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

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BRICS: Challenges and Opportunities
FGV/IBRE and FGV Growth & Development, June 9, 2015

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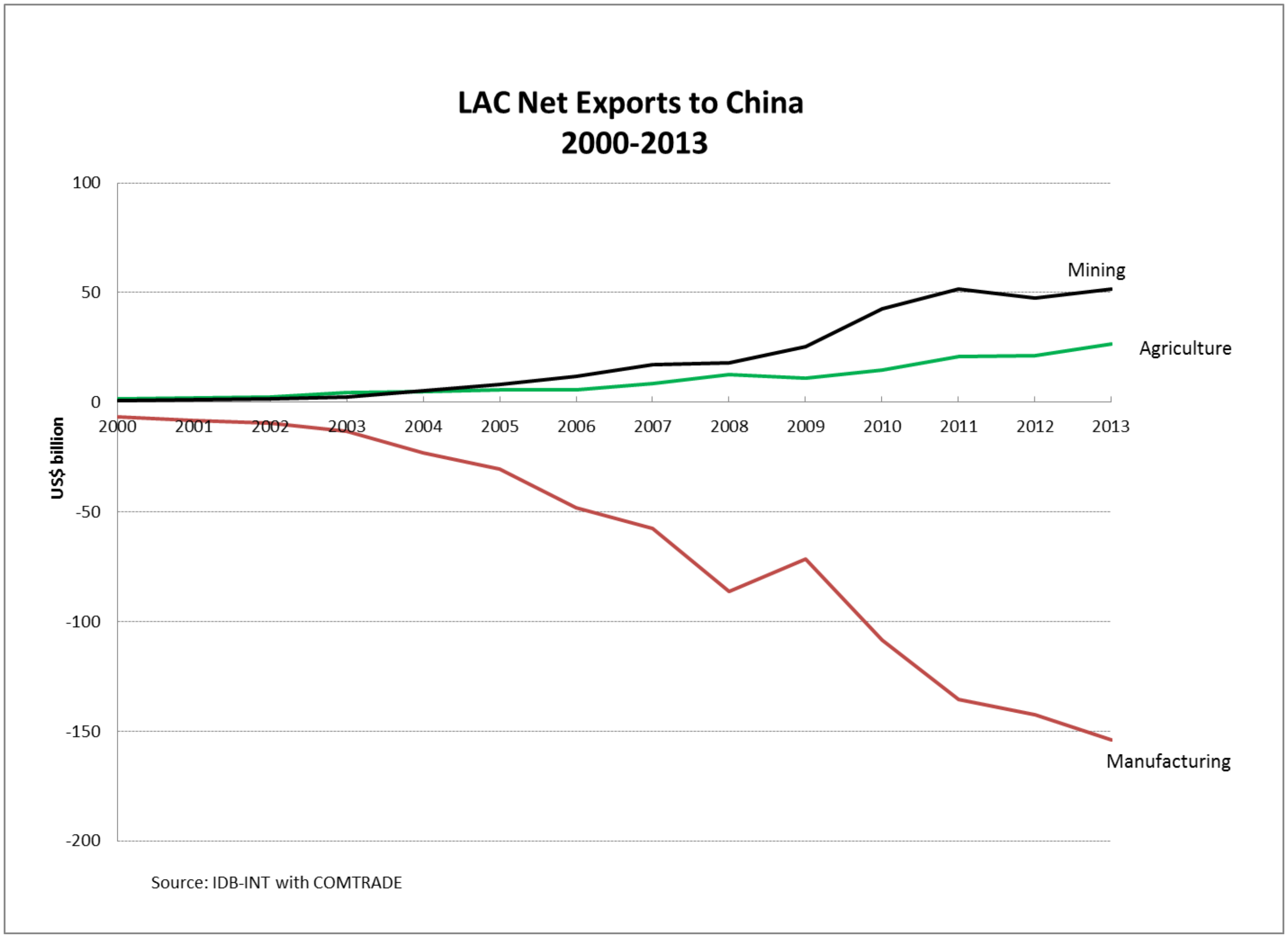
Outline

- Looking back at 15 years of boom
  - Trade
  - Investment
- What does the future brings?
  - A new relationship?
- LAC possible response
  - The nightmare
  - The dream
- Conclusions

