Short Term Policy Brief 31

China and Latin America

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**Executive Summary**

Over the past decade, the People’s Republic of China (PRC) has emerged as an important actor in Latin America, following its accession to the World Trade Organization (WTO) in 2001. The global financial crisis and the recovery in the region since 2009 has seen the role of China grow further.

The most significant aspect of China’s involvement in Latin America has been the growth of bilateral trade which reached around $200 billion\(^1\) (approx. EUR 150 billion) in 2010. China is now an important trade partner for all large Latin American countries and is currently the top export market for Brazil and Chile. There are also now signs of increased interest in the region as a destination for Chinese foreign direct investment (FDI) which rose sharply in 2010, while a number of major loans have also been made to the region. Closer political relations between China and Latin America have in the main reflected the growing economic links between China and the different countries of the region with the exception of those Central American countries, the Dominican Republic and Paraguay, which continue to have diplomatic relations with Taiwan.

China’s interest in Latin America is primarily driven by its growing demand for raw materials. This is reflected in the pattern of exports to China which are overwhelmingly made up of primary products and the sectors which have attracted Chinese FDI and loans (a general trend of Chinese overseas FDI globally). A second motive is to secure access to the Latin American market for Chinese exports of manufactured goods, which have grown rapidly since the mid-2000s. Politically, apart from its efforts to isolate Taiwan by getting countries to switch recognition to the PRC, China has maintained a relatively low profile in the region, following a pragmatic rather than an ideological course.

Closer economic ties with China have had differential impacts within Latin America. Exporters of a limited number of primary products in a few Latin American countries have benefited from growing Chinese demand and rising prices, while many manufacturers have faced increased competition from Chinese goods both at home and in their export markets. Attitudes towards China in different Latin American countries partly reflect the relative significance of these different interests. Chile and Peru have enjoyed substantial benefits from booming exports to China and both signed Free Trade Agreements with China in 2005 and 2009, respectively. At the other extreme, Mexico has suffered from competition from Chinese imports both in its domestic market and in the US in industries such as garments, electronics and televisions, while exporting relatively little to China. Brazil and Argentina have a more mixed situation with industrialists complaining about unfair competition from imported Chinese products, while exporters have gained substantially. Relations with Brazil are particularly important for China as its most important trading partner in the region.

China’s shares of both Latin American imports and exports are projected to overtake those of the EU by the middle of the decade. This does not mean that EU trade with the region will

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\(^1\) IMF direction of trade statistics
decline but could lead to increased competition. At present the EU’s major exports to Latin America do not compete with China’s, but there is considerable similarity in terms of the products which are imported. The most serious economic concern for the EU is therefore continued upward pressure on commodity prices and potentially greater difficulty in obtaining access to Latin American resources in the future. Politically, there is no reason to believe that China is having a negative impact in relation to EU interests in the region.

Main points

• Relations between China and Latin America have grown rapidly over the past decade.
• The most significant aspect of the relationship has been trade which reached over $200 billion (EUR 150 billion) in 2010.
• FDI and other financial flows from China have been more limited but have grown rapidly over the past couple of years.
• China’s interests in the region are primarily economic. The most important of these is to obtain raw materials; a second interest is market access for Chinese manufactures.
• China competes with Taiwan for diplomatic recognition in Central America and the Caribbean, although this has become less intense since 2008.
• Chinese demand for raw materials has benefited primary product exporters.
• Latin American industrialists have faced increased competition from China in both domestic and export markets.
• Although China has a Latin America strategy, the region does not deal with China collectively, but at the level of individual countries. As a consequence, different countries within Latin America have been affected differently by China’s expansion.
• Brazil is China’s most important partner in the region.
• Mexico has the most difficult relation with China among the larger Latin American countries.
• Chile and Peru have benefited from substantial exports of minerals to China and have signed Free Trade Agreements with China.
• China continues to maintain a relatively low profile politically in the region.
• China will overtake the EU in terms of its share of Latin American trade by the middle of the decade.
• The EU’s main exports to Latin America are not currently threatened by Chinese competition.
• The EU and China import similar products from the region and this may lead to rising prices and reduced access for the EU in future.
1. Introduction: The growing presence of China in Latin America

Before 1970, the only Latin American country with diplomatic relations with the People’s Republic of China (PRC) was Cuba. Although most South American countries and Mexico established relations with China during the 1970s and 1980s, economic links were relatively limited until the start of the Millennium. Since then, particularly after China’s accession to the World Trade Organization (WTO) at the end of 2001 and President Hu Jintao’s visit to Latin America in 2004, economic relations have grown rapidly, paralleled by an expansion of diplomatic contacts. This led to the Chinese government publishing its first Policy Paper on Latin America and the Caribbean in 2008.

