.: The World Bank, 2010), pp. 7–9.

¹¹CEPAL, *op. cit.*, p. 19.

¹²Bloomberg, "China Beats Brazil in Backyard as Summit Seeks Unity," April 15, 2010.

¹³Bloomberg, "China Signs Loan-for-Oil Agreement with Petrobras, Sina.Com Says," May 25, 2010. See also, John Pomfret, "China invests heavily in Brazil, elsewhere in pursuit of political heft," *Washington Post*, July 26, 2010, p. 1; MercoPress, "Cina on course to become biggest foreign direct investor in Brazil," August 12, 2010. Chinese investments in Brazil include steel mills, automobile and construction machinery factories, telecommunications and utilities infrastructure, and agricultural land.

deal with Venezuela, trading a reported \$20 billion in loans for 200,000 barrels a day for 10 years of Venezuelan oil.¹⁴ In August 2010, Ecuador—otherwise cut off from international capital markets following a 2008 bond default—signed a \$1 billion loan with China for oil and infrastructure projects.¹⁵ China paid \$7.1 billion in October—reportedly the largest transaction ever between China and Latin America—to acquire 40 percent of Brazil’s assets in the Spanish energy firm, REPSOL.¹⁶

But the inexperience of Chinese companies—many state-owned or -influenced—in the sensitive areas of labor relations, environmental concerns, and relations with local communities have led to more than occasional frictions. Peru-based scholar Cynthia Sanborn noted that more recent Chinese investments in that country seem to be operating in a more socially-conscious manner, but that China’s relative newness to the Latin American milieu and the corresponding lack of attention to similar concerns in their home country will be a continuing issue for Chinese investors.

China’s laser-like focus on economic benefit means that a number of political concerns that must be taken into consideration by Western governments and companies—human rights and political participation, for example—are frequently ignored. And China’s role as the world’s leading air polluter and producer of carbon emissions raises the potential for political conflict with many Latin American countries that take environmental issues seriously. That said, China has succeeded in lowering its energy intensity rate more quickly and extensively than other countries around the world, and its investment in clean energy dwarfs that of the United States.

According to World Bank chief economist for Latin America Augusto de la Torre, the long-term challenge for Latin America is to “manage well” the commodity bonanza fueled by Chinese demand and to channel earnings into improvements in human capital, infrastructure, and innovation.¹⁷ In addition to trade, the doubling of

¹⁴Simon Romero, “Chávez Says China to Lend Venezuela \$20 Billion,” *New York Times*, April 18, 2010; Dan Molinski, “China’s Spending in Latin America is a Mixed Blessing for the Region,” Dow Jones News Service, October 4, 2010.

¹⁵Reuters, “Ecuador sings \$1 billion loan deal with China,” August 31, 2010.

¹⁶Dan Molinski, *op. cit.*

¹⁷World Bank LAC, “Latin America: “Commodity dependence” can lead to Sustained Growth, World Bank report argues,” Press Release No. 2011/083/LAC, September 13, 2010. The press release marked the publication of *Natural Resources in Latin America and the Caribbean: Beyond Booms and Busts?*, cited in note 10 above.

Chinese investment in the region between 2008 and 2009 (from \$3.7 billion in 2008 to \$7.3 billion in 2009) suggests that China's role in the region is continuing to accelerate at a rapid pace. Statistics from China's Ministry of Trade indicate that, after Asia, the region is the second largest destination for Chinese investments.¹⁸ How best to profit in development terms constitutes the principal challenge for countries of Latin America and the Caribbean.

¹⁸Infolatam, "El Foro de Inversores China-América Latina busca ir más allá de las materias primas," 15 de septiembre de 2010. Brazil, Chile, and Peru absorbed over half of these investments.

WHAT A GROWING CHINA MEANS FOR LATIN AMERICA'S ECONOMIES

In a keynote address, **Enrique García**, president and CEO of the Corporación Andina de Fomento (CAF), a Latin American development bank, indicated that despite the economic downturn in 2009, the global economic crisis has not obstructed Latin America's path to sustained economic growth, macroeconomic stability, and positive external balances. On average, the region was projected to grow by 4.5 percent in 2010, and in certain countries, by as much as 7–8 percent. This success is partially due to the implementation of conservative fiscal and monetary policies, continued central bank independence, and strict financial regulations. Strong regional growth rates and resilience in the face of the crisis can also be attributed to the favorable terms of trade between Latin America's resource rich countries and China.

García warned that despite the benefits of high export prices, the concentration of exports to China in specific areas—such as soya, raw materials, and minerals—makes Latin America vulnerable to an economic downturn and reinforces its traditional production structures. In order to create more equitably distributed and sustainable growth, the China-Latin America trade model must move beyond free trade agreements. However, at present Chinese foreign direct investment (FDI) in Latin America and the Caribbean is low, and 80 percent of FDI is directed toward tax havens.

In addition, García highlighted some of the main challenges that Latin American countries are currently facing: low rates of savings and investment (an average of 18 percent and 20–21 percent of GDP over the last ten years, respectively), as well as slow productivity growth. According to the World Economic Forum's rankings, Latin America also suffers from a lack of competitiveness. This is related to both low investment rates and poor infrastructure—the region on average invests a mere 2–3 percent of its GDP in infrastructure. García warned that because China's reserves help to compensate for the savings/investment gap in the region and the fiscal deficits in the United States and Europe, there will be competition for China's financial resources.

The fundamental questions for the economic relationship between China and Latin America are how to improve trade quality and how to diversify direct investment beyond raw materials. CAF has tried to facilitate a better relationship with China through, for example, an agreement with the China Development Bank. Through this relationship, CAF shares its knowledge on Latin America with the Chinese, while also encouraging them to co-finance private sector projects that contribute to diversifying Chinese investments in the region. García suggested that initiatives such as these increase social and intellectual interaction and could also play a role in building mutual understanding for a more constructive relationship with China.