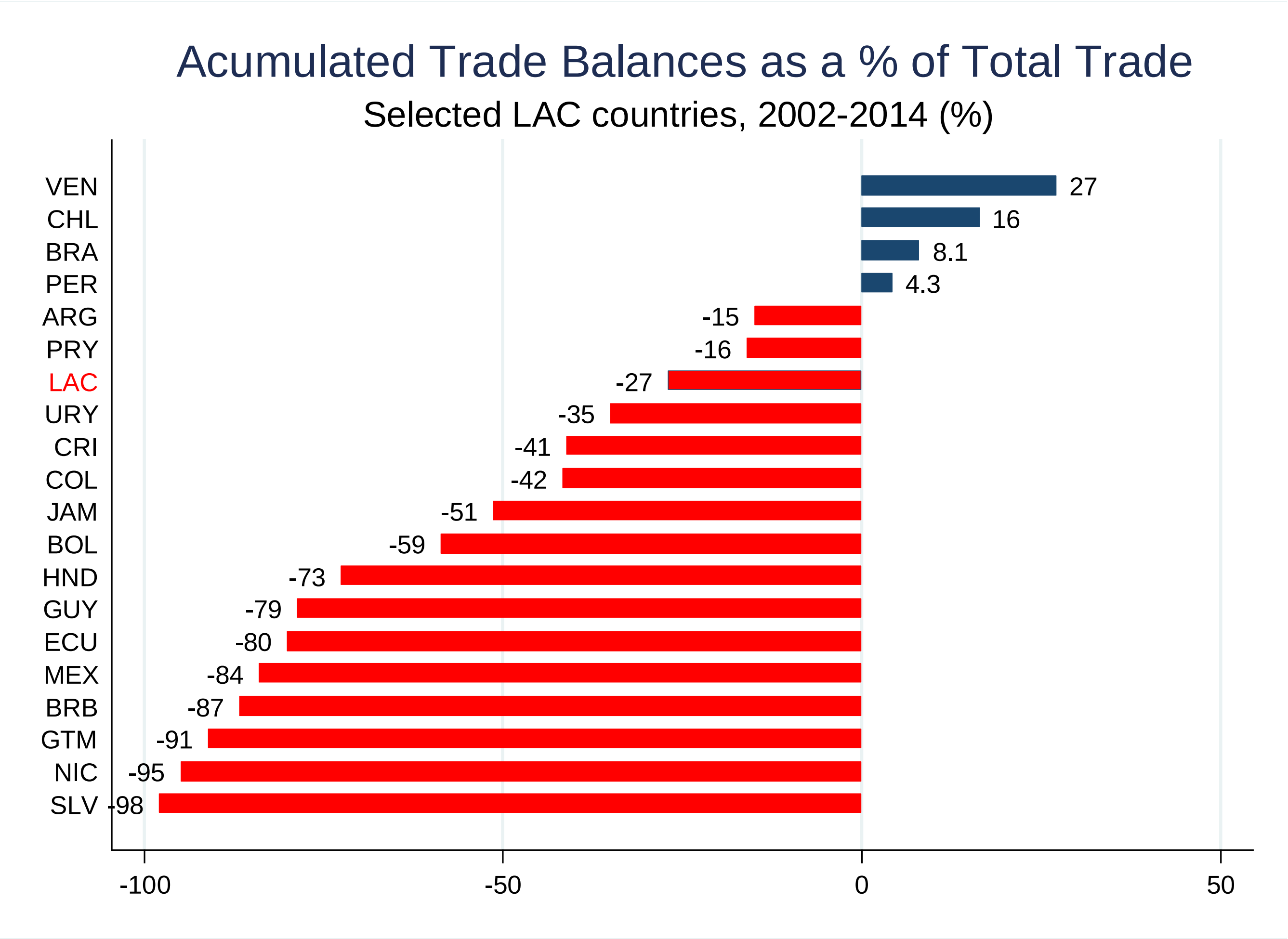
Looking back at 15 years of boom

Bilateral trade boomed in the last 15 years…

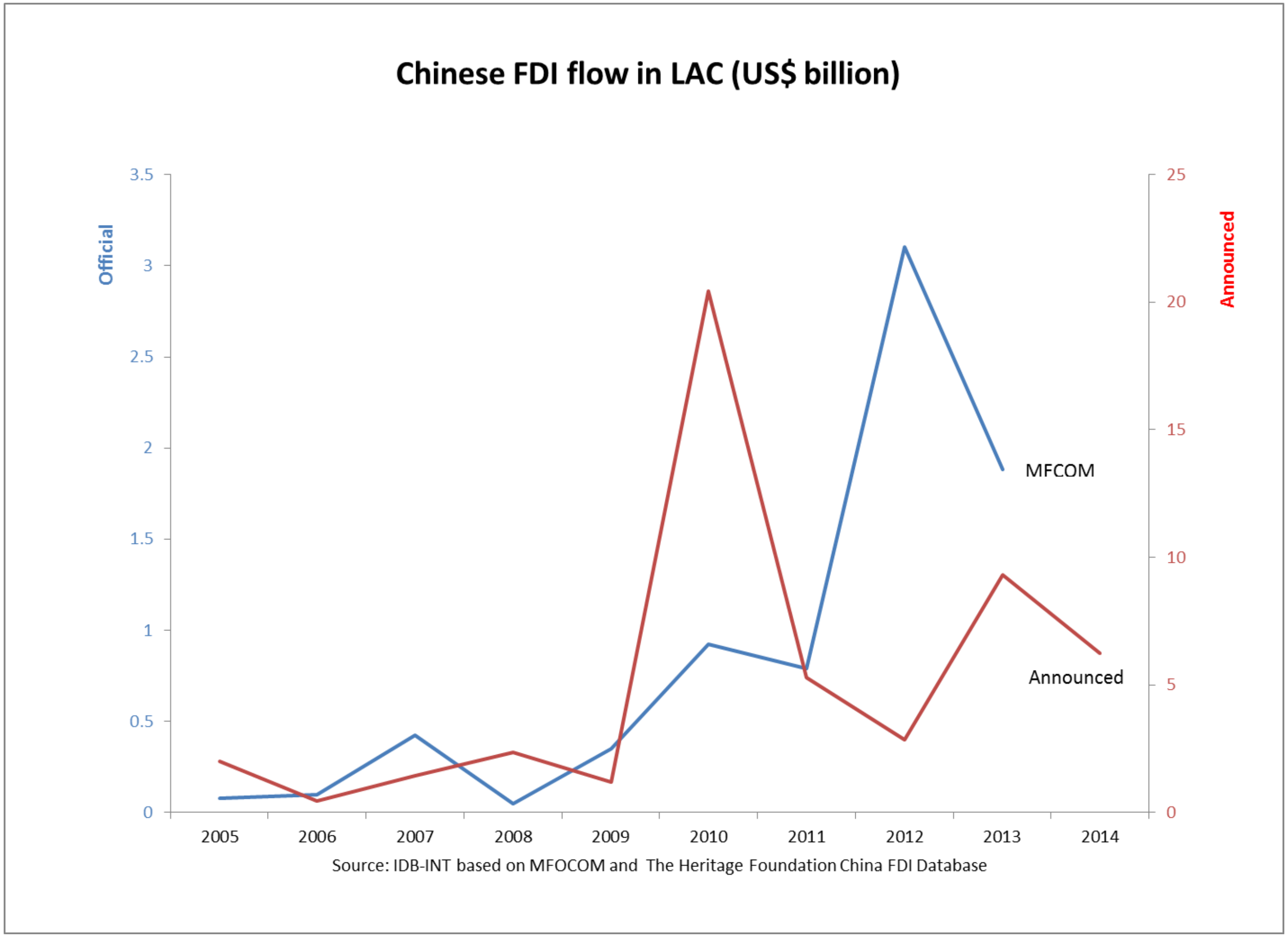