The most striking evidence of the growing involvement of China in Latin America is the increased level of bilateral trade. Between 2000 and 2010, Latin American exports to China and Hong Kong grew more than fifteen-fold to US$77 billion (EUR 58 billion), while imports to the region grew from less than $10 billion (EUR 7.6 billion) to almost $125 billion (EUR 95 billion). China’s share of the total exports of 19 Latin American countries rose from 1.3% in 2000 to 9.1% in 2010, and was more than 15% in Cuba, Chile, Peru and Brazil. Over the same period, China’s share of total imports to these countries increased from 2.5% to 14.1%. China is the top export destination for Chile and Brazil and the second most important for Argentina, Peru and Colombia. It is the top import supplier in Chile and the second most important in all the other larger Latin American countries. Three countries have sought to consolidate their economic links with China through signing Free Trade Agreements. The first to do so was Chile in 2005, followed by Peru (2009) and Costa Rica (2010).

Chinese foreign direct investment (FDI) in Latin America lags a long way behind the growth of bilateral trade, but has grown rapidly over the past couple of years. There is no reliable comprehensive information on Chinese FDI in the region since investments are often made through holding companies located in tax havens or subsidiaries elsewhere, rather than directly from China. The UN Economic Commission for Latin America and the Caribbean (ECLAC) has estimated that China invested a total of over $15 billion (EUR 11 billion) in 2010 (making it the third most important investor in the region in that year) with a further $22 billion (EUR 17 billion) in the pipeline from 2011 onwards. Investment has gone mainly to Brazil, Argentina and Peru, all of which have strong trade links with China.

Loans, primarily from the China Development Bank (CDB) and the Export-Import Bank of China (China Ex-Im Bank), also grew rapidly at the end of the last decade. Again data is difficult to come by, but a recent Inter-American Dialogue Report estimated that total Chinese loans to the region increased from $6 billion (EUR 4.6 billion) in 2008 to $18 billion (EUR 14 billion) in 2009 and $37 billion (EUR 28 billion) in 2010, although indications suggest that they fell back to $13 billion (EUR 10 billion) in 2011. In 2010 China’s loans to the region exceeded the total lent by the World Bank and the Inter-American Development Bank. More than half of Chinese loans to the region between 2005 and 2011 went to Venezuela, with Brazil, Argentina and Ecuador accounting for the bulk of the remainder.

Political relations between China and Latin America have followed closer economic links. Since the start of the Millennium, China has signed “strategic partnership agreements” with

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2 US$1 = EUR 0.76
There have been a number of high level diplomatic exchanges with President Hu Jintao visiting Latin America on four occasions, while numerous Latin American presidents have visited China during the same period, some of them on more than one occasion. China is also becoming increasingly involved in multilateral fora in the region. After initial resistance, it was accepted as a member of the Inter-American Development Bank in 2008. It also has permanent observer status at the Organization of American States. China is a member of the East Asia-Latin American Cooperation Forum, established in 2001 and has also initiated a series of dialogues with regional organizations such as MERCOSUR and the Andean Community. Cultural exchanges with Latin America are also growing with 32 Confucius Institutes established since 2006 and growing people-to-people exchanges. There are 100 pairs of sister province and city relationships between Chinese and Latin American localities.

2. China’s Key Interests in the Region

China’s interests in Latin America are primarily economic and, with one notable exception (the issue of the diplomatic recognition of Taiwan), political relations with the countries of the region tend to reflect these economic interests. China’s burgeoning demand for raw materials has been the primary driver of trade between Latin America and China. Over 70% of the region’s exports to China are of primary products and over half of the remaining 30% are processed raw materials. As trade grew after 2000, the share of primary products in Latin American exports to China increased. The main products exported are copper ore and concentrates, soybeans and soy oil, iron ore, crude oil, refined copper and fishmeal.

The importance of securing raw materials is also reflected in the pattern of Chinese FDI in Latin America. The bulk of Chinese investment in the region is of the “resource seeking” variety focussing on oil and minerals. Unfortunately there is no detailed breakdown of Chinese FDI by sector in Latin America, but it is clear that oil, gas and mining have been a major focus for such investment. The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) estimates that 92% of confirmed Chinese investments in the region were in natural resource extraction, primarily oil and gas. Ten of the twelve major mergers and acquisitions by Chinese firms in South America between 2002 and 2008 were in raw materials, energy and power. Major Chinese companies with investments in Latin America include Sinopec, China National Petroleum Corporation and China National Overseas Oil Corporation in oil and gas and Minmetals, Chinalco and Wuhan Steel in minerals.

