Boston University
Global Development Policy Center
Frederick S. Pardee School of Global Studies
53 Bay State Road, First Floor
Boston, Massachusetts 02215
bu.edu/gdp | 617-353-7766 | @GDPC_BU

Testimony before the U.S.-China Economic and Security Review Commission
China in Latin America and the Caribbean

Dr. Rebecca Ray[1]
Senior Academic Researcher, Boston University Global Development Policy Center
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Thank you for the opportunity to testify before the commission on the topic of China's role in Latin America and the Caribbean (LAC), and appropriate US responses. Together with an interdisciplinary team of colleagues at Boston University and academic institutions across Latin America, I have spent most of the last decade studying Latin America's "China boom" and the lessons it holds for economic development, sustainability, and governance. I hope my contributions will help the Commission plot a path forward for smart, pragmatic, and constructive engagement.

Introduction

LAC demand for Chinese investment, finance, and trade is here to stay. China is now the top trading partner for South America and the second for Latin America as a whole. Regional governments across the ideological spectrum have readily embraced the opportunity to do business with *both* China and the US, rather than just one or the other. In fact, doing business with *both* external actors has been crucial to Latin American economies. For example, this diversification of economic relationships was instrumental in buoying the region during the US financial crisis of 2008-2009, and it will be crucial in rebuilding the region after the crisis year of 2020. Furthermore, Chinese firms are not directly threatening US business interests in the region, because they tend to specialize in different commodities than US firms. Thus, any attempts to sideline China in the region will not help US businesses but will hurt LAC economically, which has come to depend on a diverse array of external partners.

That said, opportunities for US constructive engagement abound. The China-LAC relationship has brought new challenges on both economic and governance fronts, which the US can help address:

- Economically, the heavy importance of commodities has brought renewed **economic vulnerability** to swings in global commodity prices and slowed the region's progress toward its industrialization goals.
- Environmentally and socially, this concentration in commodities as well as infrastructure has brought governance challenges to the region. In particular, these sectors are endemically linked to **environmental degradation** and **social conflict** in the LAC region.

[1] I would like to thank Kevin P. Gallagher, Amanda Pareja Villegas, and Jake Werner for helpful comments. All errors remain my own.

- Furthermore, China's stance of deferring environmental and social **governance** of international investment projects has enabled high-risk projects to move forward with little oversight and has created pressure on regional regulatory authorities to relax their standards to expedite new potential investment.

In these areas, the US has an opportunity to lead by example, help strengthen the region, and bolster our international economic and diplomatic relations. Specifically, US action is needed in 3 fronts:

- **Increasing finance and investment support for infrastructure** development, to better meet the region's ongoing demand for connectivity and support the region's long-term industrialization goals
- **Stronger collaboration with China in regional fora** such as the Inter-American Development Bank to encourage China to channel its capital and technology through regionally governed bodies with high-level environmental and social standards.
- **Boosting international cooperation in institutional capacity building** with Latin American regulatory agencies to reduce demand for high-risk investments and improve oversight of both commodity and infrastructure development

The Rise of China as a Supplement to LAC-US Economic Relations

Since the turn of this century, China has skyrocketed in importance as an economic partner for Latin American and Caribbean economies. For the last decade, it has been the top export market for South America, and the second export market behind the US for the LAC region as a whole. As Figure 1 shows, China now buys over 10% of LAC goods, including over 20% of the region's agricultural goods and over one fourth of the region's mineral goods. In terms of investment, in the last decade, China has been the second largest source of new foreign direct investment projects (known as greenfield FDI), behind the US, and the third largest source of FDI through mergers and acquisitions (known as M&As), behind the US and Canada.[2]

This new partnership has brought much needed revenue to the region. It also brings geographic diversification of the region's partnerships, which can help LAC weather global economic boom and bust cycles. For example, LAC survived the US' 2008-2009 economic downturn relatively unscathed, with GDP falling by only two percent over the course of 2009. Such resilience in the face of a US recession is unusual in LAC history and was largely due to being able to continue working with China on trade, investment, and finance.[3] Overall, doing business with partners in multiple global regions – particularly when those partners' economic cycles do not line up with each other – can bolster developing economies against downturns in one or another partners' economies.

For this reason, LAC governments across the ideological spectrum have treated China and the United States as supplemental partnerships, rather than exclusive substitutes for one another.

[2] Ray, Albright, and Wang (2021).
[3] Bárcena et al (2015).

Two examples show this trend starkly: Ecuador's left-wing president Rafael Correa and Brazil's right-wing President Jair Bolsonaro. After it partially defaulted on its government bonds in 2008, Ecuador was effectively excluded from western sovereign bond markets until 2014. In the interim, the country covered its financing needs largely through credit from China.[4] But as Figure 2 shows, once it returned to the bond markets in 2014, those bond markets accounted for most of the new debt taken on through the end of Correa's tenure in mid-2017, at which point the portfolio had reached a greater balance among multilateral, bilateral, and other forms of credit (including bonds). Given the possibility, he opted to pursue a pragmatic approach of using both western and Chinese finance.

Jair Bolsonaro staked out a more skeptical approach to China during his presidential campaign, complaining that "China is not buying from Brazil, but buying Brazil [itself]" and making a visit to Taiwan.[5] However, during his tenure, Brazilian trade with China has continued to boom. Despite President Bolsonaro's rhetoric, his policy and tone toward China became more pragmatic, including sending his Minister of Agriculture, Livestock and Supply, Teresa Cristina, to China just a few months after Bolsonaro took office. This balanced approach, recognizing the importance of continuing to do business with both the US and China, has paid off in a continued trade and investment boom.[6]

Challenges Brought by the LAC-China Relationship

Notwithstanding the crucial economic gains that came with this new relationship, the "China boom" has also brought significant challenges to the region because of its heavy concentration in raw commodities and infrastructure. These challenges fall into three broad categories: economic fragility from a shift back to raw materials, environmental damage from booms in sectors that are closely tied to pollution and natural resource misuse, and social conflicts related to the economic and environmental problems.

