What's *Left* for Latin America to Do With China?

By Kevin P. Gallagher

CELEBRATED WITH MUCH FANFARE, VENEZUELA and China signed a "strategic alliance" in December. Under this new bilateral deal, Venezuela began sending 600,000 barrels of oil per day to China in January. In return, China will begin investing in Venezuelan mining and energy production.

Deals like these are not limited to Venezuela. Indeed, since the world economic crisis began to unfold, China has signed on the dotted line with Ecuador to lend it $1 billion to build a hydroelectric plant, and with Brazil's national oil company, Petrobras, for $10 billion.

In Peru a Chinese consortium has invested $2 billion to upgrade the port facility at Tacna, and $8 billion to run a new highway and rail links connecting Tacna to El Mutún, a mineral field in eastern Bolivia.

China has also made $10 billion in Chinese yuan available to cash-strapped Argentina, to help it pay for Chinese imports.

These are just a few examples. Compare them to the efforts of the Inter-American Development Bank, whose entire allotment for all of Latin America each year is about $11 billion.

The high-gloss, made-for-flat-screen signing ceremonies between Chinese and Latin American officials are staged to portray the triumphant return of the New International Economic Order. Yes, it's true, the Global South is banding together again to trade once more.

But wait a minute. Why are recent reports by the World Bank and the Organization for Economic Cooperation and Development also hailing this increase in China–Latin American trade relations?

The Bank and others like to cite the fact that Latin American exports to China grew by 370% between 2000 and the dawn of the financial crisis in 2007, dwarfing overall Latin American export growth of 62% during the period. The vast majority of those exports were in primary products—oil, soybeans, copper, iron ore, and forest products. This in part fueled unprecedented economic growth in the region. In per capita terms, Latin America grew by 4.2% each year during that period—faster than at any time in recent history.

Why is the World Bank so happy about this? Is it now a champion of the new internationalism? Not if you ask them. It's because the Washington Consensus is finally working, they say. To the World Bank, China trade will reveal to Latin America that its true future lies in what it has a comparative advantage in under free trade—exporting primary commodities. So once and for all, the bank says, get the state out of the way!

LOST IN THE JUSTIFIED EUPHORIA OF CAMERA-flashing South-South trade deals is that heterodox, left economists in the hemisphere have long warned about the longer-run perils of primary-commodity-based exports in the region. China trade only accentuates these concerns.

A closer look reveals that Latin American exports—the same goods that China seeks to lock up in "strategic alliances"—are in low-employment, environmentally sensitive Latin American sectors that can cause macroeconomic vulnerabilities when dominant in a nation's export profile. What's more, China's ability to import raw materials from other parts of the developing world frees it to diversify its economy toward higher-value-added manufactured goods that outcompete their Latin American counterparts in world markets.

For example, on the surface the surge in soy exports to China from Latin America looks extraordinary. In 2008, more than a quarter of all Latin American soy exports (seeds and oils)

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went to China, for almost $10 billion. Virtually all of those soybeans come from Brazil and Argentina. In 2008, almost half of all Brazilian soy exports when to China, as did 75% of Argentina's. Thus, China is a large and key market for this commodity.

That's the good news. Yet despite all the exports, the industry has become more concentrated, and employment has decreased significantly. According to Mamerto Pérez, Sergio Schlesinger, and Timothy A. Wise in their 2008 report, "The Promise and the Perils of Agricultural Trade Liberalization: Lessons From Latin America," by 2005, only four companies composed 59% of Brazilian soy processing and 61% of soy-based exports. Two of those firms are from the United States, Archer Daniels Midland and Cargill. In terms of generating employment, the authors found that while soy production tripled between 1985 and 2004, employment in the sector fell by 80%, from 1.7 million to just 335,000 jobs.

Soybean expansion also has an environmental price tag. Brazilian soy exports have increased by almost 50% each year since 2004, with about half of it destined for China. As shown by Carmen Vera-Diaz of Tufts University and others, China-led demand has significantly expanded the territory cultivated for soy in Brazil. In 1990, 88% of all soy production was located in the state of Mato Grosso do Sul. However, by 2005 that figure was only 40%, and soy production has expanded into Maranhão, Pará, Acre, Roraima, and Rondônia.

The accentuation of commodity dependence raises concerns over the so-called Dutch disease: Resource-dependent countries do not develop strongly because they are victims of a "resource curse." Nations that overly depend on commodities have been shown to de-industrialize because discoveries of such resources raise the value of a nation's currency and make manufactured goods and services less competitive, eventually increasing imports, decreasing exports, creating balance-of-payments problems, and leading to poor economic performance.

