

China-Latin America Economic Bulletin 2017 Edition

WORKING GROUP ON DEVELOPMENT AND ENVIRONMENT IN THE AMERICAS

Rebecca Ray and Kevin P. Gallagher

This China-Latin America Economic Bulletin is the fourth annual note summarizing and synthesizing trends in the burgeoning China-Latin America economic relationship. The goal of the bulletin is to provide analysts and observers a handy reference to the ever-changing landscape of China-Latin America economic relations, a landscape where data is not always as readily accessible. Highlights from this year's edition include:

- The “China boom” in Latin America and the Caribbean (LAC) appears to be cooling. LAC exports to China have barely grown over the last five years, after doubling during the previous five years. Meanwhile, LAC imports from China have fallen, shrinking the region's trade deficit with China.
- However, China's importance to LAC continues to soar in one sector: extractive industries. China has maintained its presence in LAC's extractive sectors, despite the slump in minerals prices, while other countries like the US have pulled back. China now purchases over one-fifth of all of LAC's extractive exports, and extractive goods account for over half of LAC's exports to China.
- Chinese investment and finance in LAC is also heavily focused on extraction. Mining, drilling, and refining accounts for over half of Chinese mergers and acquisitions in LAC, and coal, oil, and natural gas account for over half of public-sector lending: a record \$17.2 billion in 2017.
- A new official Chinese policy paper on LAC sets priorities for the coming years: a continued concentration on natural resources and energy, but supplemented with upstream and downstream investments to create supply chains in related industries. There are some signs of China-LAC moving in that direction.

The authors gratefully acknowledge research assistance provided by Zhao (Jackie) Chen.

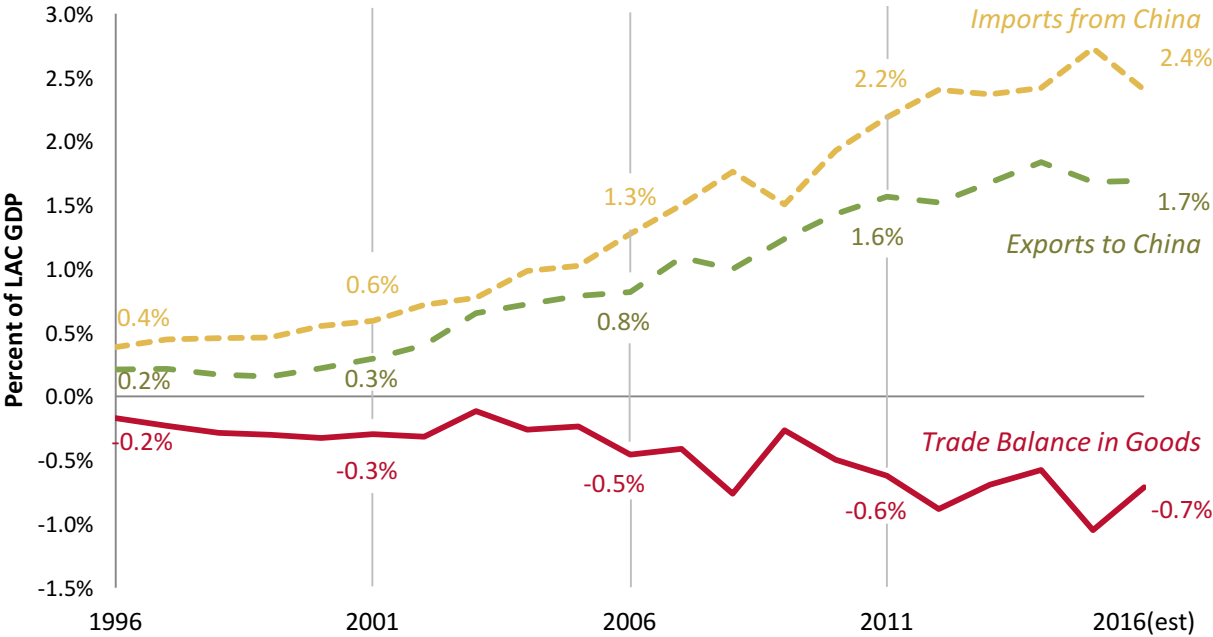
Major Trends in Trade, Investment, and Finance

In 2016, LAC’s economic relationship with China did not move much in total quantity: exports were flat while investment and finance fell slightly. However, one sector in particular reinforced its centrality in all three major channels: extraction. As the sections below show, China’s interest in LAC as a source of extractive raw materials has remained, even as other economic partners have shied away during the commodities price slump of the last several years.