Professor Chai Yu of the Chinese Academy of Social Sciences stated that while Latin America's trade partnership with China is increasingly important, "it's not enough." According to Yu, China's development model is unique in that GDP growth is driven by consumption, foreign and domestic investment, and to a lesser extent, exports. Between 1993 and 2009, the majority of China's imports and exports, 59.9 percent and 46.5 percent, respectively, were with trading partners in Asia. Latin America, meanwhile, only accounted for 6.9 percent of China's imports and 5 percent of its exports. Brazil and Chile have been the principal Latin American beneficiaries of China's growth and have moved up in the ranking of China's import shares. However, Asian nations still account for the majority of China's import shares (See Figure 1).

China is currently facing a number of economic challenges. In 2008, a new labor law expanding rights for workers increased labor costs by upwards of 40 percent. The *renminbi* has appreciated by 21 percent since 2005. Yu predicted that as a result, there would be a decrease in labor-seeking investment and an increase in market-seeking investment by transnational corporations. The WTO accession process will further limit China's exports for at least the next ten years. At the domestic level, these challenges are contending with China's attempts to make the results of economic development felt more broadly by its population through what Yu labeled "people friendly" or "inclusive" development.

Yu emphasized that China's inclusive development model presents an opportunity, not a threat; within this framework China's task is to promote a stronger relationship with Latin America. The case of the Association of Southeast Asian Nation's (ASEAN) economic integration with China

FIGURE 1: WHICH PARTNERS BENEFIT?

2006–2007, 100 million USD			1993–2006, 100 million USD		
Partners	↑ import	↑ share	Partners	↑ import	↑ share
Japan	182.77	11.11	Japan	508.55	16.54
Korea	140.02	8.51	Korea	377.75	12.28
Taiwan	139.34	8.47	Taiwan	364.29	11.85
US	101.82	6.19	US	232.78	7.57
Germany	75.02	4.56	Germany	182.95	5.95
Australia	65.31	3.97	Malaysia	129.03	4.20
Philippines	54.43	3.31	Thailand	82.27	2.68
Brazil	51.38	3.29	Singapore	79.15	2.57
Malaysia	51.38	3.12	Thailand	60.93	1.98
Thailand	47.05	2.86	Australia	53.56	1.74
Chile	45.21	2.75	Saudi Arabia	50.76	1.65
India	43.56	2.65	Brazil	49.82	1.62
Iran	33.55	2.04	Russia	48.68	1.58
Canada	33.18	2.02	France	44.57	1.45
Total	1645.78	100.00	Total	3080.00	100.00

is instructive. In the early 1990s, the ASEAN countries were roughly the same size as Latin America and expressed similar concerns in the face of China’s economic development. The 2007 free trade agreement implemented between ASEAN and China diminished many of these concerns as the ASEAN countries began to benefit from increased natural resource exports. Yu suggested that with increased cooperation, China and Latin America’s relationship could parallel that of ASEAN and China.

Yu responded to concerns about China’s natural resource-dominated commercial relationship with Latin America. She framed this phenomenon within the context of the country’s economic relationship with its neighbors and the United States as well as China’s own strategies for development. As the hub of the International Production Network, China imports intermediary products from its neighbors—Japan and Korea—and exports final products to the U.S. and Europe. At home, its principal priorities are employing its massive population in industry and stimulating innovation. China is therefore focused on addressing

its own situation of underdevelopment. However, Yu remarked that in the future, both China and the region could benefit from preferential trade agreements and China's installation of factories in Latin America that produce for local markets as well as export abroad.

According to **Ambassador Sergio Ley**, Mexico's former ambassador to China, commercial relations between China and Mexico predate contemporary conversations about the "freshly emerging neighborhood" by 500 years. Latin American *conquistadores* first transported Chinese silks, porcelain, teas, and spices through Pacific Ocean ports and Mexico to later arrive in Spain, where they were purchased using Mexican silver. In the mid-19th century, Chinese nationals worked as indentured laborers on Cuban sugar and tobacco plantations. However, commercial ties did not translate into political relations until the late 19th century, when Peru, Brazil, and Mexico signed diplomatic treaties with China. Soon after, economic and political relations between Latin American countries—particularly Mexico—and China came to a virtual standstill following the decline in the international price of silver.

Cuba established diplomatic relations with the PRC in 1960. However, when Cuba decided to strengthen its alliance with the USSR and as the relationship between the two communist powers deteriorated, Cuba no longer served China's interests. In the 1970s, China turned back to Mexico as an outpost for its foray into Latin America and as a training ground for Chinese specialists in Latin American affairs. Today, those academics and diplomats are the core actors influencing Chinese strategy towards the region. Between 1974 and 1986, Ley noted instances of learning and cooperation through traditional Chinese medicine, donations of corn seed, and education about massive job creation, using the Mexican *maquiladora* (factory) model as an example.

China and Mexico's relationship was challenged by the 1980s financial crisis in Mexico. Subsequently, Mexico began to implement protectionist measures in response to the proliferation of cheap Chinese products in the Mexican market. From the Chinese perspective, the negotiation of North American Free Trade Agreement in 1994 and the delayed Free Trade Agreement (FTA) with China represented a realignment of Mexico's interests away from China. Indeed, Mexican businesses were duly concerned with the effect that competition would have on Mexican development. However, trade between the two countries continued to

grow and by 2009, Mexico was China's largest trading partner in Latin America and China was Mexico's second largest trading partner.

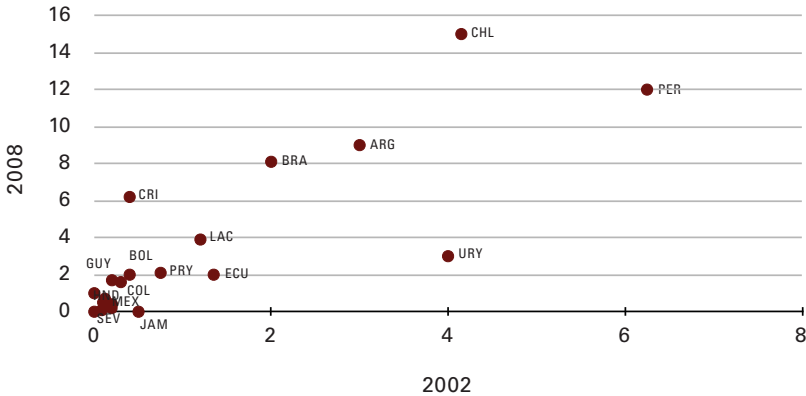
The specific dynamics of the China-Mexico economic relationship reveal certain imbalances and discrepancies. For example, while imports from China to Mexico totaled \$32.5 billion in 2009, exports to China from Mexico only measured \$3.9 billion. Moreover, Chinese statistics place the value of total trade with Mexico at \$16.2 billion, while Mexico's figures registered \$34.7 billion. Both figures might be right; and the discrepancy reflects not only the diversion through third countries of bilateral trade, which neither country's statistics can capture, as well as the lucrative opportunities that could result from a more direct trade relationship. Despite these potentially conflictive areas, the relationship must be handled carefully because Mexico depends highly on Chinese imports to produce finished products for export. Ley warned that the price of these finished products could be influenced by a change in the value of the Chinese currency.