…. on the back of a commodity (export) and a manufacturing (import) boom …



….with very different impacts across the region.

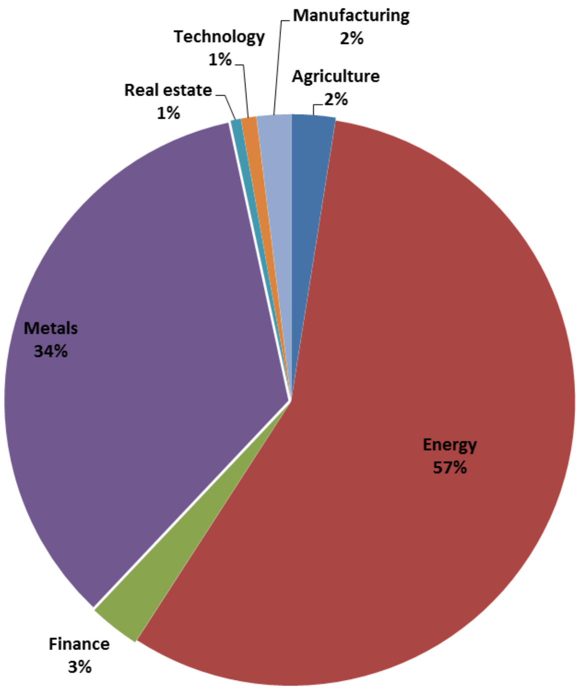


Investment took off much later….