Economic challenges

Economically, the heavy concentration of Chinese trade and investment interests in the region has brought a retreat from the LAC region's long-term goals of industrialization. This trend is due to several factors, as documented thoroughly by scholars.[7] Briefly, these factors are: China's skyrocketing demand for raw commodities from LAC, LAC imports of Chinese manufactured goods, and LAC manufacturers' inability to compete with their Chinese peers in export markets such as the US.

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[4] Gallagher, Irwin, and Koleski (2012).
[5] Frenkel, 2018; Saraiva and Costa Silva (2019).
[6] Stuenkel (2019).
[7] Including Bittencourt et al (2012); Gallagher and Porzecanski (2010); Jenkins (2015): Jenkins and Dussel (2009); and Koleski and Blivas (2018), among many others.

China's demand for LAC raw materials has created a regional commodities boom, both in terms of the quantity demanded and in terms of world agricultural and minerals prices. As Figure 3 shows, China's demand for LAC commodities stands in stark contrast with what LAC exports to the rest of the world. The vast majority – over 90% – of goods exported from LAC to China in the last five years are in raw or processed commodities, with essentially no technological inputs. In comparison, about half – 51% – of what LAC exports to the rest of the world are manufactured goods, the vast majority of which involve medium or high levels of technology. So LAC's "China boom" is not simply due to the arrival of a new export market but new demand that sharply diverged from LAC's more-balanced export basket to the rest of the world.

Secondly, the rise of China as the "factory of the world" has meant an import boom of Chinese goods, not only in LAC but worldwide, hurting local manufacturers. China's rapid labor productivity growth in the manufacturing sector during the first decade of this century (shown in Figure 4) was more than three times that of LAC overall. It outpaced that of traditional regional manufacturing centers such as Argentina, Brazil, and Mexico by even more. As it did elsewhere in the world, local manufacturing gave way to imports from China. Third, LAC lost market share in other export markets like the US for their manufactured goods. Economic threat analysis shows that most LAC manufactured goods faced substantial threats from Chinese competition in third markets.[8]

Why have LAC manufacturers struggled to compete, further complicating the region's path toward industrialization? In part, the answer lies in the trade and investment agreements that LAC countries have signed with the US. In the 1990s, the region shifted away from enacting further regional integration to build LAC value chains and toward further integration with the United States, through NAFTA, DR-CAFTA, bilateral investment treaties with the US, and the negotiations for the Free Trade Area of the Americas [9] Scholars broadly agree that this shift – and the requirements of the agreements themselves – limited policy space for LAC governments to enact local contact requirements, industrial policy and other industrialization strategies.[10] As a result, the region's fledging progress toward industrialization stalled, leaving it more vulnerable to new competition from China.

Another important part of the answer lies in infrastructure. Regional infrastructure needs have long outpaced the supply of infrastructure finance and investment from western and multilateral sources, creating a stubborn obstacle to industrialization. Facing this severe connectivity deficit, LAC countries have struggled to form the regional supply chains that were crucial to the industrialization of East Asian economies.[11] In fact, LAC is among the least well-connected regions in the world: in 2019, LAC's intra-regional trade was less than 15% of total exports, above only Oceania.[12]

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[8] Gallagher and Porzecanski (2010).
[9] Bértola and Ocampo (2012); Malamud and Gardini (2012).
[10] See for example Frederick and Gereffi (2011); Kuwayama (2009); Moreno-Bird, Santamaría, Rivas Valdivia, and (2005).
[11] See for example Amsden (2001); Wade (1990).
[12] UNCTAD (2020).

Making matters worse, aging and incomplete infrastructure networks raise the cost of exporting goods to external partners like the US. Research by multilateral development banks (MDBs), including the Inter-American Development Bank (IDB) and the World Bank, finds that these logistics costs have significantly eroded LAC competitiveness on international markets.[13] IDB researchers estimate that a regional "infrastructure gap" of approximately 2.5 percent of regional GDP, or $150 billion per year.[14] World Bank researchers, analyzing the effectiveness of regional infrastructure services, find that transportation needs are particularly underserved.[15] In contrast, annual reports from multilateral development banks active in LAC (World Bank, International Finance Corporation, CAF - the Development Bank of Latin America, IDB and its private-sector investment arm IDB Invest) show total approvals in all sectors combined of just $50 billion in 2020.

As regional demand has so dramatically outpaced western investors and lenders' appetite to support new infrastructure projects, the region has turned to China. As Figure 5 shows, Chinese foreign direct investment (FDI) in LAC has been heavily concentrated in infrastructure, much more so than other countries' investment in the region. Over 60% of new (greenfield) Chinese FDI projects in LAC over the last decade have been in the infrastructure sector, as have roughly half of Chinese mergers and acquisitions (M&As) in the same time period.

This infrastructure-driven Chinese investment and finance boom in LAC has brought an additional economic challenge for the region: market concentration. Regardless of the source, any concentrated influx from one country or just a handful of firms may ultimately give outsized market power to a handful of actors. Concerns have recently arisen regarding China's market share in a few sectors of LAC investment and finance, in particular the electricity market in Peru and sovereign debt markets in a few South American countries. However, on a regional level, these concerns do not appear to be borne out by the evidence.

