Between Heaven and Hell: Scenarios for LAC’s relationship with China

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Outline

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  – Trade
  – Investment

• What does the future brings?
  – A new relationship?

• LAC possible response
  – The nightmare
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Looking back at 15 years of boom
Bilateral trade boomed in the last 15 years...
.... on the back of a commodity (export) and a manufacturing (import) boom ...
....with very different impacts across the region.
Investment took off much later..
….but has a similar composition to LAC exports.
More impressive than the FDI take-off was the upsurge in “policy” loans

Chinese Announced Loans to LAC – 2005-2014

- **Venezuela**: $56.3B
- **Brazil**: $22B
- **Argentina**: $19B
- **Ecuador**: $10.8B
- **Bahamas**: $2.9B
- **Mexico**: $2.4B
- **Peru**: $2.3B
- **Jamaica**: $1.4B
- **Bolivia**: $611M
- **Costa Rica**: $401M
- **Honduras**: $298M
- **Chile**: $150M
- **Guyana**: $130M
- **Colombia**: $75M
- **Uruguay**: $10M

Source: Inter American Dialogue
….with infrastructure gaining ground on energy

-> 54 projects
-> US$ 21.4 billion

30 projects & US$ 3 bi
Public infra projects (houses, roads, stadiums)

10 projects & US$ 9.4 bi
Railway/Power-Hydro energy/Ports/Public Housing

8 projects & US$ 3.5 bi
Power – Hydro energy

4 projects & US$ 0.14 bi
Power – Hydro energy

2 projects & US$ 5.3 bi
Railway (Belgrano-Cargas reform project)

New: bi-oceanic railway
MOU for feasibility study signed between China Brazil and Peru in 2015

New: Roadway project

New: Unconfirmed participation in the Nicaragua canal (US$ 50 bi)

New: interest in a series of Power-Hydro energy projects

New: confirmation of the Nicaragua canal (US$ 50 bi)

Source: IDB-INT
LAC investment in China has yet to acquire a critical mass
What does the future bring?
A new relationship?

• The commodity cycle and China’s slowdown brought bilateral trade to a halt, calling into question the future dynamism and pattern of the relationship, particularly with the perspective of the “rebalancing”.

• Yet, there are good reasons to believe that this more about a cyclical adjustment and that trade growth will resume its upward trend.

• China’s growth, though slower, is expected to remain robust, rebalancing have yet to show its force and when it does, China’s natural resource constraints will be increasingly biding (land & and water)
Demand for commodities aren’t going away…

Figure 11- Copper and Soy Consumption per capita.

Figure 9 - Potential Availability of Uncultivated Land

Note: The trend line is obtained by regressing consumption per capita on GDP per capita and the square of GDP per capita.

Source: IDB/INT with UN and USGS data, 2009

Note: Uncultivated land are areas with high agro-ecological potential with a population density of less than 25 persons/km2.

Source: Fischer and Shah 2010
...and competition in manufacturing is likely to remain strong.
Possible LAC responses: nightmare scenario

Trade

➢ **Governments**: a) fail to push for the removal of trade barriers (tariffs, tariff escalation, NTBs and subsidies in agriculture), and government support and TRIMs for industry.

   b) Resort to protectionism and subsidies to stave off a perceived threat of deindustrialization, delays inevitable adjustment and cut incentives to increase productivity.

➢ **Private sector**: instead of fighting market access and increase productivity, lobbies the government for protection and subsidies and remains content with natural resource rents;

➢ **China**: Push for total, “soil to shop”, control of supply chain in agriculture and mining undercuts the potential for diversification and erodes rents (transfer pricing);
Possible LAC responses: nightmare scenario

Capital flows

- **SOE investment in natural resources** continues to heavily dominate China’s FDI in the region, contributing little to diversify the local economy and raising governance, sovereignty and environmental concerns.

- **LAC’s FDI in** China remains negligible, with firms failing to take advantage of tariff jumping, proximity to clients and to reap the benefits of variation in market prices.

- Taking advantage of macroeconomic imbalances and seeking to leverage its considerable reserves, China’s steps up the signing of **opaque loan-for-resources or loan-for-infrastructure deals**, and in the process countries see their rents erode, debt sustainability compromised and their local companies shut out of Chinese financed projects.

- **Financial dependence**, disguised under the rhetoric of “South-South cooperation”, leads LAC governments to fail to advance their own interest in bilateral and multilateral trade negotiations.
Possible LAC responses: best scenario

- Fortunately, none of the nightmare need come to pass, if LAC governments and the private sector make a different set of choices.

- Backed by strong macro and fiscal positions, governments take a more pragmatic and forceful trade policy stance, challenging China trade and industrial policy practices. The motto is trade not aid.

- China’s FDI is led by the private sector and diversifies into manufacturing and services and operates under a strong set environmental and competition safeguards. Motivation is not tariff jumping but transport cost and access to the local and U.S. market.

- China finance continues to flow into the region to finance infrastructure, but under more transparent and market-led conditions. It moves away from badly managed economies.
Conclusions

✓ Bilateral had boomed in the last years, driven by an exchange of commodities for manufacturing goods, with heterogeneous impact across the region.

✓ Capital flows only came late in the cycle, and by in large reinforced the pattern of bilateral trade.

✓ The commodity cycle and the slowdown in the Chinese economy brought trade to halt, but the fundamentals suggest this is just a cyclical adjustment and growth is likely to resume sooner rather than later, but a slower pace.

✓ Moving ahead, LAC governments and firms have clear choice: reinforce some of the worrying trends of the status quo into a nightmare scenario..

✓ ...Or take a more pro-active stance to turn the bilateral relationship into a powerful force for sustainable growth.