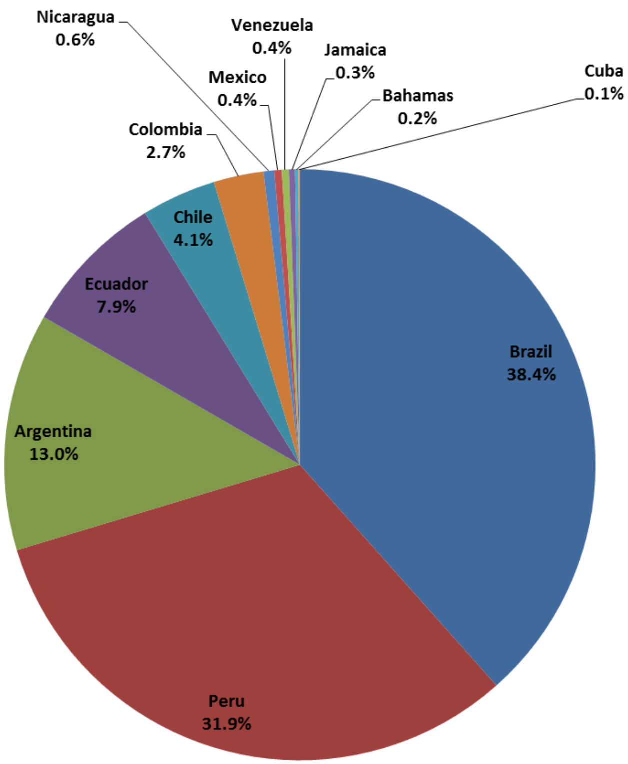


....but has a similar composition to LAC exports.