Securing access to natural resources has also been an important factor in other financial flows from China to Latin America. Two-thirds of the value of the loans made since 2008 involve deals under which Latin American countries supply oil and it is estimated that China will receive around 1.5 billion barrels of oil over the next ten years. Some of the most high profile examples include a loan of US$10 billion (EUR 7.6 billion) from the China Development Bank to Petrobras in Brazil and a series of loans to the Venezuelan state oil company PDVSA. Other loans have been for mining, including one for naval transportation of iron ore to China, and for infrastructure development.

A second key Chinese interest in Latin America is its value as a market for the country’s exports of manufactured goods. Although it does not represent as large a market as the United States
or the European Union, accounting for only about 5% of total Chinese exports, China is keen to diversify its exports and the region represents a growing market. Although imports from China fell during the economic crisis in 2009, they recovered strongly in 2010 and buoyant growth in the region since then makes it a particularly attractive market at a time when both the US and EU are facing economic difficulties.

An important objective of Chinese diplomacy in the region has been to improve market access for Chinese goods. One way in which it has tried to do this is by obtaining “market economy” status from Latin American governments. This was one of the key objectives of the visit of President Hu Jintao to Latin America in 2004 and Brazil, Argentina, Chile, Venezuela, Peru and several Caribbean countries agreed to grant China market economy status at the time, although the necessary legislation has never been approved in Brazil.

Although, as discussed earlier, Chinese FDI in Latin America has been largely focussed on extractive industries, there has also been some Chinese investment in manufacturing for example in textiles and electronics in Mexico and in consumer electronics and telecommunications in Brazil. Most of the Chinese FDI in manufacturing has been market seeking i.e. to supply the domestic market, while investments to create export platforms to sell in third markets have been minimal. Whereas investment in oil and mining is dominated by large state companies, FDI by manufacturing companies involves a wider range of firms in terms of ownership and size. Surveys of small and medium Chinese firms have found that FDI is often seen as a means of promoting exports, either of the firms themselves or of other Chinese firms.

Chinese loans to Latin America also help promote exports from China. Most are wholly or partly tied to purchases of Chinese products such as construction machinery, telecommunications or railway equipment. A $10 billion (EUR 2.6 billion) credit line to Argentina to purchase a train system, for example, will go directly to Chinese railway companies. In some cases, part of the loan has been denominated in Chinese yuan (e.g. half of the $20 billion (EUR 15 billion) loan to Venezuela in 2010 was made in yuan) thus ensuring that it is used for the purchase of Chinese goods.

It is often noted that half of the countries that continue to recognise Taiwan and do not have diplomatic relations with the PRC are in Latin America and the Caribbean. These include Paraguay, all of the Central American countries apart from Costa Rica, and the Dominican Republic. A third key strategic interest of the PRC in the region is to use its influence to try to isolate Taiwan diplomatically, although this has been emphasised less since Ma’s election in 2008. Both countries have used aid in order to get diplomatic recognition from the smaller countries of the region. Trade and FDI flows between China and those countries which recognise Taiwan tend to be less, as might be expected, than with those countries with which they have diplomatic relations. In this case it seems that political considerations affect economic relations rather than the other way around.

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3 Market economy status is a WTO designation which affects the ease with which countries can apply anti-dumping measures. By achieving this status, China hopes that it will not be subject to so many anti-dumping actions. The EU still regards China as a non-market economy.
3. China’s Relations with Particular Latin American Countries

The economic interests of China in Latin America impact groups within the region differently. Exporters of primary products have benefited from growing Chinese demand for raw materials and rising commodity prices. On the other hand, the region’s manufacturers have faced increased competition from Chinese goods, both in their domestic markets and for exports. As a result there have been complaints from industrialists about ‘unfair’ competition and pressure put on governments to restrict Chinese imports. These tensions play out differently in different countries, reflecting the extent of these impacts and the strength of the affected parties.

From China’s point of view its most significant relationship in the region is with Brazil. The two countries embarked on scientific and technological cooperation signing the China-Brazil Earth Resources Satellite agreement in 1988, even before China recognised Brazil as a strategic partner in 1993. As co-members of BRIC, they meet regularly at an international level and Brazil is China’s most important trading partner in the region and the most significant destination for Chinese FDI. Nevertheless, despite this friendly relationship, the growth of Chinese imports to Brazil has led to tensions, particularly with industrialists, and has resulted in a number of anti-dumping cases being brought against Chinese products.

