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The New Mercantilism: China's Emerging Role in the Americas

ERIC FARNSWORTH

My first visit to China was in 1986; my second was in 2010. The difference between the two visits was profound. Within one generation, it seemed as if everything except the Forbidden City and the Great Wall had changed. Cars had replaced bicycles, shining office towers had replaced ramshackle tenements, and consumerism had replaced the dreary economic hopelessness that many Chinese previously endured.

Which is not to say all is well there. Newly acquired wealth exists side by side with abject poverty. Stunning natural beauty contrasts with choking pollution. And overseeing the country's dramatic change is the Communist Party leadership, which remains jealous of its 60-year monopoly on political power and is unwilling to tolerate any challenge to its rule.

To maintain legitimacy and power, the government has made a strategic bet—that it can keep political control by allowing and even encouraging economic liberalization. Growth and job creation are the keys to making this strategy work, and have become a virtual obsession of Chinese leaders. According to the International Monetary Fund, China accounted for almost a fifth of world growth in 2010. Exports have been and continue to be critical to this success; China uses an undervalued currency as a tool to keep global demand for its exports high.

Production, however, requires inputs, and exports require raw materials. Thus, over the past 10 years, China has been on a global hunt for the raw materials that it needs to keep its production lines humming and its people employed, including the additional millions who join the work force every year. Coal, oil and gas, ores and minerals, soy and other agricultural goods: Chinese demand for these has caused a secular shift in global commodities markets.

China's leaders, moreover, are not content to leave their procurement efforts to the vagaries of global markets. Rather, they seek long-term, guaranteed access to raw materials, in some cases even looking to control the means of production and in-country infrastructure such as ports and rail. Raw materials are then turned into value-added products and re-exported from China around the world.

This is a transparently mercantilist strategy, with domestic political requirements at its core. It is a strategy designed, fundamentally, to keep the ruling party in power. It is not a strategy to project power or to contribute to the development of the impoverished abroad. Nor is it a strategy primarily to build political alliances, though political influence will naturally increase with enhanced trade linkages. (China has asked trading partners, for instance, to support the diplomatic isolation of Taiwan.)

It is a strategy, however, that is changing the world. In Latin America, in particular, the impact has been significant, with game-changing implications for economic growth, long-term development, governance, and US policy.

THE DRAGON ENTERS

Traditionally, China had virtually no footprint in Latin America or the Caribbean. It was a region that Chinese leaders considered the "backyard" of the United States and were reluctant to enter. Similarly, Latin American and Caribbean leaders gave almost no thought to China, the exceptions

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ERIC FARNSWORTH *is vice president of the Council of the Americas.*

being smaller nations that recognized Taiwan as a result of Taiwanese financial incentives, and extralegal groups like Peru's Shining Path that purposefully fashioned themselves after Maoist revolutionaries.

Latin American and Caribbean trade and investment generally flowed on a north-south axis, with European connections also playing an important role, particularly in economic relations with Brazil and South America's Southern Cone. Japan, too, played an important, though tertiary, trade role.

In recent years, however, China has entered the region forcefully. Between 2000 and 2009, China's imports from Latin America and the Caribbean ballooned from approximately $5 billion to $44 billion. Exports to the region have followed a similar trajectory, rising from $4.5 billion to $42 billion over the same time period. China is now Brazil and Chile's largest trade partner, and may soon be Peru's as well. The United Nations Economic Commission for Latin America and the Caribbean estimates that China will displace the European Union as the second-largest regional trading partner by 2015, and will trail only the United States.

China promises only a commercial relationship without political or policy interference.

The US share of regional trade, meanwhile, is declining. From 2002 to 2008, the US share of exports to the region fell from 48 to 37 percent, while China's grew from 4 to 10 percent. This trend is likely to continue, especially as China locks in trade arrangements for the long term. Bilateral free trade agreements are now in force between China and Chile, Costa Rica, and Peru. Additional agreements are just a matter of time.

China buys primarily raw materials from Latin America. In fact, commodities make up fully 80 percent of Chinese purchases—driven, again, by China's domestic development needs. As a result of China's dash for growth, cyclical commodities markets have stabilized and prices have remained at historic highs. Conversely, most of what China sends back to Latin America and the Caribbean is in the form of competitively priced manufactured goods, actually threatening the manufacturing base of countries like Mexico, the Central American states, and even Brazil.

This is the very definition of mercantilism. China buys raw materials from the region, engages in value-added production at home, and then re-exports the finished products to Latin America and the Caribbean, thereby undercutting the region's own efforts at value-added production.

