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China's Rising Economic Presence in Latin America

Before the U.S.-China Economic and Security Review Commission
China's Growing Global Influence: Objectives and Strategies

China's Economic Performance

China has experienced almost 8 percent average annual GDP growth rate in the past two decades. China's trade volume totaled US$1,154 billion in 2004, reflecting an 18 percent of annual trade growth rate (Figure 1). Now, China's trade volume accounts for more than 6 percent of world trade. In particular, China's accession to the World Trade organization (WTO) in 2001 has caused external trade to surge. In 2004 China overtook Japan, becoming the world's third largest trading country, behind only the United States and Germany. China's emergence in the world market has significant implications for the global economy as well as for all Latin American economies. (This paper is based to a large extent on the paper by the same title, written by T. Funakushi with Claudio M. Loser, issued earlier this month by the Inter-American Dialogue).

China's Increasing Influence in Latin America

Latin American economic relations with China traditionally had not been strong. China and Latin America do not have significant political interests in common, except for Taiwan. Some Latin American countries still recognize Taiwan. Due to the potential long-term advantages of developing economic relations with China, Dominica and Grenada switched their allegiances in 2004. China seeks to expand its influence by persuading Central America, Panama, Paraguay, and some Caribbean countries to break diplomatic relations with Taiwan. Recently, however, Latin America has been at the center of attention of China. Latin American countries offer large markets for China's manufacturing export products. Moreover, China's market is very attractive to Latin America. The rising demand from China, especially for agricultural products, raw materials and energy, partly accounts for recent Latin American economic growth.

Trade between China and Latin America has increased dramatically, especially since 2000 (Figure 2). Trade volume grew from US$200 million in 1975, to $2.8 billion in 1988, and to some $40 billion by 2004, rising by 54 percent compared to the previous year. China's exports reached $18 billion and imports nearly $22 billion.

In Latin America, Brazil, Mexico, Chile, Argentina and Panama are China's top five trading partners. Brazil totaled US$8 billion in 2003, followed by Mexico at $5 billion, Chile at $3.5 billion, Argentina at $3.2 billion, and Panama at $1.5 billion. The Andean Community countries as a whole amounted to $2.6 billion in 2003.

China's share in Latin American exports expanded from 0.7 percent in 1990 to 2.9 percent in 2003, and its share in Latin American imports grew from 0.5 percent to 4.8 percent during the same period. Table 1 shows China's growing presence as a trading partner in major Latin American countries.

In 2003, the United States accounted for 48 percent of Latin American total trade, followed by intra-regional Latin American trade at 16 percent and European Union (EU) trade at 13.8 percent (Figure 3). Although China has gained greater influence in Latin America over the last decade, China constituted only 3.9 percent of Latin American total trade. The share of exports to Latin America in China's total exports increased from 1.6 percent to 2.6 percent, and the share of imports from Latin America in China's total imports grew from 2.4 percent to 3.6 percent (Table 2).

China's Trade Relations with Latin America

While most of Latin America's economies are far better managed today than they have been in the past, the region as a whole has fallen behind the rest of the world. Over the past 50 years, economic growth in Latin America has lagged that of most other developing regions. More specifically, in 1994, China's economy was one-third the size of Latin America's; today, they are about the same size. China is exporting more, saving more, investing more in education, and securing far more foreign investment. It has to be noted, however, that China suffers from many inefficiencies, including high levels of corruption, complex regulation, poor accounting standards, ineffective bankruptcy procedures, heavy government intervention, and an unsound banking system, areas where Latin America has made considerable progress over the last 15 years. (This has been described in "A Break in the Clouds: Latin America and the Caribbean in 2005", Inter-American Dialogue Policy Report, July 2005).