Trade

In 2016, LAC’s exports to China remained nearly unchanged from 2015 and 2014, at \$103 billion. But LAC’s imports from China fell by 14% to \$113 billion, shrinking LAC’s trade deficit with China. This is not unexpected, given the region’s falling GDP during 2016 (a fall of 0.6 percent, according to the IMF). In 2009 (when the region was suffering from the recent financial crisis and experienced a 1.8 percent drop in GDP) LAC saw a similar drop in imports from China and in the trade deficit with China. In contrast, LAC exports to China stayed constant, at 1.7 percent of regional GDP during that period.

FIGURE 1: LAC Trade with China, as a share of LAC GDP

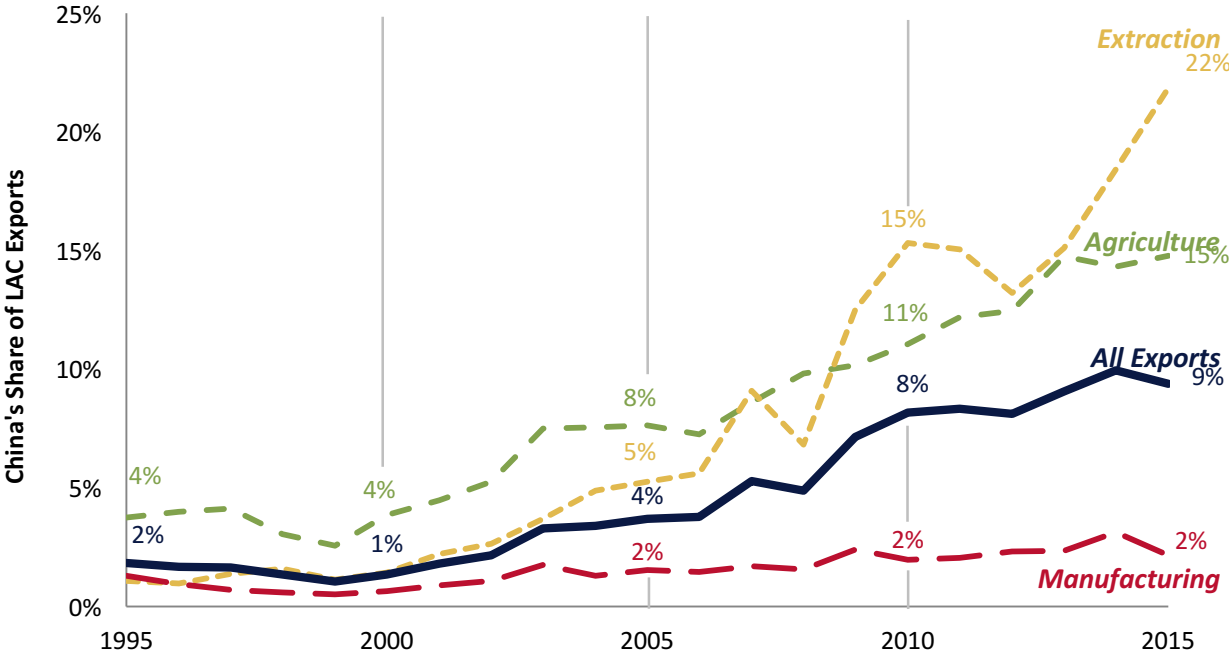


Source: Authors’ calculations using China Customs Information Center, UN Comtrade and World Bank World Development Indicators data. Data for 2016 are estimates.