Distribution of Announced Chinese FDI in LAC. Sector, 2000-2014

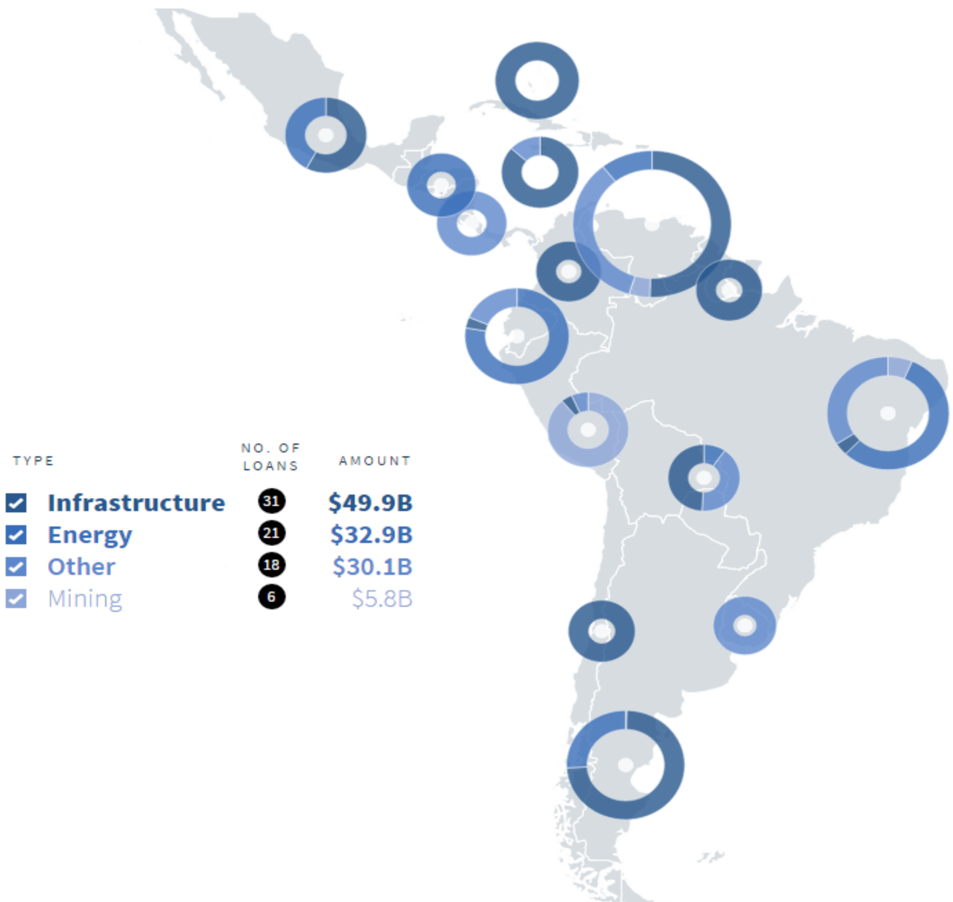


Distribution of Announced Chinese FDI in LAC. Country, 2000-2014



More impressive than the FDI take-off was the upsurge in “policy” loans

Chinese Announced Loans to LAC – 2005-2014

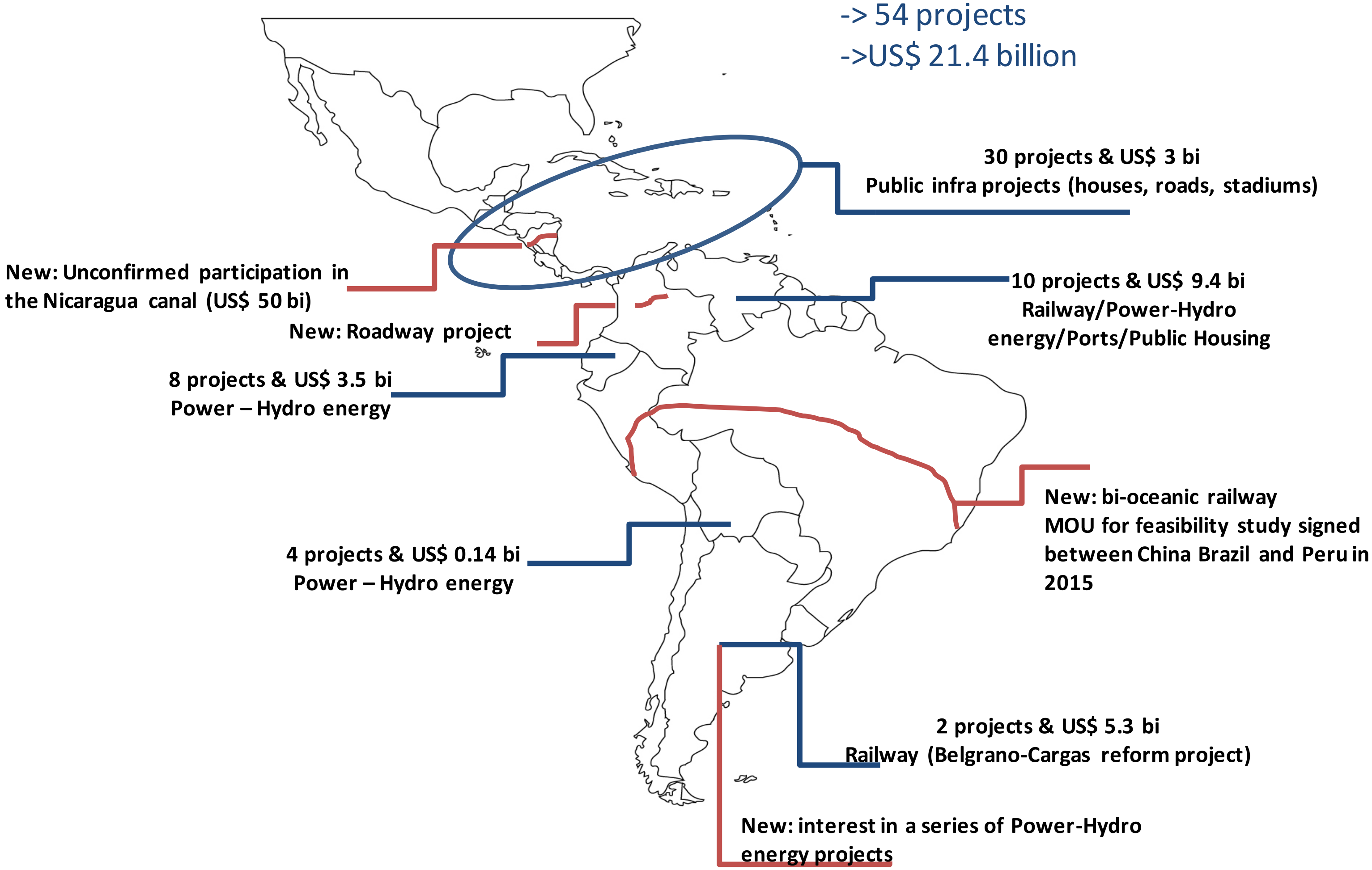


Venezuela	16	**$56.3B**