The accelerated growth of China (and India) is having a mixed impact on Latin America's economies. For Southern Cone countries such as Brazil, Chile, and Argentina—as well as other resource-rich nations such as Venezuela—the rapidly expanding Chinese market for foodstuffs and minerals has produced sharply increased export revenues. These countries are also looking to China as a potential source of new investment. Other countries, such as the Central American republics and Mexico, view China largely as a competitor, a low-cost producer of manufactured goods, which is cutting into their markets. With this year's expiration of worldwide textile quotas, China has emerged as an even stronger commercial rival. The longer term challenge for Latin America, however, is China's rapid technological advance, given the comparative quality of Chinese schooling, the country's commitment to build its science and engineering capacity, and its access to international capital.

On the export side, China's recent export surge has been largely attributed to the manufacturing sector that accounts for more than 90 percent of China's total exports. Some of the fastest growing sectors include toys, textiles and apparel, and electronic machinery. China poses the greatest threat to countries that rely heavily on labor-intensive manufacturing as their export advantage, particularly in Central America and Mexico. In recent years, the manufacturing sectors of such countries have suffered the effect of Chinese competition, especially in the U.S. market (Figure 5). The year 2003 also marked the first year in the post-NAFTA era in which Mexico lost market share in the U.S. import market. More than 250,000 Mexicans in the *maquila* sectors lost their jobs during 2001-2003. Some 300 *maquiladoras* moved from Mexico to China.

The direct competition in the textile and clothing sectors between China (and other emerging countries like India) and Latin America in world markets has intensified since the Multi-Fiber Agreement (MFA) quotas on textile and apparel were phased out in January 2005.

In 2003, China and Latin America (Mexico 10 percent and other 16 percent) each accounted for one-quarter of the U.S. clothing market. In the post MFA era, China and India share may double and that of Latin America may fall by two-thirds.

Most Latin American countries are losing their shares in the U.S. textile and clothing markets. The proximity to the United States and lower transportation costs should be an important source of comparative advantage, especially for Mexico and Central America. However, this hardly compensates for the advantage of Chinese costs both in labor and fabrics. Labor costs in China are about one third of those in Mexico. Given these conditions, textile and clothing exporters in Mexico, Central America and Caribbean countries are unable to compete against Chinese and other Asian manufacturers in spite of preferential agreements.

On the import side, there has been a rapid growth in imports of raw materials and mineral fuels. China, though a major crude oil producer, became a net importer in 1996. In addition, China's imports of agricultural products have been increasing. Although China is a large producer of agricultural products in the world, it became a net importer of agricultural products in 2003. China is importing more energy and raw materials from Chile, Andean countries and Brazil; and is also importing more agricultural products mainly from Brazil, Argentina, Chile and Uruguay. Argentina and Brazil now stand as China's second and third largest agricultural product suppliers respectively. Hence, these countries are likely to benefit from China's economic growth. In particular, China's imports of soybeans from Brazil and Argentina, iron ore from Brazil, and copper from Chile and Peru are significant, and are helping their exports to boom.