China has become one of Mexico's main competitors in the U.S. market. To address this, Ley suggested, "If you cannot fight the competitor, join forces with them, and together conquer the market." Structural economic reforms, Chinese investment in the Mexican manufacturing sector, and continued attempts to increase Mexican exports to China are necessary in order for Mexico to address the challenges and opportunities presented by China. In sum, a state policy must be present to guide bilateral relations between the two countries into a real strategic partnership.

According to **Mauricio Mesquito Moreira** of the Inter-American Development Bank, China played an important stabilizing role in Latin America and the Caribbean (LAC) during the recent global financial crisis. In fact, as the world's exports fell in 2009, LAC's exports to China grew. Prior to this, from 2000–08, LAC's exports to China grew at an average annual rate of 40.2 percent. Moreira posited that this export growth boom, largely composed of natural resources, was partially due

If you cannot fight the competitor, join forces with them, and together conquer the market.

**FIGURE 2: CHINA'S SHARE OF LAC'S EXPORTS:
2000 AND 2008 (%)**



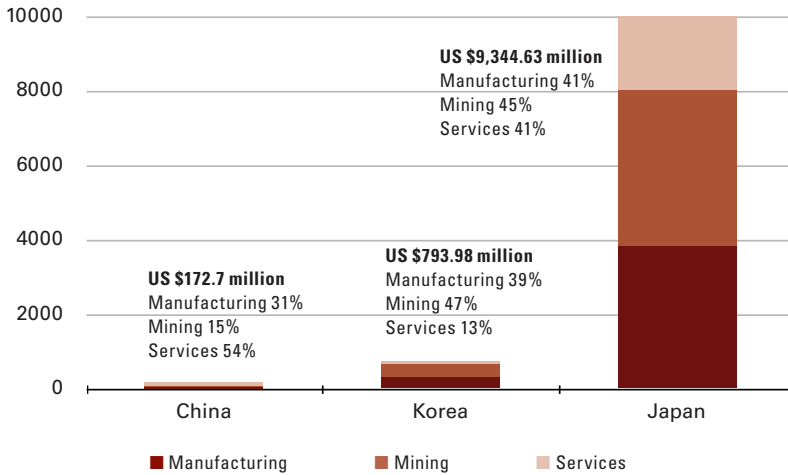
Note: For Chile, Honduras and Nicaragua the Latest Data is for 2007
Source: COMTRADE

to China’s internal resource constraints and as well as obstacles within the WTO accession process. The complementarities between China and LAC are evident: if China grows by 10 percent, the demand for LAC exports grows by 25 percent. The downside is that the benefits of this trade are not evenly distributed across the region; Chile, Peru, Brazil, Argentina, and Costa Rica make up a demonstrably larger share of exports to China than other LAC countries (See Figure 2).

Further, Moreira echoed prior panelists in noting the disparity between the massive trade between China and LAC, and the small amount of Chinese FDI in the region. In 2008, total Chinese FDI to the region (excluding tax havens) was \$48.9 million, paling in comparison to Latin American’s overall FDI of \$122 billion. Between 2001 and 2009, China’s cumulative FDI to Brazil was \$172.7 million, a significantly smaller sum than Japan and Korea’s investments in the country. As Figure 3 demonstrates, the majority of Chinese FDI in Brazil targeted the services sector, while Japan and Korea largely invested in mining.

According to Moreira, most countries of the region have adopted a “sit and wait” approach to China’s competitive entry into the region.

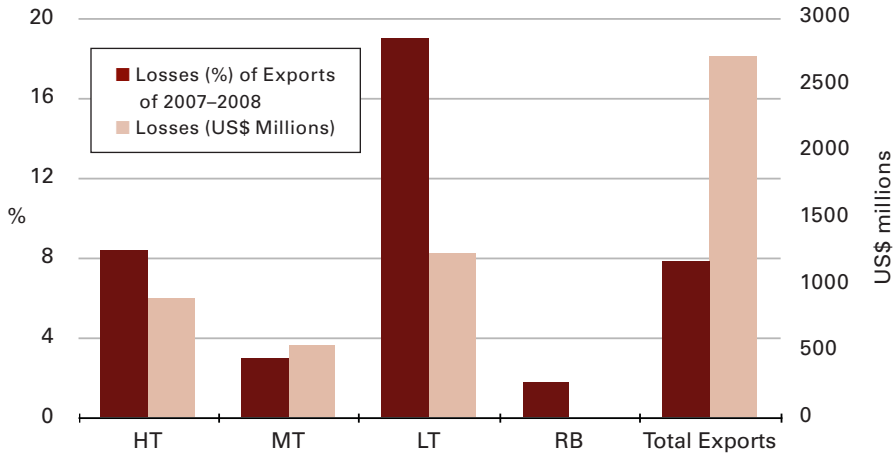
FIGURE 3: BRAZIL'S FDI INFLOWS FROM CHINA, KOREA AND JAPAN. CUMULATIVE FLOWS, 2001–2009. USD MILLIONS



He cautioned that despite the simultaneous increase in China’s share of the U.S. market and the decrease in the shares held by Mexico and Central America, one cannot infer a causal relationship without first looking at the composition of each country’s market share. As Figure 4 demonstrates, between 1996 and 2008, LAC lost approximately \$27 million in exports to the United States, mostly in low-tech, labor-intensive industries that have traditionally supported the region’s poor. In addition, countries of the region are unable to increase their export share to China itself because of high tariff barriers in the Chinese market—as much as 15 percent in the manufacturing sector—that do not encourage growth or diversification of LAC trade. Echoing García’s recommendation, Moreira concluded that maintaining a sustainable relationship between the region and China in both the economic and political spheres will require the Chinese to follow the Japanese model and invest in more diverse industries.