Brazil	10	**$22B**
Argentina	10	**$19B**
Ecuador	12	**$10.8B**
Bahamas	3	**$2.9B**
Mexico	3	**$2.4B**
Peru	4	**$2.3B**
Jamaica	8	**$1.4B**
Bolivia	3	$611M
Costa Rica	2	$401M
Honduras	1	$298M
Chile	1	$150M
Guyana	1	$130M
Colombia	1	$75M
Uruguay	1	$10M

Source: Inter American Dialogue

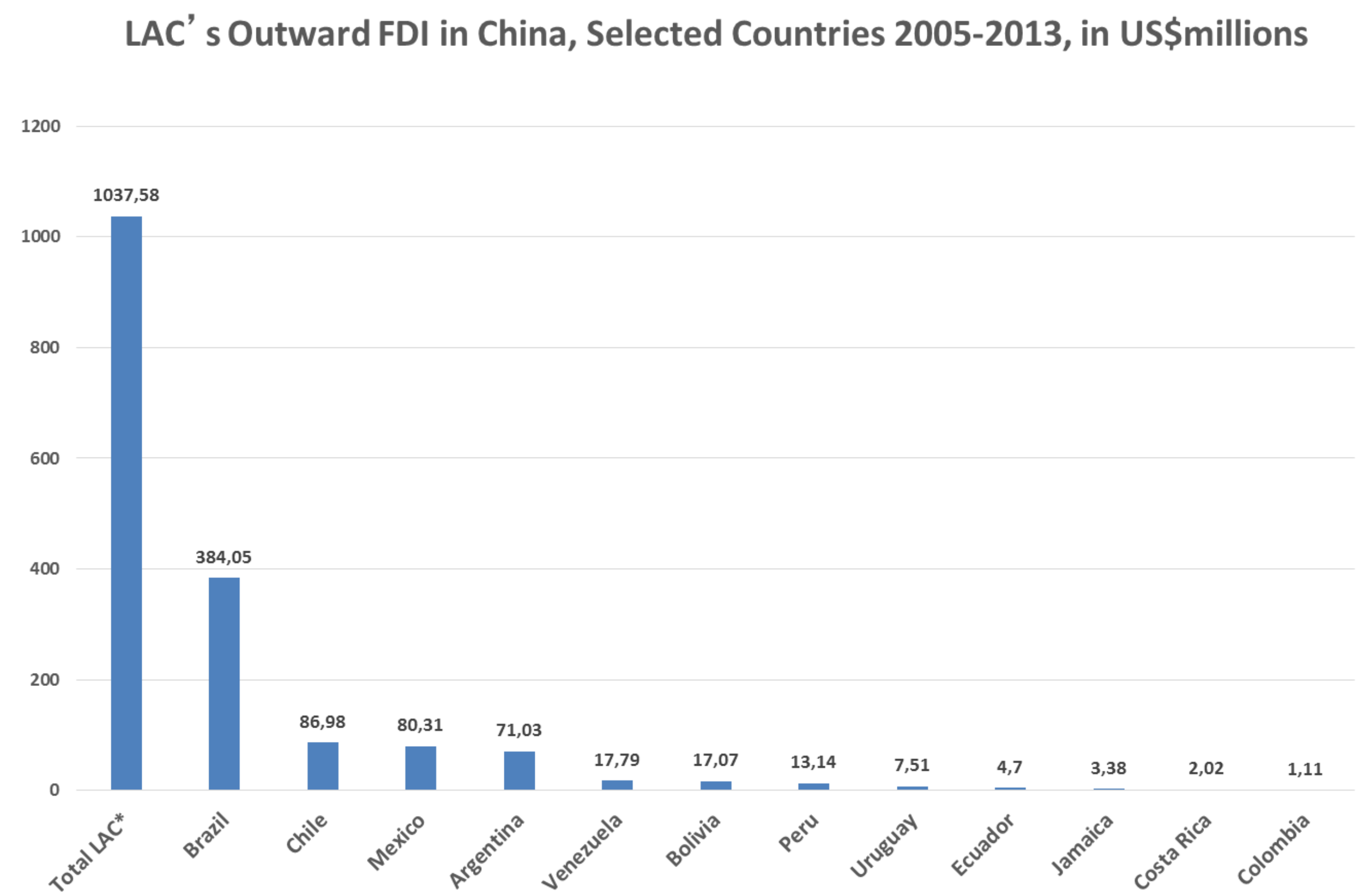
….with infrastructure gaining ground on energy