Chinese Investment in Latin America

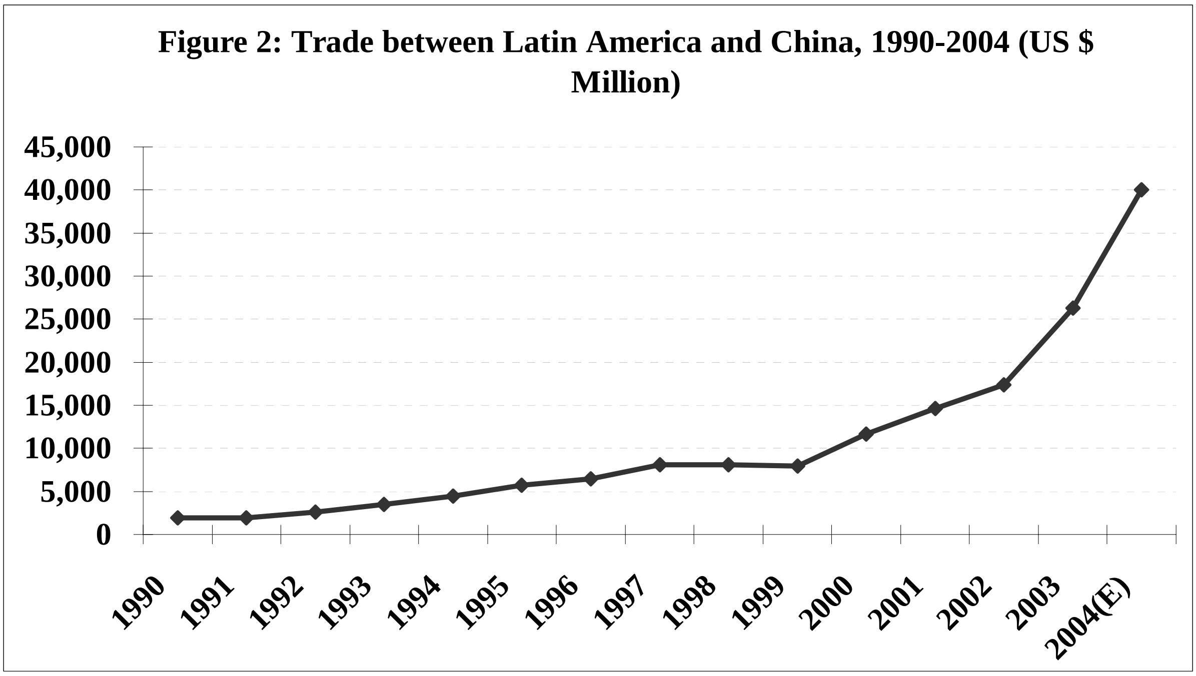
While China's trade volume has increased rapidly, both globally and in Latin America, Chinese investment abroad has not been significant. According to the *China Foreign Economic Statistical Yearbook*, China's cumulative foreign direct investment (FDI) worldwide amounted to US$33.4 billion at the end of 2003, which made up for only 0.5 percent of global FDI stock. China has been actively seeking investment opportunities in Latin America to secure supplies of needed inputs. Latin America accounted for 46 percent of China's total FDI destinations in 2004. Chinese President Hu Jintao stated that China would invest $100 billion in Latin America over the next decade, during his visit to several Latin American countries in November 2004.

Chinese investments have been concentrated in the petroleum and mining sectors, mostly in Peru, Chile, Venezuela and Brazil, as well as in the manufacturing sector in Mexico. China's relations with Brazil are the most extensive of any Latin American country, including cooperation in areas such as mineral exploration, aerospace, technology science, satellite and nuclear energy. China is offering an investment of about $8.5 billion in port and railway, oil, steel, and aviation projects in Brazil. China promised to invest heavily in Venezuela's oil and gas sectors, to help secure its access to fuels. China also promised Argentina in broad terms $20 billion of investment in railways, oil and gas exploration and construction projects in the next 10 years. Moreover, China intends to invest in the Bolivian gas, Ecuadorian oil, Colombian oil and coffee sectors, as well as in the expansion of the Panama Canal, where Chinese ships are now the second largest users after the United States.

Nonetheless, there are concerns over Chinese investment in Latin American countries. The pace of new investments is slow and many plans do not materialize due to the continued presence of political and institutional risks. China has little experience in investments abroad and lacks information about business climate. The Chinese government may offer a tied loan for its political objectives and control over investments abroad, and furthermore it may become disillusioned about the region, as Japan did in the past.

