

Latin America's China Challenge

By [Kevin Gallagher](#)

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[China Petrochemical Corporation bought](#) Occidental Petroleum's Argentina operations, capping close to \$15 billion of Chinese foreign investment in Latin America for 2010. In addition to this new source of foreign investment, China has become a new export market for Latin America. Well over \$50 billion of Latin American products, chiefly iron and copper ores, soya, and crude oil, will reach China this year as well.

China's unprecedented and impressive growth has been a great boon to Latin America in the short-term. It is up to Latin American nations to translate these short-term gains into longer-run economic development.

Not only has China become a new source of export and investment demand for Latin American commodities, China's demand has boosted the price of key commodities as well. Indirectly through China then, Latin Americans enjoy a higher price for their key commodities across the globe. In the aftermath of the crisis, Latin America is set to grow at a pace of more than five percent in 2011, [according to the IMF](#).

In order for Latin American nations to leverage its new economic relationship with China for long run benefit, Latin Americans will have to use newfound gains to enable macroeconomic stability, economic diversification, and environmental protection.

In the longer run, a renewed emphasis on primary commodities production in Latin America could trigger a "resource curse." High prices and demand for commodities could steer investment away from manufacturers, push up the exchange rate, deem Latin American manufacturers uncompetitive, and put pressure on the natural environment.

Exchange rates in Latin America are rising fast, with Brazil's real appreciating almost 40 percent since 2008. In my book with Uruguayan political economist Roberto Porzecanski, [The Dragon in the Room: China and the Future of Latin American Industrialization](#), we show that Latin American firms are losing ground to China in world and home markets. We find that 92 percent of Latin American manufacturing exports to the world are in sectors where China is gaining market share and Latin America is losing share, or where both China and Latin America are gaining ground but Latin America at a lower rate.

In Brazil's case, 2010 marks the year when [commodities exports outstrip manufacturing](#) exports as a percent of GDP. Close to half of Brazilian soy exports go to China, which boosts profits. However, as Brazilian soy exports have intensified, job creation in the sector has declined and deforestation in the Brazilian Amazon has intensified.

China is not to blame for these concerns. Indeed, Latin America would do well to learn from China—a nation that not long ago transformed itself from a commodity-based society to the

world's largest exporter. Latin American nations need to create parallel policies to follow in China's footsteps.

One set of policies would be to establish stabilization and sovereign wealth funds with the windfall profits from commodities exports to China and beyond. [Chile's stabilization fund](#) allows the government to have funds on hand to stabilize the economy when copper prices are volatile. Such a fund enabled Chile to have the largest stimulus package to respond to the financial crisis in Latin America. Peru has set up a sovereign wealth fund from copper and silver exports—a fund that could be used for public investment.

Such funds also create the fiscal space for spending on poverty programs, industrialization, and environmental protection. This is the area where Latin Americans can learn from China most. Whereas China's approach follows Deng Xiaoping's approach to globalization of "crossing the river by feeling the stones," whereby the state plays a key role in economic development, under the "Washington Consensus" many Latin American nations shocked their economies by immediately pulling the state from economic affairs.

There are some signs of change. Although Brazil's manufacturing share of exports is in decline, the nation's development bank has begun to [invest in industrialization](#) and innovation. The bank is also investing in clean energy technology. However, they also invest heavily into infrastructure projects that enable commodities production and further degrade the environment.

China presents itself as an enormous opportunity for the Latin Americans. China is an example of a nation that used ties with other nations to transform itself from an agrarian society to an industrial giant. Latin America would do well to learn from China's example. If the region doesn't rise to the challenge, China's rise could be a missed opportunity.

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