In the face of China’s massive labor market and cheap wages, Moreira suggested that Brazil and Mexico capitalize on their low-wage areas in the northeast and south, respectively. LAC countries should increase

FIGURE 4: LAC'S MARKET SHARE LOSSES TO CHINA IN THE U.S. MARKET: MANUFACTURING GOODS EXPORTS, 1996/97–2007/08



Note: HT=High Technology Manufactures, MT=Medium Technology Manufactures, LT=Low Technology Manufactures, RB=Resource Based Manufactures
Source: Own calculations based on USITC data.

their productivity, and in the case of Mexico and Central America, use their comparative advantage of proximity to the United States to focus on goods that are time sensitive and require “speed to market.” He also noted a “market failure” in which 90 percent of the final costs of goods shipped to China are freight costs that do not go to the country of origin, but to the shipping companies; this inefficiency could be an opportunity for LAC countries to extract higher rents from the natural resources it exports to China.

From Washington’s perspective, China’s entry into Latin America is a fairly recent phenomenon, with the exception of an ongoing discussion over which countries favor diplomatic relations with Taiwan over the PRC. The current situation reflects a new reality based on trade and growth; 12 years ago, China accounted for 4–6 percent of Latin American trade, but is now a top trading partner for many countries in the region.

Nelson Cunningham of McLarty Associates argued that from a strategic perspective, China's interests appear to be purely commercial. This is distinct from Russia's ideologically-based military and diplomatic alliance with the government of Venezuela, described by Cunningham as aimed at balancing U.S. influence in the region. Latin American countries may have initially pursued the Chinese market to serve as a "strategic counterweight" to the region's historical commercial and political dependence on the United States. Yet the relationship has not necessarily fulfilled these expectations. For example, popular accusations have been leveled against Brazilian President "Lula" da Silva that China took advantage of him through both the commercial arrangements between the two countries and in negotiations over China's accession to the WTO.

Building a strategic relationship with China is challenging not only because of low levels of Chinese investment in the region, but also because the investment that does occur generally employs Chinese laborers and materials brought over for specific infrastructure projects. While China's lack of human rights and environmental restrictions makes it an easier commercial partner as compared to the United States and Europe, the relationship lacks the deep cultural kinship that exists between Latin America and these other two areas of the world. Within this context, Cunningham posited that the relationship between China and Latin America will remain strictly commercial, but recommended that the United States be vigilant regarding the way that increasing commercial ties can transform into political alliances. In order for the United States to maintain its privileged relationship with the region, it must compete with China at the commercial level. This consists of lowering trade barriers to Latin American exports and expanding pre-existing commercial and corporate ties.

While China's lack of human rights and environmental restrictions makes it an easier commercial partner as compared to the United States and Europe, the relationship lacks the deep cultural kinship that exists between Latin America and these other two areas of the world.

DISCUSSION

Panelists pointed to Singapore's experience with China as a model for Latin America. Ley suggested that Singapore could extend its role as an "honest broker" between China and Southeast Asia to Latin America. García agreed, stating that Singapore's competitive advantage derives from its highly developed infrastructure—this has been a particularly weak point for Latin America. Moreira commented that Singapore's experience could be instructive for small Caribbean countries regarding ways to leverage their development. Returning to the issue of the trade and investment asymmetry between the two regions, Cunningham added that strong Latin American economies are in the interest of the United States regardless of whether or not they are based on exports to China. Ley agreed and suggested that the best way to diminish the trade deficit in Mexico is by increasing exports. Similarly, Moreira recommended that Latin American countries take advantage of natural resource rents to diversify their industries. He also suggested that the region follow in the footsteps of the United States and push China to lower trade barriers to Latin American imports.

CHINA AND LATIN AMERICA: POLITICAL AND ECONOMIC PARTNERS, OR COMPETITORS?

Conference participants also addressed the implications of China's growing energy demands for LAC countries, for China's own economic development, and for the world energy market. "Are we looking at China and Latin American oil as [a] panda or a dragon?" asked **Jeremy Martin**, director of the Energy Program at the Institute of the Americas. Estimates project that China's demand for oil will grow from 8 million barrels per day (mbd) to 16 mbd by 2030; current imports as a percentage of consumption are over 50 percent. Beijing's general strategy for satisfying Chinese demand consists of securing access to a diverse array of material reserves and inserting itself into production positions in oil projects. Beijing is pursuing "a strategy to assure that all of its oil reserve and production eggs are not in the same basket." Despite its ready economic capital, the Chinese must face increased competition for oil resources as they undertake their strategy against the backdrop of a global shift to "peak access;" in today's world there are few easy targets and access to resources has been seriously diminished.

As a result of the failed and conflictive U.S. (UNOCAL) and Ecuador (Andes Petroleum Ecuador Ltd.) acquisitions in 2005, China has learned that it can no longer "go it alone" in the Western hemisphere. China's strategy now includes mergers and acquisitions (M & A) through the purchase of local shares, joint ventures with local companies, and oil swaps, where long-term credit is exchanged for oil (for a listing of these initiatives as of May 26, see Figure 5). According to Martin, oil swaps are becoming the "most important arrows in Beijing's quiver." This is exemplified by Venezuela's recent agreement with the Chinese Development Bank to receive a \$20 billion credit line that can be repaid in oil. Brazil has negotiated a similar \$10 billion credit line

According to Martin, oil swaps are becoming the "most important arrows in Beijing's quiver."

FIGURE 5: CHINESE DOLLAR DIPLOMACY & LATIN AMERICA'S OIL PATCH



that will provide Petrobras with a portion of the massive capital needed to develop its recently discovered pre-salt deep sea fields. Martin warned against overstating the current energy relationship between China and Latin America, noting that while a \$10 billion oil swap for Brazil may sound considerable, it is less than 20 percent of Petrobras’ annual capital expenditure program of \$47–50 billion.

