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Latin America and China: Sino Amigos?

More Latin American Winners than Losers Due to China's Developing Economy

In November last year, President Hu Jintao of China spent two weeks traveling throughout Latin America. During his trip, Hu signed a total of \$30 billion in trade and development deals with Brazil, Argentina, Chile and Cuba and promised \$100 billion in investment into the Latin America and Caribbean region (LAC).

Conventional economic theory might suggest that economies with seemingly similar compositions as those of China and Latin America would have relatively little to gain from their economic integration. China's development of a comparative advantage in labor-intensive manufacturing, influencing international prices, factor returns, and specialization patterns across the world, would seem a threat to a region that relies heavily on inexpensive labor. However, a closer look at these economies provides an indication of a growing commercial relationship and a degree of compatibility not immediately evident. This article examines some of these issues and ways investors can profit from this rising trend.

Competition or Cooperation?

In some sectors, production in China and Latin America has converged towards making an increasingly similar basket of exports. Such similarity is particularly evident in their respective manufacturing industries. For example, countries with large light-manufacturing industries such as Mexico, have seen a decline in demand for exports due to competition by Chinese goods. On the other hand, natural resource-based sectors, in countries such as Argentina, Brazil and Chile, have been able to maintain comparative advantages and even increase sales and growth prospects due to China's demand for inputs and intermediary goods.

An export similarity index analysis, like the one provided in the Inter-American Development Bank's publication *The Emergence of China: Opportunities and Challenges for Latin America and the Caribbean*, depicts the intersection of goods exported from a particular region with those exported by China. The index can be used to indicate the degree to which the respective economies currently compete, and to forecast the manner in which China's increased competitiveness would affect various regions. As one can appreciate from the study, an increase in China's competitiveness will have the greatest effect on other Asian countries, as these economies have the greatest similarity in export composition compared to China. Latin America, on the other hand, has an export similarity index with China that is closer to that of OECD countries. Furthermore, if one analyzes the market share of exports to the U.S., in terms of different product categories, one notes that the only areas in which LAC and Asia coincide are labor-intensive sectors such as textiles, manufacturing materials and machinery.

While changes in trade flows due to China's growth may be limited to certain sectors, changes in Foreign Direct Investment (FDI) inflows pose a threat to LAC with a broader economic scope. China

has signed treaties to protect investors from double taxation with 72 countries, but only a few are Latin Americans. Such policy reform, culminating in WTO accession, has largely opened the Chinese economy to FDI, giving foreign investors access to inexpensive labor and an enormous, and increasingly affluent, domestic market.

Growth in Chinese-bound FDI is expected to continue, given expectations of further liberalization, an absence of a foreseeable competitor in labor prices in the near future, and forecasts of continued income growth coupled with a growing propensity to spend.

Current Trends

Economic areas with the lowest degree of similarity, measured by relative global market share between China and LAC are those supported by natural resources, such as foodstuffs, beverages, minerals, fuels and animal and vegetable oils.

From 2000 to 2003, Latin America's exports to China grew significantly. During this period trade volume between China and Latin America reached a historical high of \$26 billion in 2003, increasing 50.4 percent annually.

During this period, exports from Brazil increased 503 percent, Argentina's by 363 percent and Chilean exports grew by 238 percent. Over same period, Mexico, the last country to reach a WTO entry negotiation agreement with China concerned with potential harmful effects on the Mexican domestic economy, exported 953 percent more goods to China. China's burgeoning demand for LAC goods is evident in the following 2003 China-bound export values from LAC: iron and steel \$123 million; non-ferrous metals at \$140 million; electrical machinery, apparatus and appliances at \$100 million; oil-seeds and oleaginous fruits at \$320 million; metalliferous ores and metal scrap at \$265 million; and petroleum and petrochemical products at \$37 million, growing at 6157 percent compared to the previous year.

