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# Globalization Commentaries

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## China is the new bank in Latin America. Is it a better deal?

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China's presence grows ever larger in Latin America. Yet it is still unclear whether the Asian giant's expanding influence will favor sustainable development in the region.

Latin America's abundance of oil, minerals, and other natural resources attract China to the region and the numbers prove it: our study "The New Banks in Town: Chinese Finance in Latin America," estimates that, since 2005, China has provided approximately $86 billion in loan commitments to Latin American countries. Sixty-nine percent of these loans were loans in exchange for oil.

Putting the data in context, in 2010, for example, China offered more loans to Latin America than the World Bank, the Inter-American Development Bank, and the Export-Import Bank of the United States combined. What does this deepening of ties with China mean for the region?

It's often thought that – contrary to international financial institutions and Western governments – China provides more favorable financing terms to Latin American countries, does not impose political or structural conditions on borrowers, and that its loans have overly lax environmental standards. These claims tend to perpetuate either suspicion or loyalty toward China in Latin America and elsewhere. Our research shows that the reality on the ground is more complicated.

To begin with, so far, the majority of Chinese loans have been targeted toward a small group of South American countries. Argentina, Brazil, Ecuador, and Venezuela – countries that, with the exception of Brazil, have difficulty in accessing global capital markets – received 93% of Chinese financing between 2005 and 2011. This large influx of capital has become the main source of external financing for Ecuador and Venezuela, given that since 2005, for example, the World Bank has granted only two small loans to Ecuador and none to Venezuela.

Yet, this does not mean that the Chinese Development Bank and the Import-Export of China – the two banks responsible for the majority of Chinese lending – are displacing the competition with more favorable, or "low-ball," financing. Most Chinese loans to Latin America actually come with stricter terms than loans from their Western counterparts. Latin American countries generally pay a higher premium for loans from the Chinese Development Bank. In 2009, for example, a credit line of $10 billion for Brazil, from China, was extended with a Libor rate plus 280 basis points; a similar loan to Brazil by the World Bank loan was priced at Libor plus 55 basis points.

To mitigate the risk of lending to countries with dubious credit profiles, China often backs its loans with oil or with requirements to purchase Chinese equipment and contract Chinese companies. This seems to explain, for example, how in 2010 the Chinese Development Bank could extend a $20 billion oil-backed loan to Venezuela. Or how it was able to provide Argentina with a $10 billion credit line the same year for a railway construction project. In effect, the loan to Argentina funded the Chinese companies that were contracted for the project. Such terms can actually raise the total cost of borrowing for Latin American countries; but without these creative arrangements, these countries would not be solvent.

On the positive side, Chinese loans are often targeted at infrastructure and industrial projects, essentially closing the onerous infrastructure gaps that exist in Latin America. Additionally, the financing terms for oil-backed loans also appear to be more favorable to Latin American countries than perceived at first glance. It's often thought that, in exchange for funding, Latin America simply sends barrels of oil to China at previously agreed upon prices. Critics claim that Latin American countries therefore lose out on potential revenue if the price of oil increases. Yet, our analysis shows that China buys a pre-determined number of barrels of oil per day, paying the current market price.

That said, the environmental ramifications of Chinese-sponsored projects are troubling. The majority of Chinese loans are directed at areas and industries that are sensitive from an environmental point of view. And the environmental standards associated with Chinese loans are not up to par with their Western counterparts'. This deepens Latin America's historical dependence on raw materials and threatens the region's long-term growth prospects.

In 2009, when many of the traditional sources of capital dried up as a result of the financial crisis, Beijing took the opportunity to deepen its global reach and it accelerated its lending to Latin America. The character of Chinese financing and its implications for the region are more complicated than what is generally assumed. There are a number of reasons why China has offered such large loans to Latin America. China wants to diversify its investments beyond North America; Beijing is interested in internationalizing the yuan; and the government wants to provide opportunities for Chinese companies while ensuring access to natural resources that are so essential its continued development. If Latin America could reinvest some of the resources it receives from China in innovation, industrial diversification, and environmental protection, its relationship with China could be mutually beneficial. Otherwise, this new source of funding could pose a great risk to the region.

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