In Peru, concerns have arisen over the last few years as the China Three Gorges Corporation (CTG) expanded its holdings in the nation's electricity market. However, the oversight steps taken by regulatory authorities give early indications that the government has sufficient institutional capacity to appropriately regulate foreign investors and hold them accountable. In 2016, CTG signed a contract with government investment promoter ProInversión to develop the 206MW San Gabán III hydropower plant. Three years later, in 2019, the collapse of Brazilian infrastructure firm Odebrecht led to the sale of its 456MW Chaglla hydropower plant in Peru, which CTG purchased. Finally, US-based Sempra Energy sold off its South American holdings, including selling a majority stake in one of Peru's largest electricity distributors, Luz del Sur, to CTG for over $4 billion. Given CTG's participation in both energy generation and distribution, concerns arose over the possibility of self-dealing and price-fixing, and the sale was initially put on hold. The Ministry of Energy and Mines recommended that the sale be permitted, on the

[13] See for example Mesquita Moreira, Volpe, and Blyde (2008); Gonzalez, Guasch, and Serebrisky (2007).
[14] Cavallo and Powell (2019).
[15] Fay et al (2017).

condition that the newly acquired Luz del Sur be required to purchase power through a transparent bidding process to avoid collusion, and the sale was completed in 2020.[16] This chapter gives hopeful signs for the capacity of Peruvian energy regulators to oversee a significant investment influx. However, as described below, environmental and social risks have not always been met as effectively, in Peru or elsewhere in the region.

More broadly, the regional growth of Chinese state finance – mostly through China's two policy banks that operate abroad, the China Development Bank (CDB) and the Export-Import Bank of China (ExImBank) – have raised concern of a "debt trap" or otherwise outsized market power by a few lenders. However, the evidence has not borne out these concerns on a regional level. The idea of Chinese "debt trap diplomacy" arose after the 2017 Sri Lankan sale of its failing Hambantota port to a Chinese firm to pay off other debts.[17] Although the details of this particular example did not constitute a traditional "debt trap" (in which a creditor lends with the expectation that the borrower will default, allowing the creditor to seize the underlying asset), the case raised concerns among observers that perhaps debt traps would come to characterize Chinese lending more generally. However, recent research has created a broad consensus that no such pattern has emerged.[18]

Figure 6 explores Chinese state finance to LAC governments since the last regional economic peak in 2008, in conjunction with the region's overall public debt burdens. It shows total loan commitments from CDB and ExImBank to each country, as well as each country's total outstanding public and publicly guaranteed (PPG) debt as a share of GDP in 2019. Among all of the countries represented in Figure 6, only Venezuela stands out as having extremely high debt exposure to China and an overall high debt burden. If China were operating under a "debt trap" framework, the crisis year of 2020 would have been an opportune moment to seize the assets underlying China's financing in Venezuela, including oil and mining interests. Instead, China has reacted to Venezuela's inability to repay these loans with what economist Stephen Kaplan labels "patient capital."[19] Successive rounds of renegotiations have given Venezuela breathing room rather than giving China oil wells. A similar pattern has emerged in Ecuador, which Figure 6 shows is the second-highest recipient of Chinese finance in the region (although to a much lesser extent than China). Last year Ecuador successfully suspended nearly $900 million in debt repayments to China.[20]

Environmental challenges

The rise of China as an economic partner for LAC has brought a boom in commodities and infrastructure development. While infrastructure development is sorely needed in the region and at least some commodity development will continue to be necessary, these sectors are

[16] Ray and Batista Barbosa (2020).
[17] For more on the "debt trap" framework, its origins, and use, see Brautigam (2020).
[18] See for example Kaplan and Penfold (2019); Kratz, Feng, and Wright (2019); Ray, Albright, and Wang (2021)
[19] Kaplan (2018).
[20] Ray, Albright, and Wang (2021).

historically associated with environmental and social risk, and the "China boom" has been no different. While Chinese investors have shown themselves willing to meet high standards where they are enforced, regional governments have faced internal pressure to relax those standards in order to facilitate as much of this new investment as possible. Thus, the environmental damage from the China-based commodity boom reflects regional institutional weaknesses.[21]

In the LAC region – and particularly in Amazon basin countries – the economic sectors most heavily associated with driving climate change are those that cause deforestation: agriculture and minerals production. As mentioned above, the rise in those sectors has been driven primarily by Chinese demand. Figure 7 explores this more closely in the Amazonian case. Two sectors are most closely associated with Amazonian deforestation: beef and soy. As Figure 7 shows, all of the increase in global demand for these two products from Amazon basin countries in the last decade has been due to Chinese demand. This trend grew even more accentuated during the US-China trade dispute of the last few years, as Chinese tariffs on US agricultural goods made South American substitutes more attractive for the Chinese market (Ray, Albright, and Wang, 2021). Across the entire LAC region, this trend holds. During the early-2000s commodity boom, LAC exports to China were associated with 16% more net greenhouse gas emissions (including the effect of deforestation), per dollar, than regional exports to the rest of the world.[22]

Local environmental damage can also have significant impacts on affected communities' daily lives. Heavy water use and contamination, for example, is an endemic problem with large-scale agriculture, mining, and oil and gas wells in LAC. In this regard, the impact of China's demand for commodities is even more stark: during the early-2000s commodity boom, LAC goods going to China were associated with 280% more water used or contaminated, per dollar, than other regional exports.[23] These environmental, and social challenges are also seen in the impacts of Chinese investment activity. My research with colleagues at Boston University and at academic institutions from across Latin America shows that Chinese investment is often associated with significant environmental degradation and social conflict.[24]

Notably, we do not find evidence that Chinese investors have performed worse on average than their Western peers. In fact, where Latin American regulatory authorities are willing to set and enforce high-level social and environmental business standards, we find that Chinese investors are willing to comply, sometimes more so than their western peers. This willingness to meet exacting national requirements stems from the heavy presence of Chinese state-owned enterprises, who do not need to meet quarterly profit targets (and thus do not face as many incentives to cut corners) but do have an incentive to support bilateral governmental relations.

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[21] Ray et al (2017).
[22] Ray, 2017.
[23] *Ibid*.
[24] Ray et al (2017).

Unfortunately, national governments have not always been willing or able to set and enforce appropriate regulatory frameworks during this commodity boom. Although the region has some of the world's most ambitious environmental laws and protections, our research shows that regulators faced intense pressure to set aside or weaken these frameworks during the commodity boom, in order to facilitate as much new investment as possible. These pressures intensified as commodity prices cooled and governments faced incentives to replace falling minerals royalties with new investments.[25] This tendency to abandon high standards is particularly unfortunate given that those high standards did not represent obstacles to Chinese investment, as mentioned above. In other words, institutional weakness led to unnecessary and harmful erosion of environmental governance.

