LATIN AMERICA: China trade poses rising pitfalls

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Abstract

Chinese impact on Latin America's economic development.

Growth in Latin America and the Caribbean (LAC) over the past decade has been fuelled by Chinese demand for raw materials. However, as the region's growth now slows, some of the drawbacks of its trade relations with China have become more apparent -- not only in terms of increased vulnerability to commodity prices but also of competition from Chinese imports both at home and abroad.

Full text

SUBJECT:Chinese impact on Latin America's economic development.

SIGNIFICANCE:Growth in Latin America and the Caribbean (LAC) over the past decade has been fuelled by Chinese demand for raw materials. However, as the region's growth now slows, some of the drawbacks of its trade relations with China have become more apparent -- not only in terms of increased vulnerability to commodity prices but also of competition from Chinese imports both at home and abroad.

ANALYSIS: Impacts.

LAC is now more affected by a percentage-point change in growth in China than in the United States.

Lower commodity prices are unlikely to alter LAC-China trade patterns radically but will increase pressure for diversification.

Chinese companies, backed by loans from state banks, could significantly help to narrow LAC's infrastructure deficit.

Between 2000 and 2012, LAC's trade in goods with China increased 21-fold to some 250 billion dollars (see LATIN AMERICA/CHINA: Economic initiatives on the rise - July 9, 2012), according to the UN Economic Commission for Latin America and the Caribbean (ECLAC). In 2011, China replaced the EU as LAC's second-largest source of imports after the United States and, in 2012, accounted for 9.0% of its exports, up from 1.1% in 2000.

Fair trade?.

As well as boosting the international prices of LAC's commodities and the volume of its exports, trade with China has also had a positive impact through cheap imports that have increased the access of poorer segments of the population to products such as clothing and technology while also helping to contain inflation. However, it has some drawbacks (see INTERNATIONAL: Latin America wary of China dependence - May 17, 2012):

Export concentration .

Only a small number of LAC companies export to China and the range of products is very limited. According to ECLAC, Peru exported just 266 products to China in 2012 as compared to 1,796 to the United States and 1,602 to the EU -- and five products accounted for 89% of sales (a figure that reached 98% in Colombia).

This is attributed not only to heavy Chinese demand for raw materials but also to Chinese import tariffs on other products as well as LAC companies' difficulties in supplying the quantities required by Chinese importers.

In 2006, Chile became the first LAC country to have a free trade agreement (FTA) with China -- and was subsequently followed by Peru and Costa Rica -- but, in 2013, the mining sector still accounted for exports to China of 16.2 billion dollars out of a total of 19.1 billion dollars.

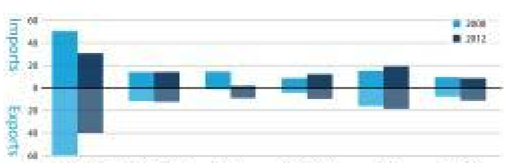
Impact on local manufacturing .

Competition from Chinese imports, combined with real exchange-rate appreciation due to strong commodity prices, has adversely affected local manufacturing industries in both their home and export markets -- a trend which ECLAC identifies as posing a risk of the region's de-industrialisation (see BRAZIL: Trade performance faces policy challenges - September 15, 2011.

In a bid to guard against this threat, some countries have erected -- or strengthened -- trade barriers. Brazil, for example, increased its tax on cars with less than 65% local content by 30 percentage points in 2012.

Trade balance .

Since 2000, Mexico and Central America have seen a rapid expansion of their trade deficit with China and, while South America has a small surplus, this could readily become a deficit depending on commodity prices.



LAC export markets and sources of imports (% of total)
Source: ECLAC

Chinese FDI in LAC .

Chinese investment abroad has been growing strongly since 2008, a trend that became apparent in LAC in 2010.

ECLAC estimates that, in 1990-2009, Chinese foreign direct investment (FDI) in LAC totalled only 6.0 billion dollars but, in 2010, jumped to an annual 13.7 billion dollars, led by two large oil acquisitions by China Petrochemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC) in Brazil and Argentina, respectively (see LATIN AMERICA:

China dependency will grow - August 1, 2014).

However, since then, Chinese investment has weakened again to just under 10.0 billion dollars per year in 2011-13 -- out of a total FDI in LAC of 184.9 billion dollars in 2013 -- and has remained heavily concentrated in the hydrocarbons and mining sectors.

This is attributed to factors that include the following:

Adaptation difficulties.Compared to the United States and European countries, China is a latecomer to LAC, with which it has not only a very different business environment but also few historical ties. Chinese investors have, as a result, experienced difficulties in areas such as obtaining permits and community relations. As new arrivals, they have also faced some suspicion, particularly with regard to the purchase of land.

Labour laws.Particularly on infrastructure projects, Chinese companies generally prefer to bring in their own full team. However, in many LAC countries, they face restrictions on employment of foreign workers and, when they have used local labour, have reported difficulties in areas such as working hours. Their preference for using their own labour has also fuelled criticism that projects contribute little to the region in terms of technology transfer and training.

Chinese lending.

FDI figures do not include all the activities of Chinese companies in LAC.

Their entry route is often through a loan by a Chinese state bank to a government institution for a particular infrastructure project on the condition that the work is carried out by a Chinese company. Examples include the construction of power plants by Sinohydro in Ecuador and Venezuela. For reporting purposes, these projects count as trade in goods and services -- not FDI.

Only incomplete information about Chinese lending to LAC is available but, according to the China-Latin America Finance Database compiled by the Inter-American Dialogue (a Washington-based think-tank) and Boston University, China has lent over 100 billion dollars to LAC since 2005, principally through the China Development Bank (CDB).

As in the case of Venezuela -- which accounted for around half of the total -- these loans are often against future oil sales. Further significant lending was promised by President Xi Jinping at a meeting with leaders of the 33-member Community of Latin American and Caribbean States (CELAC) in Brazil in July.

LAC investment in China.

The number of LAC companies investing abroad -- the so-called 'multilatinas' - remains small (see LATIN AMERICA: Record FDI is balance-of-payments risk - May 16, 2013) and they have generally preferred neighbouring countries. As a result, few have ventured into China -- with exceptions that include Brazil's Embraer aircraft manufacturer and Marcopolo bus body manufacturer.

However, a change in this trend is regarded as crucial for LAC companies' insertion into Asian supply and value chains as well as in order to take advantage of opportunities in areas that include the foods being demanded by China's growing middle class and demand for services such as earthquake-resistant construction and mine safety in which LAC has valuable experience.

CONCLUSION: With the prospect of a sustained period of lower commodity prices, negotiation will be required if LAC is successfully to harness economic relations with China to its sustainable growth and development. It would probably be more effective if negotiating as a region and this is apparently what China would prefer. However, cooperation will be difficult across a region with very diverse interests as regards China and very different economic and foreign policies.

Details

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