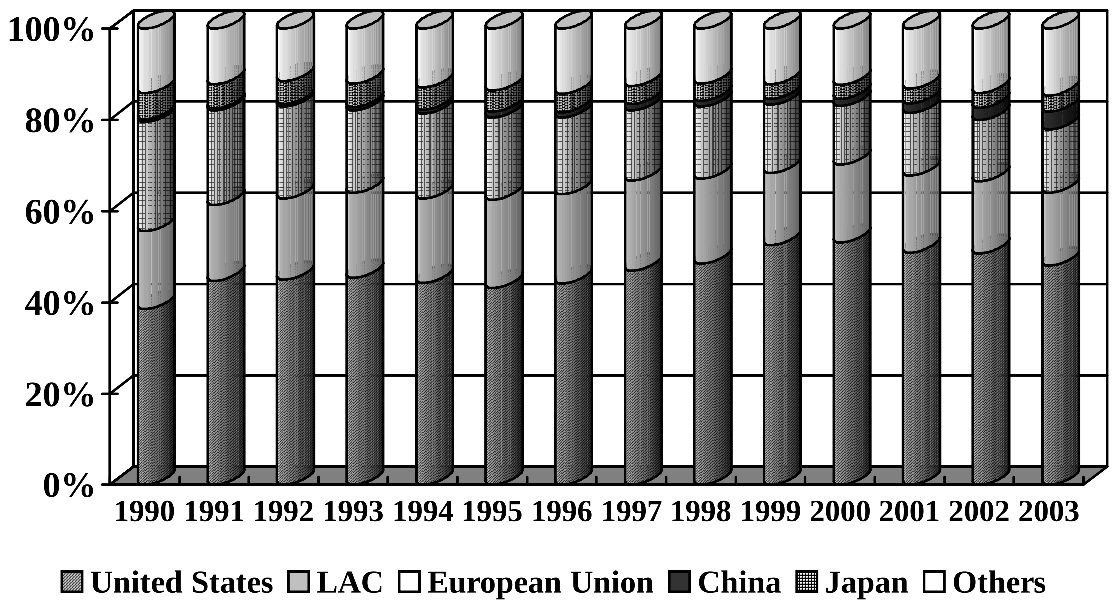
Trade between China and Latin America will continue to grow at a rapid pace over the coming years. Despite that, China's share in Latin American trade will remain relatively small, compared to the share of the United States and European Union. Taking into account China's economic bottlenecks and uncertain investment promises, Latin America probably cannot rely on China, as the source of trade expansion. With solid macroeconomic management, most Latin American nations are well positioned to compete with China and other global rivals. To succeed, however, they need to make their economies more productive and less volatile, and further integrate them into the world economy.

Source: IMF Direction of Trade Statistics



Source: IMF Direction of Trade Statistics

Figure 3: Share in Latin American Total Trade, 1990-2003 (percent)



Source: IMF Direction of Trade Statistics

Table 1: China's Presence in Major Latin American Trading Partners in 1998 and 2003

Country	Exports			
	1998		2003	
	Ranking	Share	Ranking	Share
Brazil	13	1.8%	3	6.2%
Mexico	31	0.1%	6	0.6%
Chile	9	2.9%	3	8.6%
Argentina	8	2.5%	4	8.4%
Peru	4	4.1%	3	7.7%
Panama	19	0.7%	19	1.2%

Country	Imports			
	1998		2003	
	Ranking	Share	Ranking	Share
Brazil	12	1.8%	5	4.4%
Mexico	6	1.5%	2	5.5%
Chile	7	3.8%	4	6.6%
Argentina	8	3.6%	4	5.2%
Peru	19	1.3%	6	3.5%
Panama	24	0.4%	3	9.0%

Source: IMF Direction of Trade Statistics

Table 2: Share of Trade with Latin America as a Percentage of Total Trade, 1990-2003, (percent)

	1990	1992	1994	1996	1998	2000	2001	2002	2003
Share of Exports to LAC as a Percentage of Total Exports (percent)									
US	13.7	16.9	18.1	17.6	20.9	21.7	21.8	21.5	20.6
EU	1.8	2.2	2.5	2.5	2.6	2.4	2.4	2.1	1.8
China	1.0	1.0	1.9	2.0	2.8	2.8	3.0	2.8	2.6
Japan	3.4	4.4	4.4	4.1	5.0	3.9	4.1	3.6	3.6
Share of Imports from LAC as a Percentage of Total Imports (percent)									
US	13.0	13.0	13.3	15.4	15.9	17.0	17.3	17.5	17.1
EU	2.4	2.2	2.3	2.1	2.0	2.1	2.1	2.1	2.1
China	2.4	2.1	1.8	2.5	2.1	2.1	2.7	2.8	3.6
Japan	4.0	3.5	3.3	3.2	3.2	2.8	2.6	2.6	2.5

Source: IMF Direction of Trade Statistics