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Can China change Latin America?

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A new global courtship is blossoming, and it is bringing China and Latin America closer together. Whether it ends in happiness or in tears depends mostly on Latin America.

China's economic boom has been like a tectonic shift that has sent near-shock waves through Latin America. China is on everyone's lips. Major international events have been dedicated to the country's remarkable emergence, from the World Economic Forum on Latin America to the COFACE Annual Conference on Country Risk, both held last spring.

They may just be events, but they symbolise Latin America's move towards Asia. Nor is it an accident that they are taking place mostly in Chile. In 2006, more than 36% of the country's total exports were directed towards Asia, with China taking a record of 12% of the total. Recently, in 2006, Chile concluded the first trade agreement between a Latin American country and China and started negotiations on another with India.

Chile is not alone in seeking to do business with Asia. In 2006, Brazilian corporations like the iron ore producer, CVRD, or the jet manufacturer, Embraer, concluded huge contracts in China. In early 2007 Venezuela agreed to a US$6 billion joint investment fund for infrastructure projects on its soil and oil refineries in China able to process Venezuelan heavy crude. In March 2007, Beijing launched China's official candidacy to the board of the Inter-American Development Bank. If it succeeds, it will become the bank's third Asian member, after Japan and Korea.

These ties with China are read as good news in most Latin American countries. For one thing, they allow exporters to diversify away from traditional markets to the north. It also means trading with the new engine of world growth. With the exception of Mexico and Central America, which still rely on markets in the NAFTA region and other OECD countries, in Latin America China generally represents a "trade angel", like a business partner who offers a helping hand and a leg-up into the heady world economy. It is an outlet for huge amounts of the region's commodities, while providing very little competition for Latin American products in the US and in Europe, as a recent OECD Development Centre study reveals (see references).

But for the region as a whole, and especially the possible laggards, the buzz about China should above all be taken as a wake-up call for more reform, particularly in the area of infrastructure. Even Mexico, though a thriving OECD member, will need to reform if it is to remain competitive, especially as its low labour costs are no longer that advantageous relative to China. True, Mexico's proximity to the US remains a major strategic asset, but to capitalise fully on this asset, it must improve the efficiency of roads, ports, railways and airports.

For other countries seeking to profit more from the rise of China, as well as the other Asian dynamo, India, a major policy issue will be to avoid the pitfalls of commodity dependency. China has become Brazil's second and fastest-growing export market, but 75% of these exports are concentrated in just five commodities–soybeans, iron ore, steel, soy oil and wood. Brazil is not alone in this situation. Argentina sends soybeans to China as its major export to that country, while Chile and Peru depend on copper for the bulk of their exports to China. This may benefit the trade balance of many Latin American countries in the short term, but such dependence on commodities is an issue for the long-term development of these countries.

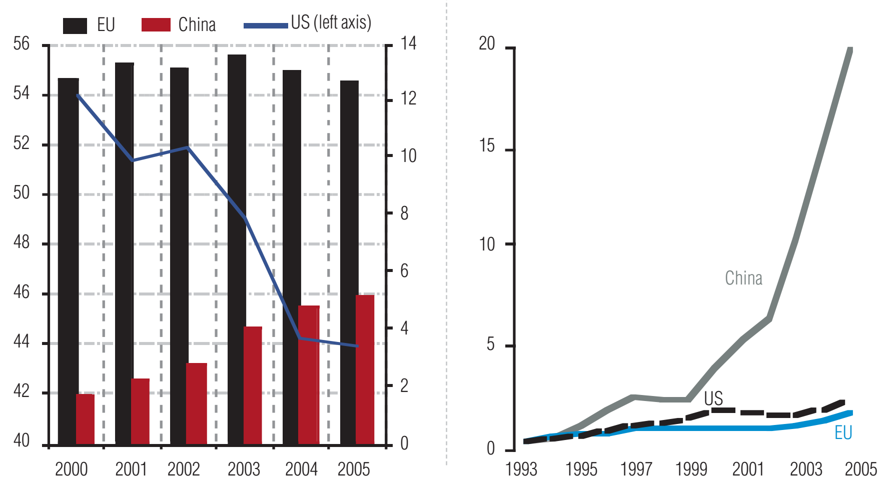
Three-quarters of Brazil's exports are concentrated in just five commodities

There are fiscal challenges too. In this regard Chile, the largest producer and exporter of copper in the world, offers a good example of adequate practice. Rather like Norway with its oil and gas revenues, its management of the copper windfall has so far been wise: most revenues are being held offshore in foreign currency, in order to ease the upward pressure on the Chilean peso. All surpluses over 1% of GDP will continue to be channelled into a new "economic and social stabilisation fund", that will also be held abroad and used in future for education, training and industrial innovation.

Relationship ups and downs

Latin American trade (exports + imports), %, share of total trade

Latin American trade volume growth (1993=0)



Source: World Integrated Trade System (WITS), Comtrade, 2007

Latin America and Asia are watching each other admiringly, but there is cause for excitement too. After all, for the first time in its history Latin America can benefit not from one but three major world growth engines. Until the 1980s the US was the major trading partner of the region. Then came the boom of European investment in Latin America during the 1990s. Now, this century, China is fast becoming a new suitor, with India and other Asian countries not far behind.

The danger for Latin America is complacency. If the continent basks in the glow of windfall profits from commodities, while traditional manufacturers continue to see operating on the US market as a given, the current courtship could become a missed opportunity. The region will have to embrace reform, as strongly as it seems to be ready to embrace China. If it does that, then its courtship with the global market's main star could bear real fruit after all. ■

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