Dr. Sun Hongbo of the Chinese Academy of Social Sciences pointed to strong Chinese economic growth, national oil companies, government, and financial organizations—especially the Chinese Development bank—as the four elements driving Chinese energy cooperation with Latin America. A new trend emerging from this mix is the increased cooperation between financial organizations and national oil companies. Sun listed five models that China employs for cooperation: 1) a technical service model, 2) a joint development model, 3) an infrastructure-building participation model, 4) a loans for oil model, and 5) a bio-fuels technology joint research model. These models can be seen across various countries with which China is cooperating (See Figure 6).

For example, in Mexico, Chinese companies had provided nearly \$1 billion in engineering services for oil projects by the end of 2007. Sun also cited successful joint ventures in Colombia and Ecuador—including the Andes Petroleum purchase of all of Encana’s assets in Ecuador—as areas of successful cooperation. In addition to the China-

FIGURE 6: COOPERATION PROGRAMS BY COUNTRY

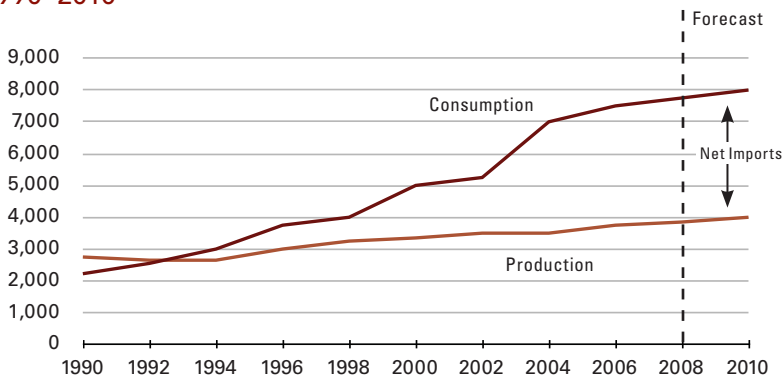
	Exploration	Development	Service Contract	Loans for Oil
Peru	✓	✓		
Venezuela	✓	✓	✓	✓
Ecuador	✓	✓	✓	✓
Colombia		✓	✓	
Brazil	✓		✓	✓
Mexico			✓	
Argentina	✓			

Brazil loan-for-oil agreement, China will also cooperate with Brazil in the development of renewable energy sources such as biofuels. However, given that Latin America only accounted for 7.58 percent of China's oil imports in 2008, Sun doubted that Latin America would play a strategic role in guaranteeing China's future energy security. While opportunities for growth and investment are present for both China and Latin America, China's national oil companies are confronting risks of social conflict at the local level, political instability, intense competition, environmental clauses, transportation costs, and the uncertain U.S. response to China's presence in the region. Sun also indicated that Latin America can still be viewed as a strategic alternative for China to diversify its oil imports.

Philip Yang of Brazil's Petra Energia offered three propositions for understanding the substance and implications of China's energy plans in Latin America. First, Yang argued that China's oil policy is the facet of its energy policy that would have significant implications for Latin America. As seen in Figure 7, China's national oil production was eclipsed by national consumption in the early 1990s. The gap between the classic supply and demand curves illustrates China's need for alternative petroleum sources.

Although a staggering expansion of the energy mix is taking place in China (from renewables to nuclear power), Yang argued that China's growing oil demand and the country's reliance on oil

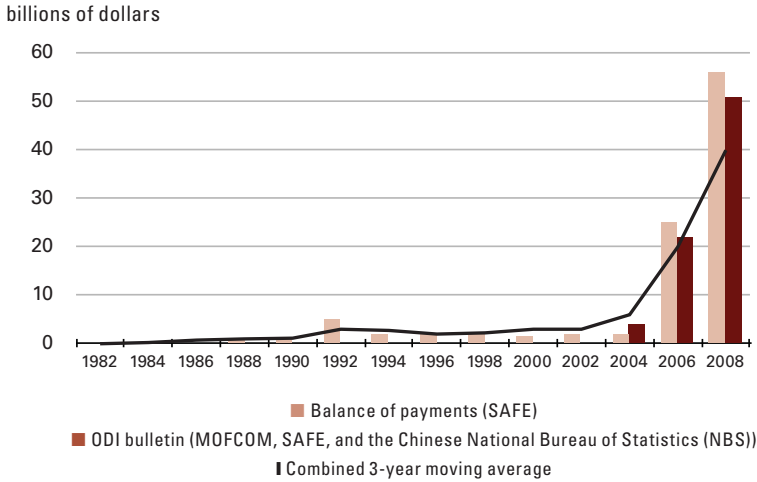
FIGURE 7: CHINA'S OIL PRODUCTION AND CONSUMPTION, 1990–2010*



*forecasted

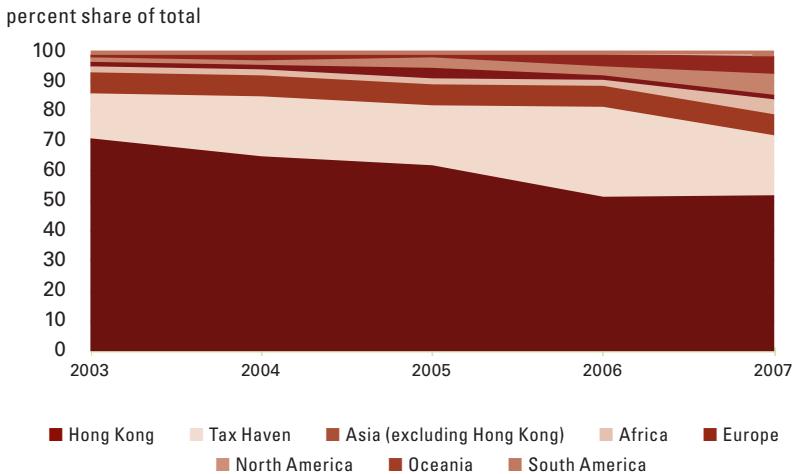
Source: EIA International Energy Annual 2006; Short-Term Energy Outlook (March 2009)

FIGURE 8: CHINA'S ANNUAL OFDI FLOWS, 1982–2008, MINISTRY OF COMMERCE OF THE PEOPLE'S REPUBLIC OF CHINA (MOFCOM) AND CHINA'S STATE ADMINISTRATION OF FOREIGN EXCHANGE (SAFE)



Source: SAFE, Balance of Payments; MOFCOM, Annual Statistical Bulletin on Outward FDI.