At the same time, Latin America and the Caribbean have clearly benefited from selling to China over the past decade. Weak economic growth, averaging little more than 1 percent per year in the 1980s and 1990s, has given way to regional growth rates in the range of 4 to 6 percent. Brazil's growth alone has risen from an average of 1.7 percent annually in the 1998–2003 period to 4.2 percent since 2004. In 2010, Brazil's economy grew an estimated 7.5 percent; projections suggest a sustainable rate of 5.5 percent through 2014. Much of this is a result of trade with China. And the rest of the commodities-exporting nations in the region have experienced similar growth.

TAKING ADVANTAGE

Those countries without much in the way of commodities sales to China, including Mexico and nations in Central America and the Caribbean Basin, have not done as well. In addition to having only limited commodities to sell in the first place, these countries are truly dependent on the US economy as their primary export market for both goods and services, and also the primary economy from which remittances are sent.

Sluggish recovery in the United States will continue to limit Mexican, Central American, and Caribbean Basin growth rates for the foreseeable future, especially as manufactures from the region come under continuing pressure from Chinese imports.

On the other hand, for those nations, primarily in South America, that have been in a position to take advantage, exports of primary goods to China have been one of the key factors keeping their economies out of the depths of the recent recession and leading them to rapid recovery.

It has also had the effect, however, of shielding such countries from the need to reform their economies to promote broad-based development and to position themselves more competitively for the long run. When nations are able to sell as much as they can produce of any particular product, the thinking is generally to continue doing so and reap the rewards. When economies are growing, there is little political imperative or incentive for reform.

Yet Latin America continues to lack knowledge-based, value-added innovation and production. Education rates remain comparatively low. Workforce development and the liberalization of labor codes have lagged. Investment in research and development barely registers in most countries. And national development strategies are virtually nonexistent.

Of course, China has aggressively and successfully promoted its own value-added production, in part by insisting on technology transfer and other capacity-building measures whenever Western companies look to gain access to the Chinese marketplace. It is a strategy that has paid off handsomely for the Chinese, who are starting to compete head to head with others on highly sophisticated products.

There is no reason at all why Latin America should not replicate this model (abstaining, of course, from obviously negative aspects of Chinese practices, such as theft of intellectual property). Brazil is beginning to take this approach, insisting on in-country investments, technology transfer, and joint research and development platforms that help to develop local valued-added capabilities and expertise. Others should, too. For example, Bolivia, South America's poorest nation, should refuse to give Beijing access to its massive deposits of lithium unless the Chinese first agree to joint research and development of the technology needed to build the car batteries for which the lithium is intended. Rather than merely mining lithium, Bolivia might then aspire to become a developer of battery technology, reaping rewards from a potentially huge demand for clean energy transportation alternatives.

The ability to promote labor and environmental protections, human rights, and the rule of law is being commensurately reduced.

LET'S MAKE A DEAL

Expanding trade always attracts attention, but headlines are drawn by investment deals—including blockbuster announcements by Chinese officials detailing massive regional investments that they intend to make. The reality of China's investments in the region is, however, somewhat more complex than the headlines would indicate. The actual flow of money has been limited despite announced figures, as China takes steps to learn about and understand markets before actually committing funds. Even so, investments and acquisitions have begun to surge.

Oil and gas deals have been leading the charge, hitting over $13 billion in 2010, up from zero in 2009. China's oil giant Sinopec has been particularly active, announcing in December 2010 that it would acquire Occidental Petroleum Corporation's assets in Argentina for $2.45 billion. This followed hard on Sinopec's October announcement that it would buy 40 percent of the Spanish company Repsol's Brazilian assets for $7.1 billion, the biggest acquisition by a Chinese firm in Latin America to date. Additional significant announcements are on the horizon, as Sinopec, China National Offshore Oil Company, and others vie for assets.

Oil and gas are not the only sectors involved, of course. Mining, power generation, fishing, and agriculture deals have also recently occurred and will continue to occur given China's strategic play to lock in access to raw materials. Because they are commodities producers, Argentina, Brazil, Chile, and Peru have benefited handsomely, while Colombia is also on track to benefit and is currently negotiating a free trade agreement with China.

Infrastructure projects are next in line, given Latin America's significant under-investment in the infrastructure required to take advantage of its emerging role in the global economy. Roads, bridges, railways, ports, and information technology and telecommunications, for example, will all require huge investments in the near term to help make the region more competitive. As well, signature projects in Brazil, as that nation gets ready to host the World Cup in 2014 and the Olympic Summer Games in 2016, will soon come on line.

The Chinese government is supportive of overseas projects generally, and the Bank of China offers attractive finance. With such backing, Chinese companies have been known to make above-market offers on infrastructure projects and for assets such as oil and gas and mineral deposits that otherwise have attracted little attention, guaranteeing that China will be in position to bid successfully.