Similar trends emerge in Chinese infrastructure finance in LAC. Recent research on infrastructure finance in the Andes and Amazon basin, comparing Chinese finance to multilateral and western development finance institutions (DFIs), finds that institutional weaknesses block the effectiveness of the region's environmental governance frameworks, and that the Chinese finance boom has exacerbated this problem.[26] Over the last decade, Chinese infrastructure finance has grown not only in number but also in geographic scope, shifting into more sensitive territories including high-biodiversity areas in the Amazon basin and indigenous territories. Chinese DFIs are open to this type of support because they do not enforce their own environmental and social standards. Instead, they rely on borrowing nations' "country systems" of regulations and enforcement mechanisms.

In some cases, my co-authors and I have found evidence that Latin American presidents have sought financing from China for infrastructure projects that were too environmentally or socially risky to secure financing from multilateral or western bilateral sources. For example, Ecuador's Coca-Codo Sinclair dam received financing from China ExImBank after the Inter-American Development Bank declined to support it. Bolivia's controversial Rositas dam project has a similar history, as do several highway projects in the Bolivian Amazon. Thus, where Latin American governments lack adequate protections or institutional capacity to enforce them, Chinese finance has enabled the pursuit of projects that would not be permissible otherwise.

The "China boom" has presented a test of LAC's ambitious environmental governance framework. Chinese investors have shown themselves willing to meet high standards, but China does not offer any additional support or oversight of Chinese overseas finance or investment projects. LAC governments may impose their own standards, but must bear sole responsibility for maintaining and implementing them. Unfortunately, the region's institutions have not always been up to the task.

[25] Ballón et al (2017).
[26] Ray et al (2020).

Social challenges

The economic and environmental challenges discussed above create tension between regional governments' stated goals and the outcomes that they are able to deliver. Political scientist Carol Wise describes the existence of an "institutional resource curse" in the LAC region's history, which combines an active, developmentalist state with "grabber-friendly" stances toward particularly powerful investors, creating high hopes that are often not met.[27] The "China boom" has exacerbated this longstanding situation, as governments have eagerly sought new investment and finance but less actively regulated it.

The conflicts that have emerged in the wake of the China boom have often been triggered by weak economic and environmental governance. They may take the form of labor disputes (for example, the use of Chinese workers or a lack of understanding of traditional Latin American labor practices), competition over natural resources (for example, water or air pollution from oil wells or mines), or the domestic pushes to roll back governance standards in general in order to expedite as much investment as possible from this new partner.[28]

Labor relations have had a central place as a driver in Latin American economic policy, in commodity production as well as manufacturing contexts.[29] Whether in the factories of Mexico and Brazil, the mines of Chile and Peru, or the oil wells of Ecuador and Venezuela, labor unions have become politically powerful actors and labor customs have become important cultural traditions. Chinese labor relations are entirely different, potentially causing significant transition challenges for Chinese investors. In this context, well-developed and well-resourced institutions are crucial for host country governments to adequately communicate and enforce local labor law.

Unfortunately, as with environmental governance, our research has found a pattern of LAC institutions that have an inability or hesitancy to intervene in this regard. Case study evidence from Peruvian copper mining, Mexican manufacturing, and Ecuadorean infrastructure construction show repeated examples of labor and sectoral ministries struggling to meet the challenge of anticipating and mitigating labor conflicts in this context.[30] Whether the conflict stems from investors' resistance to negotiating with workers' unions (in the case of the Shaugang mine in Peru), their expectations that local workers would be amenable to work schedules typical in Chinese factories (in the case of the Golden Dragon copper tubing factory in Mexico), or delinquency in maintaining safe working conditions (in the case of the Coca-Codo Sinclair dam in Ecuador), it is clear that these conditions call for institutional strengthening among LAC labor ministries.

[27] Wise (2020).
[28] Ray et al (2017); Ballón et al (2017).
[29] See for example Bergquist (1986); Bértola and Ocampo (2012); Murillo and Schrank (2005).
[30] Ray et al (2017).

Compounding these weaknesses, additional case study evidence from Latin American scholars documenting the Ecuadorean Coca-Codo Sinclair dam, as well as from the Cherry automotive group in Uruguay and China State Grid Corporation in Brazil show a tendency for Chinese investors to decline to use locally-produced inputs, disrupting existing local supply chains and creating opportunity costs for local businesses.[31] Stronger management and planning from sectoral and economy ministries can help address these concerns before new investments arrive, rather than having to mitigate conflicts as they arise.

Another important source of social conflict surrounding Chinese investment in LAC has been environmental damage, and local governments' unwillingness to uphold the ambitious protections written into their laws and regulations. Frequent triggers of these conflicts have been water use and contamination by mineral and agricultural investors, which directly harms local livelihoods (especially in farming and fishing) as well as local public health.

These conflicts are not new to the China boom. Indeed, they have characterized large-scale agriculture and mineral investment in the region for decades. However, in the early years of the China-driven commodity boom, Latin American governments enacted highly ambitious environmental protections, which promised stakeholders a greater voice in new project planning and greater accountability for environmental damage. For example, Ecuador's 2008 constitution is noteworthy as the first in the world to give rights to nature itself, effectively allowing any person or group to represent nature in court by bringing legal action against polluters. Governments around the region have signed onto International Labour Organisation Convention 169, committing to give indigenous communities meaningful say over activities that affect their traditional lands and water. The China boom provided the first major test of these new regulatory frameworks.

Across Latin America, examples have emerged of national institutions unable or unwilling to enforce these new frameworks, and in some cases, relaxing them in the hopes of attracting greater Chinese investment.[32] China's reliance on "country systems" of national regulations, rather than employing its own standards on overseas Chinese investment and finance projects, means that local institutional weakness can become widespread environmental harm, triggering significant social conflict.