FIGURE 9: GEOGRAPHICAL DISTRIBUTION OF CHINA'S OFDI STOCK, 2003–2007



Source: MOFCOM

imports is what matters most to Latin American countries. There is potential in the oil sector because: (a) Latin America and Brazil, in particular, constitute one of the world's most successful oil exploration frontiers; (b) China is hungry for oil and emerges as a global source of FDI; and (c) the oil industry is one of the few in the energy sector that is not site-specific.

Second, Yang argued that in spite of the potential for a dynamic interaction between China and Latin America in the oil industry, the Chinese presence in Latin America, and especially in Brazil, is quite meager. Figures 8 and 9 illustrate that, despite skyrocketing Chinese FDI overall, China's FDI (non-bond investment) in Latin America accounts for only 1 percent of China's total investment stock.

The relatively meager Chinese presence in Latin America's upstream as compared to the country's presence in Africa's exploration and production (E&P) is evident in Figures 10 and 11.

Yang cited three possible explanations for the disparity between China's presence in Africa and Latin America.

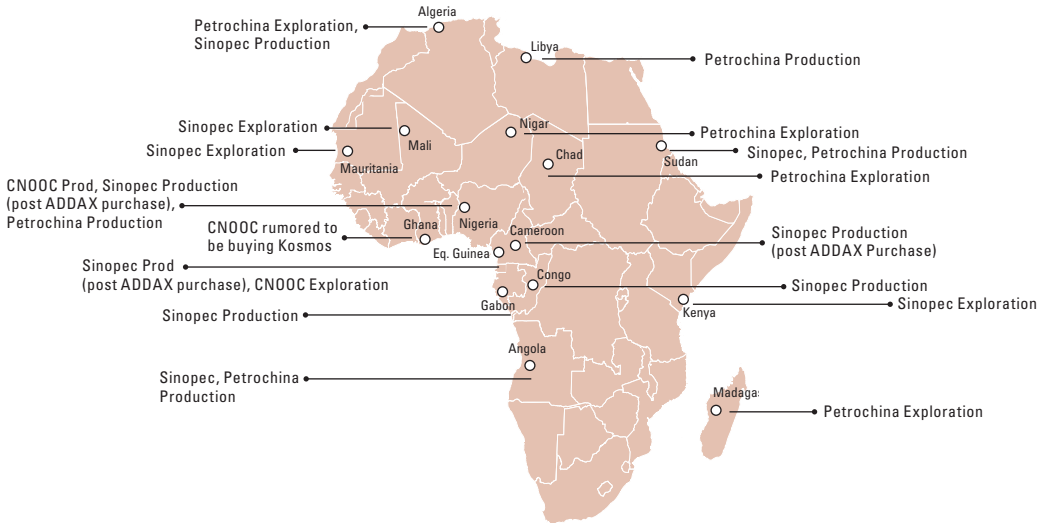
- One possibility is that China adopts a kind of “confidence-building ladder” in its approach to foreign countries. The steps of this ladder are trade, the provision of services, and then finally, investment. Trade data between China and Latin America supports this hypothesis: trade flows grew dramatically, followed by a smaller increase in services in a small number of countries. The third step of the ladder—investment—is yet to come for most of Latin America, including Brazil.
- A second possible explanation is that the Chinese have a clear preference for two types of investment destinations: (a) high-trust societies, where the rule of law prevails with clarity; and (b) societies with a “loose” regulatory framework. The hypothesis presented here would explain, for instance, why the Chinese have given priority to Australia—the top destination of China's OFDI last year—and why China's presence in Africa is so widespread.
- A third explanation reflects a possible political motive, in which Chinese national oil companies (NOCs) combine oil interests with the goal of political and strategic influence.

FIGURE 10: CHINESE E&P ACTIVITY IN LATIN AMERICA



Source: Plotted from data contained in *Meeting the Dragon's Appetite*, by Jiang Shixue

FIGURE 11: CHINESE E&P ACTIVITY IN AFRICA



Source: Standard Bank

Finally, Yang emphasized what he called the “untold story,” which explains China’s current absence in Brazil and holds a prescription for greater Chinese–U.S. collaboration in Brazil, with potential spinoffs to other countries of the region.

The untold story emerges in Figure 12, showing the evolution of oil production in Brazil since the early days of the oil industry. The graph is usually referred to as a way of showcasing the outstanding performance of state-controlled Petrobras in the exploration of Brazil’s offshore oil deposits. What is often overlooked, Yang maintained, is the abandonment of Brazil’s onshore capacity. The staggering success of offshore exploration in Brazil continues to overshadow the country’s vast and unexplored onshore potential.

When Petrobras was founded in 1953, Brazil lacked a critical mass of geologists. U.S. geologist Walter Link, a successful explorer working for Standard Oil, was invited to Brazil to assess the country’s onshore oil potential. Link stayed in Brazil for over six years, between 1955 and 1961, and ultimately recommended that Brazil develop its offshore potential instead.

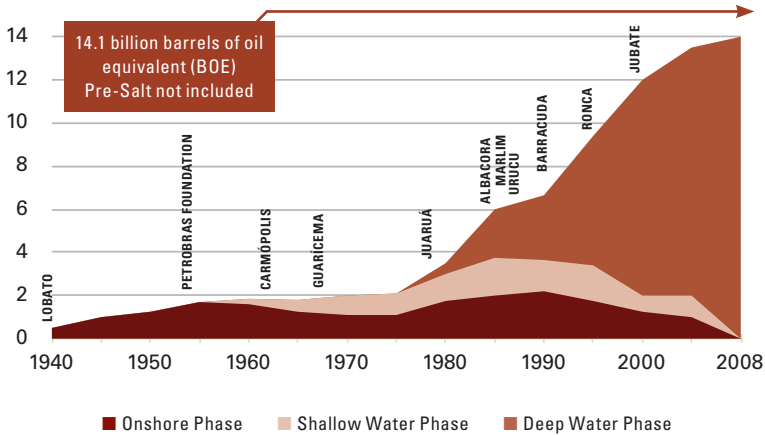
According to Yang, Figure 12 reflects the consequences of Walter Link’s suggestions. Petrobras was founded in 1953. The first offshore discovery was made in 1968 when the company was only 15 years old. The giant fields of the Campos Basin were discovered in 1974.