-> 54 projects
->US$ 21.4 billion



Source: IDB-INT

LAC investment in China has yet to acquire a critical mass



Source: MOFCOM and UNCTAD World Investment Report, 2014
*Not including tax havens

What does the future bring?

A new relationship?

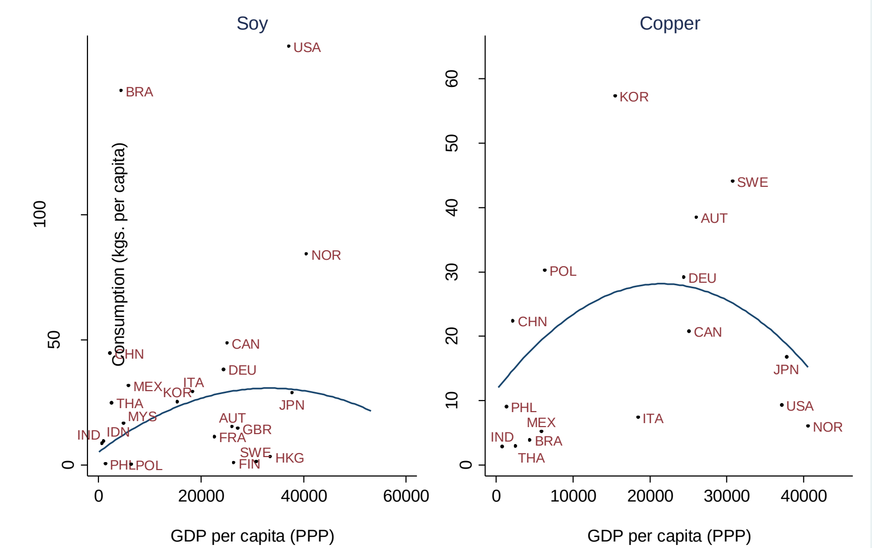
- **The commodity cycle and China's slowdown brought bilateral trade to a halt**, calling into question the future dynamism and pattern of the relationship, particularly with the perspective of the "**rebalancing**".

- 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.

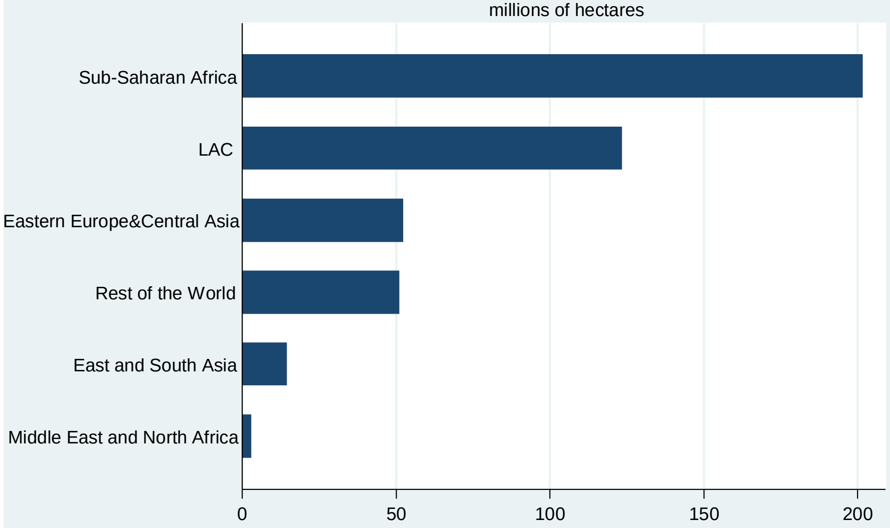


Note: The trend line is obtained by regressing consumption per capita on GDP per capita and the square of GDP per capita.