This pattern has become so widespread that it became part of China's 2008 Universal Period Review (UPR) at the United Nations Human Rights Council (UNHRC). As part of that process, a group of 20 Latin American civil society organizations – from Argentina, Bolivia, Brazil, Ecuador, and Peru – submitted a report alleging a pattern of environmental harm by Chinese investors that constituted human rights abuses.[33] Conclusions from this report were incorporated into 346 UNHRC recommendations for in China.[34] Notably, China accepted 284 of these

[31] Dussel Peters (2014).
[32] Ballón et al (2017); Ray et al (2017).
[33] FIDH (2018).
[34] UNHCR (2018).

recommendations, but the extent to which they are implemented will depend on institutional capacity and political will on the part of both China and LAC national governments.[35]

A pragmatic, constructive, and smart role for the US

LAC's development challenges have always been significant, but this year they are especially so. According to IMF estimates, LAC suffered a greater economic downturn than any other world region in 2012: a loss of 7% of GDP.[36] Given the monumental challenge of rebuilding the region's economy after the crisis year of 2020, it is unrealistic to expect LAC governments to turn away from the possibility of Chinese investment and finance. However, by inviting China and regional governments into closer collaboration, the US can pursue a policy path that is *pragmatic, constructive, and smart*.

A pragmatic US foreign policy will recognize the power of multilateral bodies to benefit LAC countries as well as US interests. *Closer engagement with China through regional bodies* can channel Chinese capital and technology through governance institutions that have deep histories of developing and employing strict environmental and social standards. Any efforts to sideline China from regional bodies are likely to backfire as long as the regional demand for infrastructure and investment continues. On the contrary, IDB has a history of overseeing special funds designated for particular uses and supported by particular member countries, such as the 2012 establishment of the IDB-China ExImBank Equity Investment Platform, and the 2013 establishment of the China Co-Financing Fund for Latin America and the Caribbean, funded by the IDB and the People's Bank of China and overseen by the IDB.[37] These funds use Chinese as well as IDB funds to support LAC projects that are open to construction bids by firms from any member country, including the US. Thus, the US can support its own firms abroad and support regional efforts for high-quality infrastructure development by initiating a stronger – not weaker – collaboration with China at the IDB.

A constructive US foreign policy will recognize the importance of two long-term regional deficits in Latin America: institutional capacity and policy space to pursue industrialization. First, evidence from LAC's China boom shows a need to invest in *institutional capacity building* for managing the China boom and dampening pressure for weakening standards or seeking financing for high-risk projects from China or any other external source. US agencies have a history of collaborating with their international peers through training and resource sharing. For example, the Environmental Protection Agency participates in the regional Latin American Network for Environmental Enforcement and Compliance, which hosts workshops with regulatory agencies across the region. The Department of Labor's Bureau of International Labor Affairs is active in institutional capacity building collaboration with its peers throughout the region, including through targeted grantmaking. A significant increase in funding and outreach for this type of activity can help draw a line under existing environmental and social governance

[35] Koop and Soutar (2019).
[36] IMF (2021).
[37] IDB (2012, 2013).

standards in LAC, manage the new influx of Chinese investment and finance, and discourage the pursuit of particularly high-risk finance projects.

A second area of constructive foreign policy in the region is to revisit the long-term barriers to industrialization that are built into US trade and investment agreements with the region. Just as bipartisan cooperation in the US Congress produced revisions to NAFTA that strengthened labor and environmental protections, other regional trading agreements can be re-examined to give more policy space to Latin American countries to enact the industrial policies necessary to develop regional value chains.

Finally, a smart US foreign policy will recognize that Latin American demand for investment in general, and infrastructure investment in particular, is far greater than what western partners have been interested in or capable of fulfilling. The resulting regional infrastructure gap has left the region unable to fully industrialize and eager for new infrastructure investment projects, even those that may not meet the environmental and social standards of MDBs. It is thanks to this local demand that Chinese finance and investment has powered a new wave of infrastructure in the region. The US can engage in this environment by *supporting calls for a capital increase at the Inter-American Development Bank*[38] as well as a *renewed commitment for infrastructure support t*hrough the U.S. Development Finance Corporation. The US has an opportunity to *lead by example* in opening a path for a new generation of sustainable and inclusive infrastructure development that stands in contrast to the environmental damage and social conflict seen during the recent China boom. *A smart foreign policy will not let that opportunity go unused.*