China's continued growth has also created demand for non-agricultural raw and processed materials. Chile, for example, has found a large market in China for its copper, wood, slag and ash and Brazil increased its exports of iron ore and pellets. In 2002, the total amount of wood imported annually to China increased by 99.8 percent. China recently announced it would require 120 to 170 million square meters of wood annually over the next ten years to sustain current demand. China is also looking to Latin America for a steady supply of copper, bauxite, iron ore, oil and other raw materials for its industries, along with soybeans, grains, chicken and other commodities.

Currently, Peru, Mexico and Brazil, have received the greatest percentage of Chinese direct investment to the region, ranking 7th, 9th and 12th globally in terms of cumulative FDI from China. Although growth in China will increase competition for FDI and possibly reduce Latin America's percentage of global FDI inflows, LAC has an opportunity to capitalize on China's thirst for raw materials.

In 2000, a survey of 100 Chinese Transnational Corporations (TNCs), indicated that the main reasons why companies wanted to invest abroad were, expanding overseas market (47.1 percent) and bettering profits (16.9 percent) followed closely by a sluggish demand (14.5 percent). The survey also

indicated that LAC was the third most desired destination with approximately 18 percent of respondents reaffirming their interest in the region; after Africa and Southeast Asia. 8.4 percent of those surveyed indicated that the most attractive factor in their host country was cheap land and proximity to raw materials.

Traditionally, Chinese investors have invested in existing companies in Latin America rather than in start-up greenfield investments. Indicative of such a strategy is China's successful investment in manufacturing companies in Mexico, Venezuelan oil, steel and iron industries, and Brazilian agriculture and forestry companies.

Chinese enterprises such as China Mineral and Metal Corporation, China Ocean Shipping Company, Sinochem and Huawei Technology have shown interest in Latin American countries such as Brazil, Chile and Mexico. Other companies such as Sinopac, Baosteel, Shanghai Deep Sea Fisheries Co., Shanghai Anxin Flooring Corp., have invested throughout Latin America in oil, petroleum derivatives, mineral extraction, forestry, fisheries and other industries.

In Brazil, Chinese investment stood at \$75 million and was directed towards wood processing, minerals, textiles, telecommunications and machine manufacturing. Over the last 20 years, Chinese investments have established more than 50 firms in Brazil; some of the largest are Huawei Technologies, Shangdong Electric Power Group and Shanghai Baosteel Group. In Chile, 19 enterprises, most of which were trading companies such as CITICFOR Chile S.A. and Internshang SMIEC S.A., were registered with Chinese capital in 2002. In Argentina, some 28 Chinese enterprises were registered in sectors as diverse as fishing, agriculture, natural resources, chemical, assembly, electronics and telecommunications. Chinese investment in Peru and Venezuela is concentrated in the petroleum and mining sectors. Moreover, changes in regulatory policies for beef have foreign investors beginning to consider new investments in Argentina.

Opportunities for Latin American Enterprises and Investors

Attracting Chinese investment has become a policy focus in Latin American countries. Argentina, Ecuador, Chile, Bolivia, and Uruguay have signed Bilateral Investment Treaties with China. Moreover, Brazil and Venezuela have signed treaties prohibiting double taxation with China, and others, such as Chile, are negotiating similar agreements as part of larger efforts to attract investments from China. Recently, the Argentine government made active efforts to invite Chinese companies to invest in Argentina's railway construction and agricultural projects.

The Inter-American Development Bank estimates that Latin American exports to China will increase by 34 percent in 2005, reaching \$14 billion. Latin American enterprises hope to fuel China's growth by providing raw materials and other inputs.

While the greatest opportunities for Chinese/LAC cooperation lay outside of labor-intensive sectors, there are still some labor-intensive niche industries in which Latin American and Caribbean countries will be able to compete. For example, Chinese investors have entered the Central American textile industry to cut transportation costs and service a segment of the market that requires shorter time-to-market intervals than are attainable from China. In addition, raw materials exports from LAC to China will require immediate investment in infrastructure such as ports, railroads and storage facilities. In

sum, early concerns that China's growth and increasingly market-friendly economy would devastate Latin American economies seem to have overestimated the degree of similarities between the economies and underestimated the potential for LAC-bound FDI with Chinese origin and the need for primary materials that the LAC supplies China.

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