Of Dragons & Elephants

Javier Santiso

China's growing influence on Latin America has, to some extent, overshadowed the rise of another emerging market giant in the East: India. ***By Javier Santiso****

China's economic effect is palpable throughout the world. The Asian giant's impact reaches even the most remote corners of the planet, like Africa, where it's displacing centuries-old European influence. In most of Latin America, meanwhile, China is turning into a commercial angel as it hops into what is looking less and less like the United States' backyard.

Because of its focus on raw materials, Latin America is seemingly one of the most complementary regions for the Asian dragon. The value of Venezuelan crude shipments to China, for example, topped $3 billion in 2005, or twice the year before. While the US is still the biggest importer of Venezuelan crude, growing Sino-Latin solidarity, in particular between Beijing and Caracas, hasn't gone unnoticed. Likewise, Latin America is becoming a region of great interest for Chinese investors. These tighter relationships center on an overseas expansion strategy that has been adopted by China's emerging multinational companies. Of the 100 largest emerging market multinationals seeking out international expansion, almost half – 44 – are from China, according to a Boston Consulting Group study. In 2005, China's outbound foreign direct investment reached $7 billion, a 26% increase over 2004. Of this amount, Latin America got 16%, making it the number two destination for Chinese investment abroad after Asia, which received 60%.

The breadth of the Chinese dragon's wingspan, nonetheless, could be overshadowing the weighty march of the Indian elephant into regions as remote as Latin America. Just a few months back, Indian steel giant Mittal Steel agreed to take control of European peer Arcelor for €27 billion to become the world's biggest steel maker. While this transaction is spectacular because it represents one of the major aggressive takeovers of an OECD leader by an emerging market company, it also has Latin American ramifications. Arcelor's operations in Brazil will become the third-biggest source of steel in terms of production volume for the newly minted multinational Mittal.

In a much more direct way, one of the most important foreign investments to date by an Indian company also took place in mid-2006, precisely, in Latin America. Jinal Steel and Power's €2 billion investment in Bolivia is emblematic of the growing appetite of Indian groups for overseas investments. As with Chinese companies, the Indian interest in Latin America centers on raw materials.

The expanding link between Asia and Latin America is symbolic of the economic shakeout going on worldwide. The map is being redesigned at great speed, with Europe, Japan and the US retreating from their roles as omnipotent centers to leave space for a more balanced configuration. This reshaping is being activated in large part by emerging markets, as shown by the cooperation between large firms like Brazilian iron ore miner CVRD and China's Baosteel or Chilean copper miner Codelco and China's Minmetals.

For Latin America, both Asian links present a challenge. For raw materials producers, it's good news in the short-term. At the same time, as Latin American countries focus on raw materials exports, they run the risk of numbing any will to diversify beyond extraction-based industries. Like Africa, some countries of the region could soon find themselves backed into a dead-end street on the road to development, shipping goods abroad with little value-added and being left out of increasingly global industrial production chains. Worse yet, mines and oil wells don't generate a whole lot of jobs.

For Latin American countries that have managed to diversify their economies in some way – like Mexico, which has an ample manufactured export base – the Asian challenge functions as an alarm bell warning them to step up their games. In the case of Mexico, that economy has an exceptional advantage in facing off with the Chinese: proximity to the United States, a country that absorbs more than 85% of Mexican exports. While it can't compete with China on labor costs, because Mexico is next the world's hungriest consumer market, it can specialize in just-in-time delivery that helps keep down warehouse costs for US retailers. Mexico's challenge now is how to better use this geographic advantage, perhaps by improving infrastructure like highways, railways, ports and airports.

All Latin American countries ought to take into account, for good or bad, the Asian giants. China and India could be angels today and demons tomorrow. Or vice versa. But one thing is certain: to avoid being knocked over by the flight of the dragon, or trampled by the elephant stampede, Latin Americans need to swerve and keep moving forward. **LF**

**Javier Santiso is chief economist and deputy director of the OECD Development Centre, in charge of emerging markets issues, and author of many books and articles on Latin America. His latest book,* Latin America's Political Economy of the Possible: Beyond Good Revolutionaries and Free Marketeers *, was published by MIT Press in 2006.*