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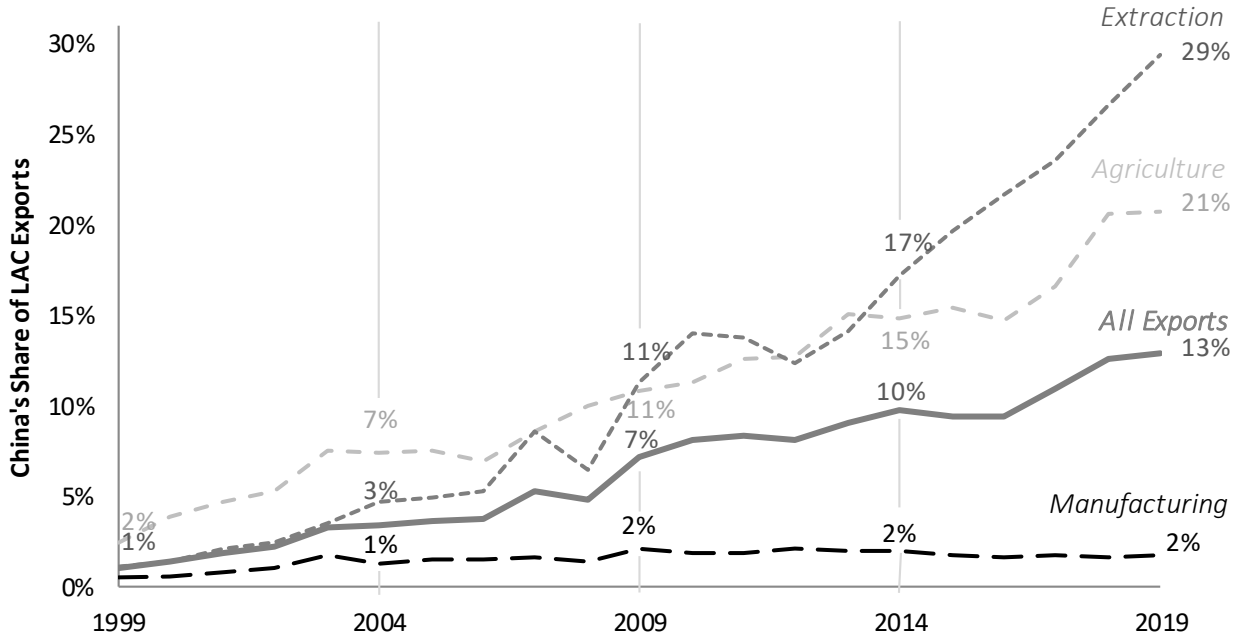
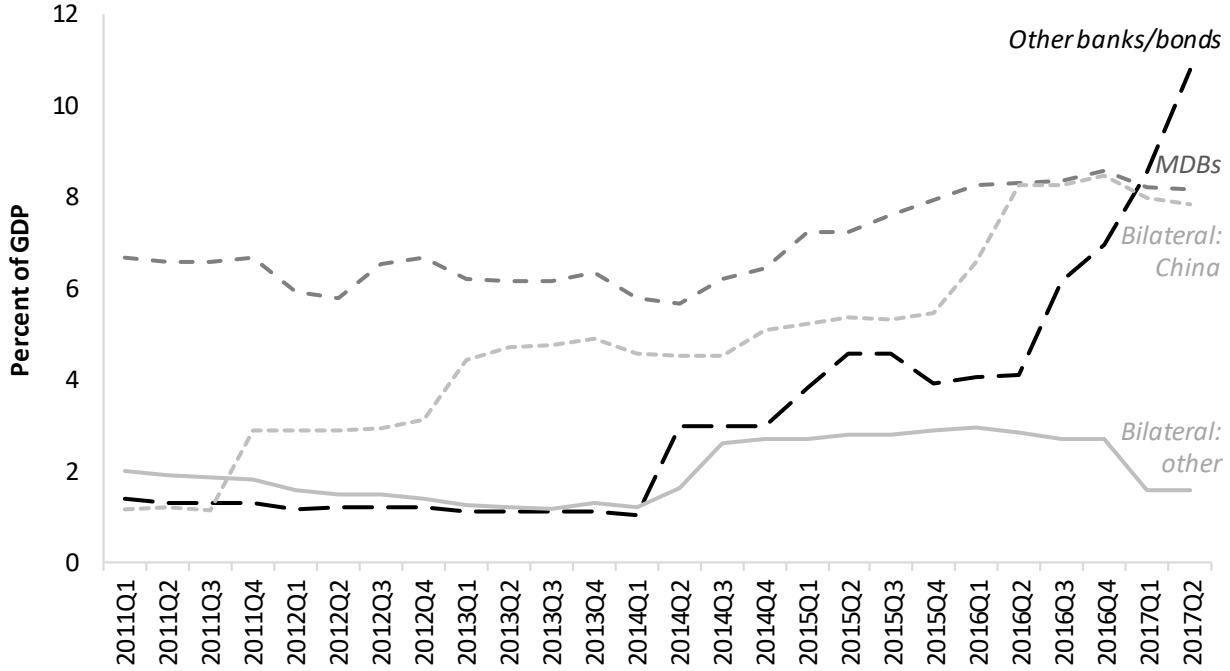
FIGURES

Figure 1. China's share of LAC exports of goods, by sector



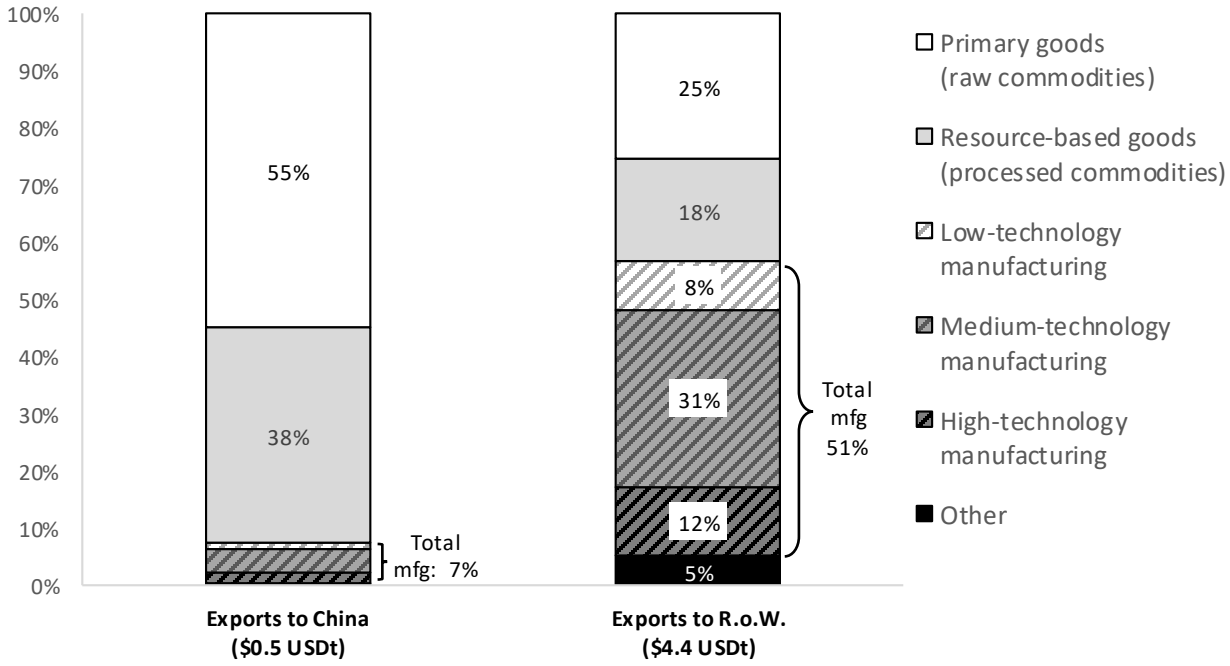
Source: Author calculations from UN Comtrade (2020).