The result was obviously an overall blessing for Brazil. The country represented one of the most successful frontiers of offshore oil exploration. But the abandonment of Brazil’s vast onshore capacity represented a curse.

Yang emphasized that from 1953 and 1998, Petrobras had a monopoly on Brazil’s oil production. Thus, if the company was unwilling or unable to give attention to onshore exploration and development, there was simply no one else to do so. Petrobras gave utmost priority to the offshore, assigning the bulk of its budget and best brains to deepwater exploration.

Yang argued that the U.S., Chinese, and Brazilian figures for domestic drilling activity offer a quantitative measure of Brazil’s underexplored onshore potential. Although all three countries are approximately the same size, the United States has drilled over 3.5 million oil exploration wells, China has drilled about 1 million wells, and Brazil reports the scant number of 23,000 wells since 1953. The figures

**FIGURE 12: EVOLUTION OF PETROBRAS DOMESTIC
PROVEN RESERVES**



Source: Society of Petroleum Engineers (SPE) oil and gas proven reserve

reveal that onshore exploration activity in Brazil has been insufficient, especially in light of the fact that whenever investments were made in the Brazilian onshore, oil was discovered. Yang concluded that, with modern geological and geophysical tools, Brazil’s onshore emerges as a new great oil and gas exploration frontier.

Citing independent certification by companies such as DeGolyer and MacNaughton, Yang indicated that the potential for hydrocarbons in Brazil’s onshore may present an order of magnitude similar to that of the pre-salt, and with much less risk.

The “untold story” is thus that Brazil’s onshore potential has been forgotten and underexplored and the country’s potential is not limited to the pre-salt. The new frontier includes unconventional natural gas. Citing information prepared by DeGolyer and MacNaughton, Yang stressed that Brazil is also undergoing a revolution in unconventional natural gas, similar to what has taken place in the United States in recent years.

Yang concluded that China and the United States may well play an important and historic role in the exploration of Brazil’s onshore potential, including that of unconventional natural gas. This would open significant opportunities for collaboration in the realms of technology, business, and finance.

Cynthia Sanborn of the Universidad del Pacífico in Lima, Peru, situated the presence of Chinese state-owned firms in Latin America in the context of the region's still fragile political democracies. These democracies are characterized by an increased concern for industry diversification, changing roles for the state and political institutions, and the presence of new actors such as global NGO's, the Catholic Church, indigenous communities, and environmental organizations that demand a voice in natural resource policy. In many countries of the region, new or expanded democratic space enables these groups to question who has the right to subsoil property, whether local communities can veto concessions and how they can benefit from revenue distribution, and how to control the environmental impacts created by these industries. In response, global programs such as the Extractive Industries Transparency Initiative (EITI) and the International Council on Mining and Minerals (ICMM) have created new industry standards for addressing revenue transparency, improving relationships with the communities where companies mine, and using cleaner technologies in the extraction process. Many Western companies have voluntarily acceded to these regulatory bodies.

By contrast, Sanborn classified agreements between China and Latin American governments as "accommodationist." China does not belong to the EITI, and one has only to look to Venezuela and Ecuador to observe that China adapts to changing rules of the game more successfully than its Western counterparts. China is not only looking for trade opportunities, but is also interested in the stability of Latin American societies and seeks local capacities for negotiation. Sanborn specifically addressed the case of Peru and its evolving relationship with China. In Peru, mineral exploitation accounts for one-fourth of tax revenues and 6 percent of GDP, though in certain regions mineral revenue constitutes up to half of GDP. Thirty-four percent of mineral investments in Peru are from China, and Peru represents 26 percent of China's global

National authorities have been largely unable to provide an effective regulatory framework for foreign firms or mediate between these firms and the communities where they plan to conduct extractive activities.

mergers and acquisitions (M &A). Indeed, 40 percent of oil production in Peru is owned by China investors through a partnership between China National Petroleum Company (CNPC) and the Argentine firm Pluspetrol. Eight large Chinese firms are present in Peru's extractive industries, and while six of them are purely state-owned, there are also private Chinese investors purchasing lots. Given that China is expected to invest \$7 billion in minerals over the next five years, this trend is unlikely to wane.

While Peruvian governments have a strong desire to attract Chinese investment and increase private development of its industries, national authorities have been largely unable to provide an effective regulatory framework for foreign firms or mediate between these firms and the communities where they plan to conduct extractive activities. As a result, the Chinese, like others, have been forced to adapt based on the conflicts they encounter firsthand. Sanborn cited two cases demonstrating China's challenges in this regard. In 1992, Shougang Corporation's purchase of Hierro Perú in Marcona was the first mining privatization to occur under former Peruvian president Alberto Fujimori's new neo-liberal regime. As part of this acquisition, Shougang brought in 350 Chinese staff, fired local employees, and assumed control of the community's water services, creating conflicts with labor unions and local government. The company was later accused of corruption—though these charges have been suspended so as not to affect further Chinese investment. Fifteen years later, the social conflict surrounding the purchase by the Zijin Consortium of a large copper project in northern Peru suggested that the Chinese had still not fully realized that the Peruvian government was largely unable to prevent or mediate conflict at the local level. The result has been violence between local residents who oppose the mine, representatives of the company, and political authorities, with the stagnation of the project itself.

Faced with the conditions listed above—a weak central government as well as regulatory framework—Chinese companies today are learning how to implement community relations at the local level. In the case of Chinalco—a major Chinese state-owned enterprise with direct ties to the Central Committee—the company has hired experts and local staff with extensive knowledge of community relations, committed to investing in environmental clean-up, and cultivated relationships with local

authorities, in order to undertake a large copper project in the Junin region. They are now in the process of negotiating compensation to local residents for voluntarily relocating in order to accommodate the open pit mine they plan to build. Sanborn concluded that both responsible national policy makers and effective civil society actors are necessary for mitigating the development impacts of mineral extraction and preventing social conflict. Absent this oversight, local communities must rely on the voluntary and often volatile action by firms themselves.