China has also done investment deals with Venezuela, Ecuador, Cuba, and Bolivia—leftist-run countries that one would predict, if ideology were an overriding factor in Chinese decisions, might attract the lion's share of investment. To date, however, China's commercial relations with Ecuador have been rocky. An April 2010 promise by Beijing to loan $20 billion to Venezuela in order to lock in access to that country's heavy oil remains pending. And Bolivia's takeover of its gas fields did not impress the Chinese, who are looking for long-term certainty in their investments.

In fact, Chinese companies have no problem dealing with populist or authoritarian leaders, but neither are they unduly attracted to doing business in countries ruled by them. With them, it is strictly business. If a decent, risk-adjusted return can be made, and access to a necessary resource guaranteed, the investment will likely be made. Otherwise, it will not. This is a matter not of charity or ideology, but of China's need to meet its domestic demands in the most efficient and effective manner possible.

It must be said that total Chinese foreign direct investment (FDI) in Latin America and the Caribbean is dwarfed by the stock of US investment in the region, and will be for some time. But Chinese investment is increasing rapidly. In 2009, for example, some 17 percent of total Chinese FDI went to Latin America. And Chinese investment is just at the beginning of the curve as the nation pursues its strategy of locking in access to raw materials.

China appears to be less interested in majority control of enterprises than in taking significant minority stakes, which allow Chinese investors to learn the ins and outs of a heretofore unknown marketplace while guaranteeing long-term access to raw materials. Chinese portfolio investment, on the other hand, has only just begun, but it will play an increasingly important role in the region as Chinese investors, like their Western counterparts, seek higher returns in emerging markets in an era of slow growth elsewhere.

RETURNS ON INVESTMENT

As investment increases, the quality of FDI is important to consider. Not all investment is the same. For example, US investors and corporations operating abroad generally follow anti-corruption provisions codified in the Foreign Corrupt Practices Act. They abide by corporate governance and reporting requirements. They comply with US and local labor laws and human resources requirements. They transfer technology and management expertise to local markets. They provide access to the global marketplace for local production. They source locally. They pay taxes, even when tax laws, as in Brazil, are complex and impenetrable.

US businesses often pursue corporate social responsibility activities, including humanitarian relief, thereby contributing to local economies and social development. They hire from the local economy, using a limited number of expatriates to manage operations while building businesses from local hires. And they abide by US government foreign policies—for example, when countries like Myanmar (formerly Burma), Cuba, or Iran are sanctioned.

Of course, not every company is perfect, and nongovernmental organizations have aggressively highlighted instances in which they believe corporate malfeasance has occurred. To the extent it has, wrongdoers should be held accountable. But in the main, US investors are required by their boards to follow these general guidelines as a matter of course.

Chinese companies, on the other hand, are less likely to abide by these guidelines, though their record is not as lengthy or detailed as that for US investors. One issue that almost universally galls observers of Beijing's investment in the region is China's lack of interest in hiring local workers. Labor forces for construction and operations are routinely brought from China to Latin America and the Caribbean. Many if not most of the jobs that could go to locals are reserved for Chinese nationals.

It is a difficult case to make, as a result, that one of Chinese investment's primary benefits to the region has been job creation. Disgruntlement over this trend can be expected to rise as investment increases, unless active steps are taken to reverse course.

More broadly, the political implications of different investment models are important. The United States and other like-minded nations have traditionally used economic and financial incentives to encourage reforms in Latin America and the Caribbean. Tools have included bilateral and regional trade agreements, market access agreements, defense and security relations, equipment sales and transfer, training and capacity building, and foreign assistance. Areas of interest to US policy makers run the gamut from democracy to human rights, from labor rights to the environment, from investor protections to intellectual property provisions.

The US trade agreement with Colombia, for example, was signed in 2006 but remains pending, given Washington's expressed concerns over labor rights and protections in Colombia. A trade agreement with Peru was held up pending the resolution of environmental concerns. The North American Free Trade Agreement required side agreements on both labor and environmental issues before Congress approved it. A unilateral Andean trade preferences program requires that recipient nations cooperate fully on counternarcotics and also maintain appropriate investment climates. And so on.

China, on the other hand, promises a commercial relationship without political or policy interference in the nations in question. Chinese investors are not hung up on whether a host nation's government is capitalist or populist, authoritarian or democratic, corrupt or not. They certainly do not care if the government is pro–United States or anti–United States.

The Chinese do not care if their investments prop up local bad guys or undercut collective international efforts to enforce norms of behavior. Their emphasis is on doing business effectively and undisturbed. For domestic purposes, they have pursued a strategy of business for business's sake in Latin America and the Caribbean, as they have around the world; they are not attempting to *change* the world.

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CONQUISTADORS

And yet, the world is changing, because by acting in this manner, Beijing offers to the countries of Latin America and the Caribbean the opportunity to forge a path independent of the United States and liberal economic orthodoxy. This is attractive to them, particularly when the US economy is struggling, and to the extent that US leaders at times have been overbearing and self-interested in their actions toward the region. Regional elites have often chafed at what they consider to be the United States' patronizing tendency to use trade and investment to leverage sensitive domestic political changes.