Figure 2. Ecuador's external public debt by source, 2011-2017



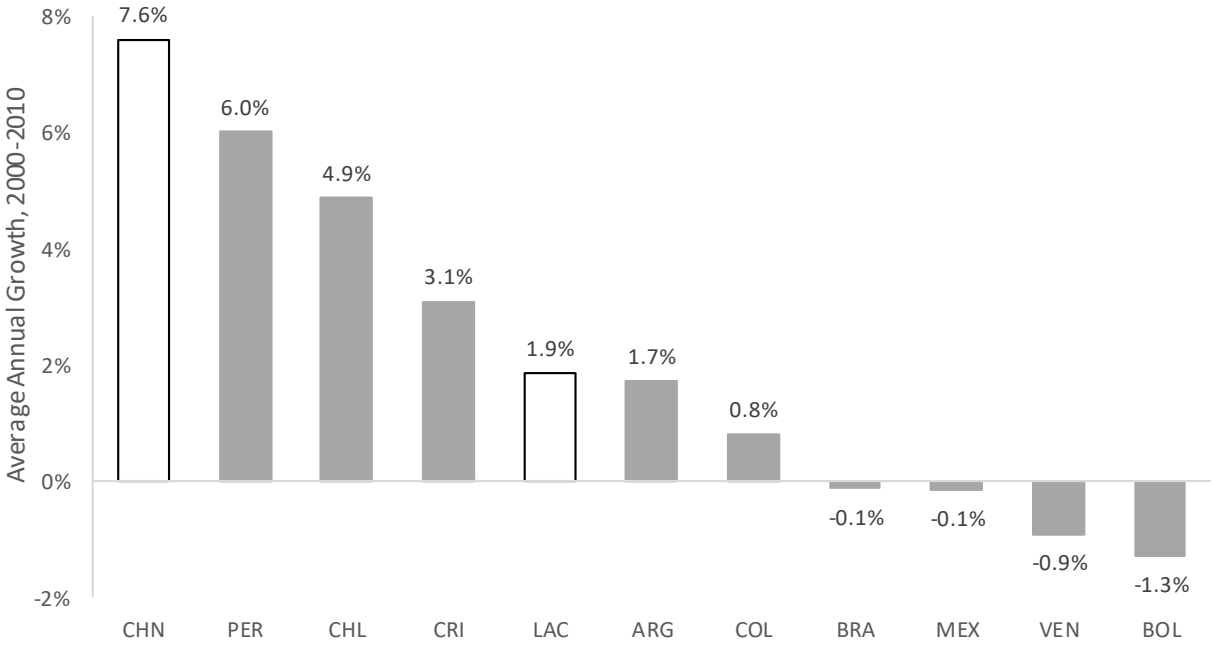
Source: Author calculations from Ministerio de Economía y Finanzas (2020).

Figure 3. LAC exports by technology level and export market, 2015-2019



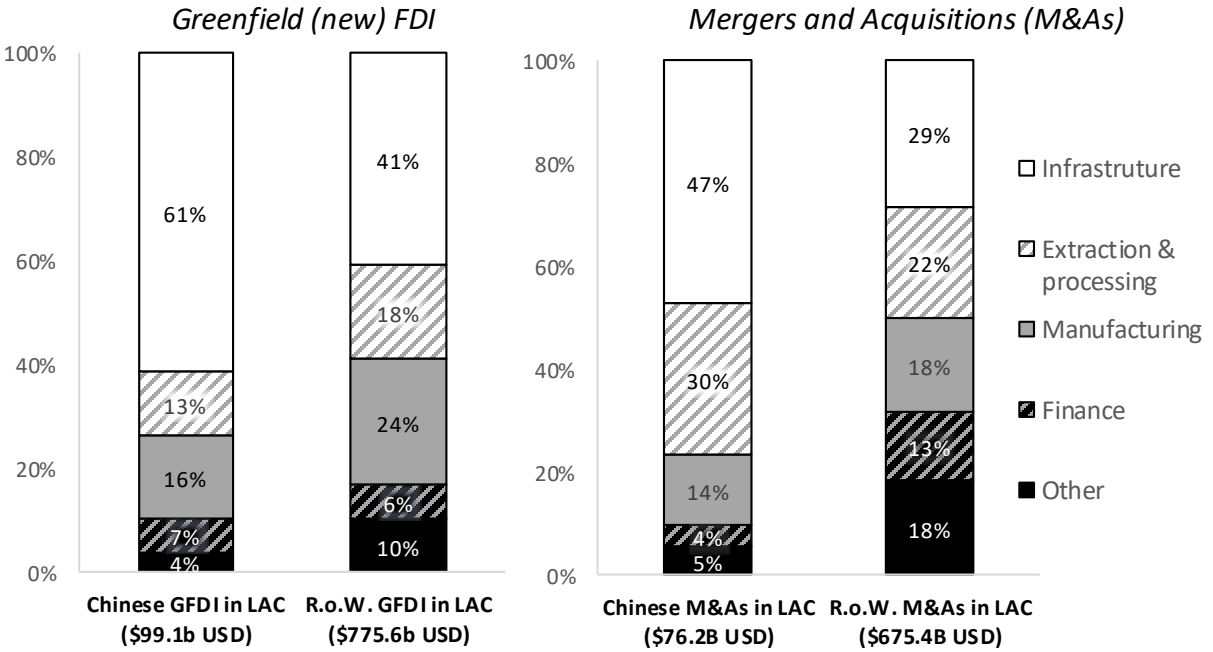
Source: Author calculation based on UN Comtrade (2021). Technology classifications taken from Lall (2000).