It's too early to tell if this long-term threat will come to roost in Latin America. But there are signs. In January Venezuela's currency was becoming so strong that the government conducted a devaluation—and citizens were photographed flocking to stores to buy flat-screen televisions and other items before they became too expensive.

And China's exports are taking a real bite out of Latin American markets for manufactured goods and global markets where Latin American manufacturing companies face their Chinese competitors.

Latin America is an important anchor market for regionally produced manufactures exports. What is more, like the world market, the Latin American and Caribbean (LAC) market was growing swiftly, at least until the financial crisis. Between 2000 and 2007 the Latin American manufacturing import market grew 73%. China outcompeted other Latin Americans for that market, however, leaving the region with a net trade deficit with China. Manufacturing imports from China grew 420% and are now almost a quarter of all such imports in Latin America.

What is perhaps most concerning is the fact that Latin American manufactures exporters are continually threatened by their Chinese counterparts in world markets. In my book with Roberto Porzecanski, I calculate the extent to which Latin American exports are "under threat" from Chinese firms on a sector-by-sector basis in world markets. Threat means that a Chinese product is increasing its market share while the Latin American share for the same product is decreasing. According to our calculations, 94% of all Latin American manufacturing exports and 40% of all LAC exports in 2007 were under threat from China.

In a nutshell, while China serves as a great new market for Latin American commodities exports, the country's manufactures exports are helping to hollow out Latin American industry by outcompeting the region's firms both on their home turf and abroad.

IN THIS LIGHT, EXPANDing COMmodities export markets has been beneficial for Latin America's aggregate economic growth, but it has come at a real cost. It is hard to argue that increasing market opportunities should be avoided, especially in the midst of a global financial crisis that is affecting the region in stark ways. However, Latin America would do well to complement its existing ties with China in ways that allow economies in the hemisphere to diversify, like China's does.

What is often overlooked is that China is doing a better job globalizing than Latin America. Think about it: In the early 1980s both China and Latin America sought to integrate with the world economy in order to grow their economies and raise standards of living. In per capita terms, China has grown at a rate of more than 8% per year, while Latin America has grown just more than 1% per annum. China has brought millions out of poverty, while Latin America has remained the most unequal place on earth.

Early on, Latin America installed a swift "shock" of Washington Consensus policies of trade and financial liberalization, privatization, and deregulation. In stark contrast China deployed a "crossing the river by toughing each stone" approach. Whereas the Latin American state (with the exception of Brazil) has largely removed itself from economic affairs, the Chinese government has strategically partnered with key sectors, aiding research and development, providing credit and information, and helping to establish a favorable macroeconomic environment.

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A stronger South-South cooperation effort would involve partners that truly share their strengths rather than trade them. There is a lot more left to do with China. Three things would get Latin America on a better path:

1. Leverage up the value chain. When China cuts deals with foreign companies from the North, it leverages the fact that it enjoys a huge market and export platform for those multinationals. In return for foreign investment, China sees to it that multinationals transfer technology and know-how, set up research and development facilities, and source from domestic suppliers. Latin America could follow suit. Instead of simply cutting deals for more raw materials, Latin America could bargain for technology sharing to move up the value chain to processing and beyond. Latin America has the leverage because many of the commodities China wants are largely located in Latin America. Bolivia has large deposits of lithium, an essential ingredient for hybrid cars. Rather than just selling or contracting for the lithium itself, what about a research and development unit or even a battery-making plant to boot?

2. Cooperate on science, technology, and innovation. The Chinese spend 2% of their GDP on research and development, register an average of 100,000 patents each year (75% of which are Chinese patents, rather than multinationals'). Latin America spends .57% of its annual GDP on research and development and registers a mere 35,000 patents each year, 87% of which are held by multinationals and are therefore hard to access by the local economy. Truly strategic partnerships between Latin America and China would include joint research laboratories, technology sharing, and innovation projects.

3. Forge coalitions for policy space at the WTO and beyond. China, along with India, South Africa, and to some extent Brazil are at the forefront of working to preserve policy space for state-led economic development in the developing countries. At the WTO and now in the G-20, this coalition has been able to "do less harm" at least and even float positive alternatives like WTO amendments for public health, a global reserve currency, and so forth. With the exception of Brazil, many Latin American countries have been working on bilateral and regional trade deals with the United States and other higher income nations that curtail their policy space and make the fragile South-South coalition for development in the WTO and beyond more vulnerable.

Latin America will need to be much more proactive if it is to truly have a partnership with China. If it doesn't, China may continue to gallop into higher income status, and Latin America will be left out in the cold.