At the same time, the ability of the United States and other Western nations to promote labor and environmental protections, human rights, and the rule of law in Latin America and the Caribbean is being commensurately reduced by the increase in Chinese economic activity. The region is beginning to have other options, a trend cheered by those who most disdain the perceived historic role that the United States has played in the region, and by those who mistakenly view trade itself as an exploitative mechanism that primarily benefits the United States. (This view is particularly pronounced within the human rights and development communities, without the recognition that trade and investment are among the most potent tools that the United States has for promoting the agendas that they themselves hold dear.)

This is ironic. For years, Latin American and Caribbean elites and observers have railed against the United States for its alleged exploitation of Latin America's natural resources, claiming that the North Americans came to conquer, despoil the landscape, impoverish the region, and make off with the riches of the continent.

An entire literature has arisen around these themes, the most famous example of which, perhaps, is Uruguayan journalist Eduardo Galeano's *Open Veins of Latin America: Five Centuries of the Pillage of a Continent*. Though it was written in 1971, the book remains popular with a new generation of leaders, including Venezuelan President Hugo Chávez, who mischievously presented a copy to President Barack Obama at the Summit of the Americas in Trinidad and Tobago in April 2009.

Even Hollywood has gotten into the act. Filmmaker Oliver Stone's 2010 documentary "South of the Border" purports to show that the United States, global capitalism, and the corporate media have caused the ills of the Western Hemisphere. The primary explanation for a lack of development and opportunity in Latin America is the predatory and exploitative behavior of the developed world, with the private sector at the vanguard, supported by the raw military, financial, and political muscle of a hegemonic United States.

This line of thinking is a tired and tiresome approach to analyzing the Americas, and has been widely and repeatedly debunked. At the same time, one often hears across Latin America—including from populist, anti-US leaders—that building relations with China and welcoming Chinese trade and investment are national priorities.

For countries such as Brazil, Chile, and Peru, links with China are intended to help build economies. For the new administration of President Juan Manuel Santos in Colombia, China links provide a means to develop a healthier, less dependent relationship with the United States. For others, they are seen as a means of diversifying relations away from traditional trade and investment patterns and the political connections that develop alongside them, while providing new economic options that will allow greater flexibility in governing.

Venezuela's Chávez is the best example of this latter category, particularly regarding the president's desire to diversify the markets for his country's heavy crude away from the United States. Accomplishing this will require massive investments in infrastructure, including specially built refineries, along the Venezuela-to-China supply chain. Economically, this makes zero sense. Politically, it makes a great deal of sense to Chávez. And if it guarantees the Chinese access to Venezuelan crude over the long term, it is win-win, even though the arrangement may take years to materialize fully.

HARD THINKING

At a time when Latin American economies are growing, and when many countries are gaining a new sense of confidence and of a direction apart from the United States, the region is running headlong into an economic embrace of China. This is not to suggest that China will supplant the United States in investment any time soon, or that Chinese economic linkages will lead to political meddling or adventurism from Beijing.

In fact, neither the pronouncements nor the behavior of the Chinese to this point supports the contentions of conservative US commentators that Beijing entertains strategic political or military designs on the Western Hemisphere. There is no evidence that China aspires to take over the Panama Canal or otherwise project power into the region. The United States will remain the strongest nation in the Western Hemisphere, albeit less able over time to determine the outcome of regional events.

Still, as economic links with China proliferate, it must be asked whether China is good for the Americas beyond the short-term economic gain it provides, no matter how beneficial this has been and will continue to be for the foreseeable future. One wonders why regional leaders and observers, so quick to condemn the United States for its alleged pillaging of the continent, have not seen fit to raise their voices to question the Chinese approach—an approach that is straightforwardly mercantilist and is lacking in any of the benevolent or pro-development impulses that can be found in US engagement with the region, including the promotion of international norms and Western values.

China's involvement in the region is not illegitimate, illegal, or even necessarily threatening, despite being economically unbalanced. But people in the region do need to think hard about the best means to ensure that Chinese engagement benefits the region over the long term, and not just in the short run.

Correspondingly, the United States needs to meet its own obligations in the hemisphere—from passing pending trade agreements to engaging with the people of the region in a manner that is conducive to cooperation and mutual respect. Perhaps then the silly idea so frequently heard in policy circles and around the region—that Chinese economic engagement is unquestionably positive for the Americas, while US economic engagement is exploitative and should be resisted—can be put to rest. The outcome of this debate will, in any event, help determine Latin America and the Caribbean's political direction, as well as its development prospects, for many years to come. ■