Figure 4: Real Manufacturing Value Added Growth per Manufacturing Employee, 2000-2010



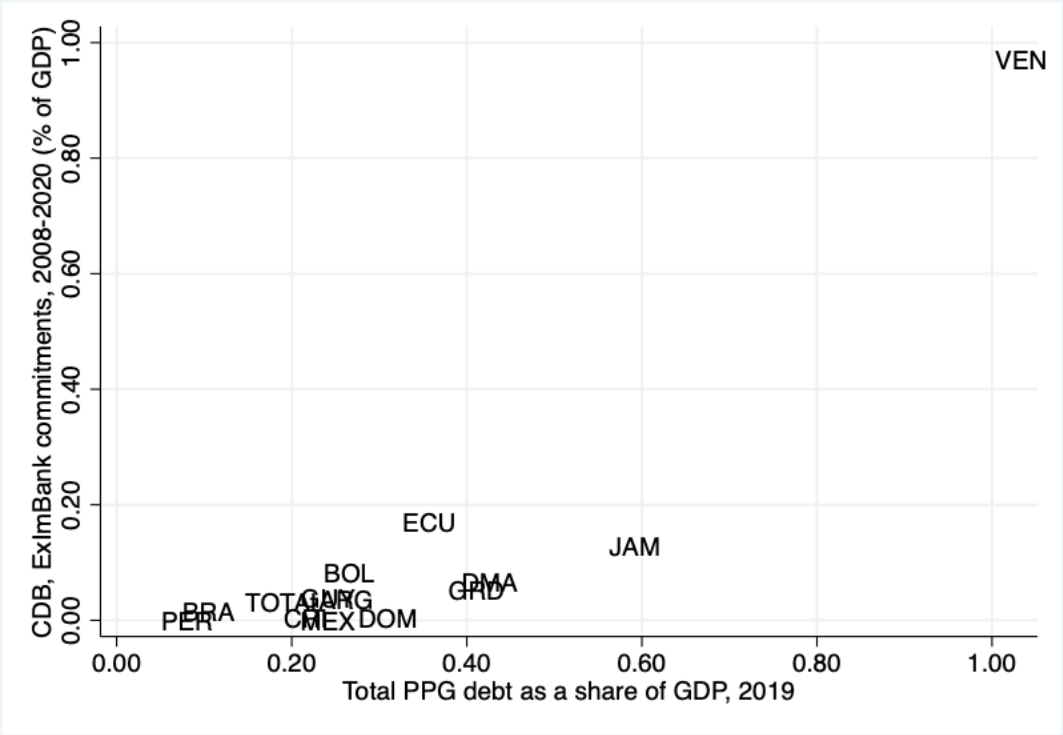
Source: Author calculation based on Timmer, de Vries, and de Vries (2015). Note: LAC figure is calculated as the weighted average of the nine LAC countries included.

Figure 5: FDI in LAC by type and sector, 2011-2020



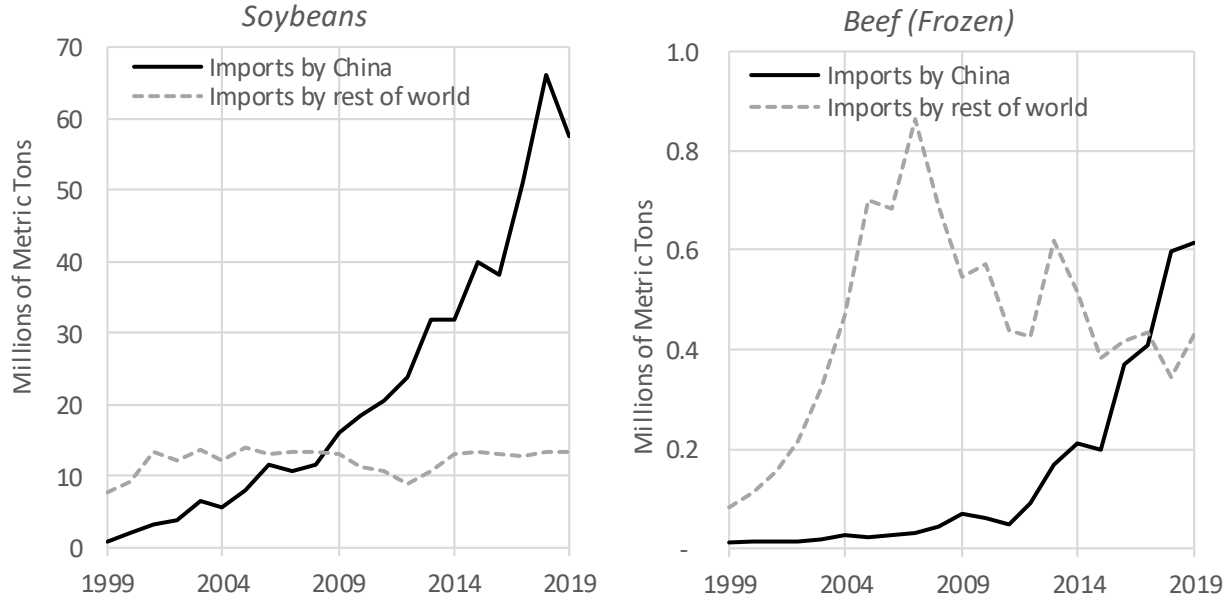
Source: Author calculation from FDIMarkets and DealLogic data.

Figure 6. Total PPG debt exposure and total Chinese policy bank finance commitments since 2008, as a share of GDP



Source: Ray, Albright, and Wang (2021).

Figure 7. World demand for deforestation-linked commodities from Amazon-basin countries



Source: Author calculation from UN Comtrade database (HS commodities 1201 and 0202). Note: These figures show trade data from the import side rather than the export side to compensate for incomplete regional export data. However, they exclude (negligible) imports by Egypt, which demonstrate irregularities.