DISCUSSION

Philip Yang noted the paradox of China's involvement in Brazil, marked by the Asian giant's interest in participating in the exploration of the pre-salt reserves, and the absence of a clear regulatory framework ensuring a *modus operandi* for investing in offshore exploration. He indicated that Brazil would not easily change or facilitate the conditions for the presence of Chinese companies if market conditions become "dire." Despite this reluctance, Sun Hongbo explained that both China and Brazil have attached great importance to energy cooperation as a means to enhance their bilateral relationship. According to the two countries' joint action plan for 2010–2014, both sides are actively attempting to reach a consensus on contractual structures in order to promote further joint cooperation. Jeremy Martin noted that one key measure that will impact Brazil's regulatory framework is encompassed in legislation currently moving through the Brazilian Congress which would grant Petrobras a majority stake in all pre-salt reserves. While this arrangement would likely be unappealing to international oil companies, Martin predicted that China is not likely to be put off by it, given its accommodationist behavior, strategy, and desire to secure production across the globe. Sanborn agreed, noting that in the Peruvian case, and despite the current government's overwhelming support for Chinese firms, a new government with stricter natural resource policies would not likely scare the Chinese away given their existing presence in the country. However, she also warned that a large number of social conflicts related to the extractive industries tend to increase the transaction costs of investment for the Chinese.

ABOUT THE AUTHORS

Cynthia J. Arnson is director of the Latin American Program at the Woodrow Wilson International Center for Scholars. Her most recent work has focused on the quality of democratic governance in the hemisphere, poverty and inequality, energy and international relations, and U.S. policy in the Western hemisphere.

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Nelson W. Cunningham served as special advisor to President Bill Clinton for Western Hemisphere Affairs and previously as general counsel to the Senate Judiciary Committee when it was chaired by Senator Joseph Biden. As co-founder and managing partner of McLarty Associates, he has contributed to building the company into a global firm serving clients in every major market in the world, including China.

Jeffrey Davidow is the president of the Institute of the Americas. Before assuming that position in 2003, he served for 34 years in the U.S. Foreign Service, with postings as assistant secretary of state for the Western Hemisphere and ambassador to Venezuela and Mexico. He is the author of *The U.S. and Mexico: The Bear and the Porcupine*, a book outlining the nature of the complicated relationship.

Enrique García has been president and CEO of the Andean Development Corporation (CAF) since 1991. Under his leadership, the bank has grown to be the leading multilateral lender in the Andean region and an important financial actor throughout the hemisphere. García has established strong ties with Chinese institutions in an effort to bring Chinese resources to bear on the CAF's two major areas of concern, regional integration and sustainable development.

Ambassador Sergio Ley López is one of Mexico's most distinguished former diplomats and a recognized expert on China. After joining the Mexican Foreign Service in 1984, he served in increasingly senior positions in Beijing, Singapore, and Shanghai as well as in Mexico City. He was Mexico's ambassador to Indonesia and served as ambassador to China from 2001 to 2006.

Jeremy Martin is director of the Institute of the Americas' Energy Program and is a frequent commentator and writer on Latin American and energy issues. He has testified before the U.S. Congress on energy issues.

Mauricio Mesquita Moreira is principal economist and research coordinator of the Integration and Trade Sector of the Inter-American Development Bank. He is the author of many studies, books, and articles, including "Fear of China: Is There a Future for Manufacturing in Latin America?" in *World Development*, 2007.

Cynthia Sanborn is professor of social sciences and politics and the director of the Center of Investigation of the Universidad del Pacífico in Lima, Peru. She is the author of many studies on democracy, civil society and corporate social responsibility. Her latest book is *La Economía China y las Industrias Extractivas: Desafíos para el Perú*.

Sun Hongbo is a research fellow in the Department of International Relations of the Institute of Latin American Studies, Chinese Academy of Social Sciences (CASS). His work has focused on the Sino-Latin American relationship and energy cooperation. He is also a research member of the Energy Diplomacy Center of China's Foundation of International Studies. He is a co-author of the forthcoming book, *China's Energy Diplomacy and International Energy Cooperation*.

Philip Yang is a leading Brazilian entrepreneur active in China. He is the founder and executive member of the board of PetraEnergia, S.A. A former Brazilian career diplomat, he was trained in the Brazilian and Swiss schools of diplomacy and served in Geneva, Beijing, and Washington, where he focused on the relationships between foreign policy, trade, and technology.

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The Institute of the Americas, established 27 years ago on the University of California, San Diego, campus, promotes dialogue and cooperation in the Western Hemisphere to foster sound public policies, economic development and social justice. Led by Jeffrey Davidow, a former U.S. ambassador to Mexico and Venezuela and Assistant Secretary of State for the Western Hemisphere, the Institute brings together industry leaders, government officials and representatives of academia and civil society for frank and open discussions on subjects of importance to the region.

The Institute's board of directors is multinational in character and includes many international business leaders as well as former cabinet ministers and ambassadors from several Latin American countries. As an impartial and independent non-profit organization, the Institute hosts roundtables, conferences and professional training sessions at its campus in La Jolla, Ca., and in cities throughout Latin America. Its location 30 miles from the U.S.-Mexico border makes it the premier institution for cultural and business exchange on the West Coast as well as a strategic point of entry to Latin America.

Internationally known for its Energy Program, the Institute has played an important role in promoting energy policies in Latin America that serve the interests of the population while encouraging private investment in a critical area of economic growth for the region.

The Institute also organizes workshops for Latin American journalists and other professionals who travel to San Diego to study and debate issues as varied as poverty, immigration, freedom of expression, science and technology and public health.

The CEPAS program is the Institute's community-based initiative and provides an important space for San Diego-Tijuana dialogue. The CEPAS program promotes networking and helps strengthen appreciation in the border region for Latin American culture.

Recognizing the growing importance of China in world affairs, the Institute began a program in 2008 that aims to serve as a bridge for policy interchange among China, the United States and Latin America.

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