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

Figure 9 -Potential Availability of Uncultivated Land

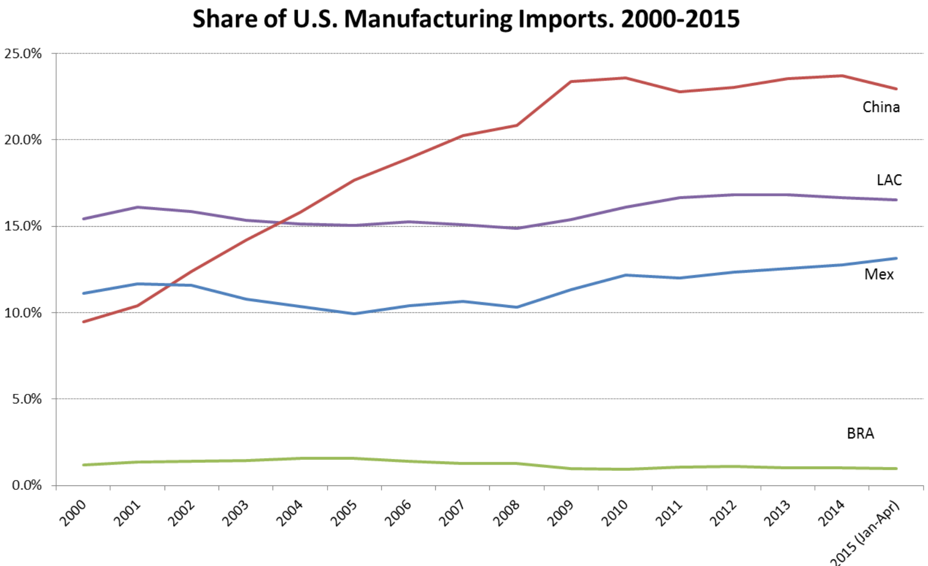
millions of hectares



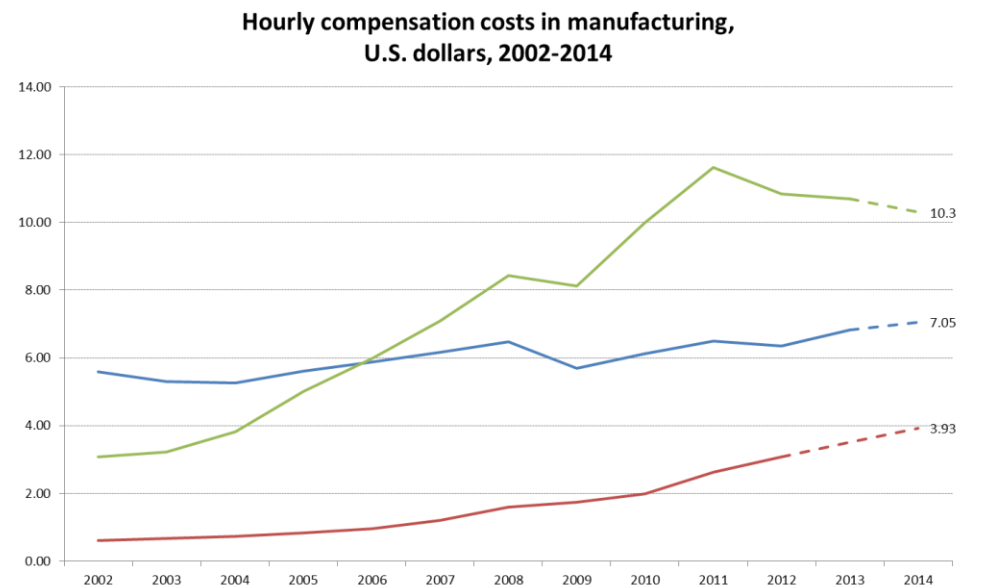
Note: Uncultivated land are areas with high agro-ecological potential with a population density of less than 25 persons/km2

Source: Fischer and Shah 2010

…and competition in manufacturing is likely to remain strong



Source: IDB-INT with USITC data



Source: IDB-INT with US-BLS , CEIC data, BIE, PIMES

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.