At the other extreme, the most fraught relationship between China and a major Latin American country is with Mexico. This in part has an economic basis, since Mexico has a large trade deficit with China and, unlike Brazil and some other South American countries, has not been able to export to China on a significant scale. Mexico was the last WTO member to agree to China becoming a member in 2001 and kept very restrictive tariffs on some Chinese imports until December 2011. Other factors, including the Chinese government’s decision to confine some Mexican tourists to their hotel in China during the swine fever outbreak and the visit of the Dalai Lama to Mexico, have further ratcheted up tension over the past couple of years.

Although not to the same extent as in Mexico, there have also been some tensions between Argentina and China, mainly around trade issues. Argentina has imposed anti-dumping measures and protectionist tariffs on Chinese imports and, allegedly in response, in 2010 China banned imports of soy oil from Argentina on the grounds that it contained high levels of a solvent.

The other country which China has recognised as a strategic partner in the region is Venezuela. Although growing, trade links with Venezuela are not as significant as those with Brazil or Argentina. It is however the largest recipient of Venezuelan loans in the region, most of which involve deals for oil, as noted above. China has sought to avoid getting drawn in to the anti-US rhetoric of the Chavez government in Venezuela. Given that China’s key interests in Latin America are economic, it is not interested in provoking an unnecessary conflict with the USA, preferring a more pragmatic strategy in the region, rather than allying itself with the more radical left wing government currently in power.

Chile and Peru have both signed Free Trade Agreements with China and are key suppliers of primary commodities, particularly copper in various forms, and fishmeal from Peru. Both countries have enjoyed significant surpluses in their trade with China and public opinion towards China is favourable. Peru, relative to its overall size, has probably received more Chinese FDI than any other country in Latin America, particularly in the mining sector and these
have given rise to some conflicts with mineworkers. However, despite this, overall relations have remained good.

4. Challenges for the EU

As already seen, China’s share of Latin America’s trade has increased significantly over the past decade. Projections made by ECLAC in 2010 indicate that China’s share of both the region’s imports and exports will overtake that of the EU by the middle of the current decade. While this does not necessarily involve a decline in the absolute level of trade between the EU and Latin America, it may well indicate increased competition. This depends on the extent to which the EU and Chinese trade with Latin America involve similar products.

Although it is no longer the case that Chinese exports are comprised mainly of traditional labour-intensive products such as garments, footwear and toys, there is nevertheless a significant difference between the types of products exported to Latin America from China and Europe. The top ten products exported from China are in the main electronic and electrical products, whereas the top ten from the EU are pharmaceutical products, vehicles and parts and non-electrical machinery. Only one product, apparatus for electrical circuits, boards and panels is amongst the top ten Latin American imports from both China and the EU.

The main imports from the region to both Europe and China are primary products. Of the top ten products exported from Latin America, as many as seven are among the top ten in both markets. These include oil, copper in various forms, iron ore, feed stuffs, oil seeds and pulp, and waste paper. This suggests that, at present, the main concern for the EU as far as China’s growing involvement in Latin America is concerned comes in terms of competition for natural resources. This is of course not to rule out the possibility that in the not too distant future, the continued expansion of Chinese exports and the growth of technological capabilities in industries such as motor vehicles and machinery, will lead to intensified competition for the Latin American market.

Up to now the main impact of Chinese demand for raw materials has been to put upward pressure on prices, particularly of minerals. However, as seen above, Chinese firms are beginning to invest directly in exploration and production in Latin America and the Chinese authorities are providing financing in return for long-term supply contracts. Because the firms involved are almost all state-owned enterprises, there is a possibility that they will be required to give priority to supplying Chinese producers, making access for European buyers more difficult and more expensive.

There is no reason for the EU to fear the growing political influence of China in the region. While some governments may welcome the opportunity to diversify their trade and financial relationships that the growth of China provides, they are not about to replace existing links with either the EU or the US. Neither is China showing signs of wishing to challenge the US in its own “backyard”; indeed, it has been keen to avoid confrontation. As an important trading partner and a major investor in Latin America, the EU will continue to play a significant role in the region even while the China’s international links become more diversified.
5. Conclusion

The paper has highlighted that:

- China is becoming an increasingly important actor in Latin America, economically and politically.
- Its main interests in the region are economic—Latin America is primarily viewed as a source of raw materials and, to a lesser extent, a market for Chinese exports.
- China will overtake EU as a trade partner for the region by the middle of the decade.
- Although EU trade with Latin America will continue to grow, competition with China for raw materials is likely to intensify.

Recommendations:

- The EU should monitor Chinese investments and loans to Latin America, particularly where they involve natural resources.
- The EU should encourage transparency in FDI and loans to the region, particularly where they involve natural resources.
- The EU should continue to ensure that it is regarded as a strong bilateral partner both for individual countries and regional groupings in Latin America.