Nevertheless, China continues to be central to LAC trade: it is the top destination for South American exports, and the second destination for all of LAC exports, after the United States. China’s importance is especially noteworthy among extractive exports, as Figure 2 shows. In

2015, the most recent year for which sector-level data is available, China bought a record 22 percent of LAC extractive exports, up from 18 percent in 2014. China has more than quadrupled its market share of these exports in the last decade.

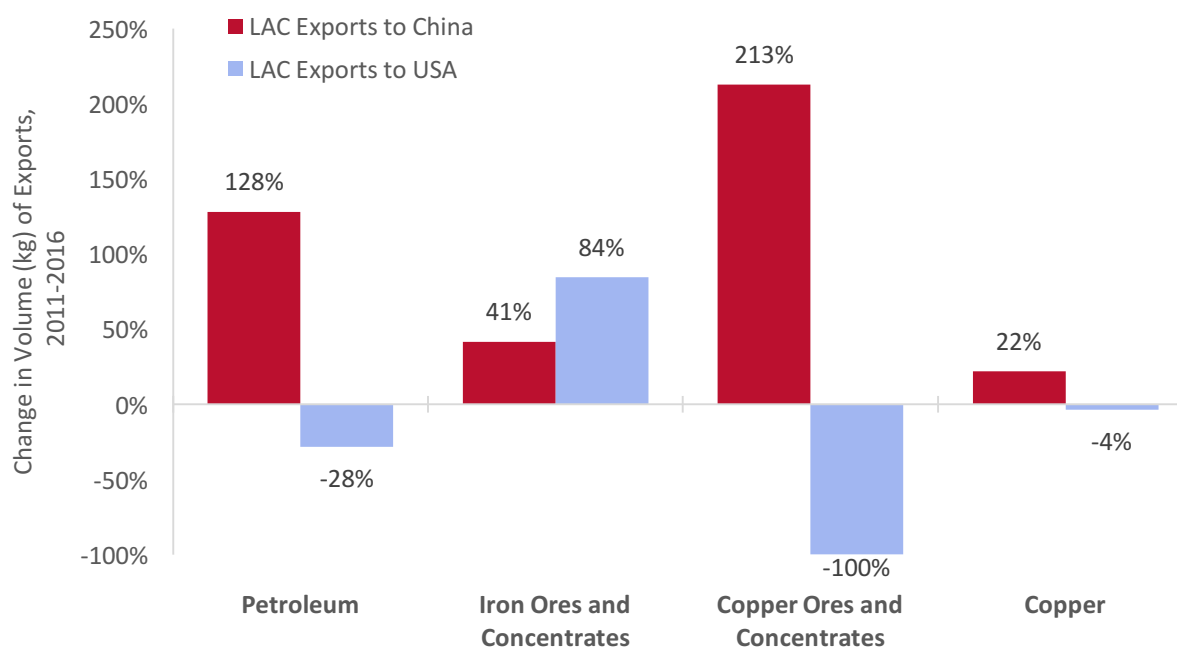
FIGURE 2: China’s Market Share of LAC Exports, by Sector



Source: Authors’ calculations using UN Comtrade data.

How is it possible to reconcile the apparent stagnation of the “China boom” shown in Figure 1 and the soaring importance of China among LAC extraction exports in Figure 2? The answer lies in the shrinking importance of the US, the largest market for LAC extractive goods. As Figure 3 shows, LAC’s top extractive exports to China have grown – but this growth has been mostly counterbalanced shrinking exports to the US, which has seen dramatic drops in its demand for metals from overseas (US International Trade Commission, 2016). In other words, China is effectively substituting for the traditional relationship with the US for these goods.

FIGURE 3: Change in Volume of LAC Extractive Exports to China and US, 2011-2016



Source: Authors' calculations based on UN Comtrade and China Customs Information Center.

The four commodities shown in Figure 3 dominate LAC's exports to China, along with soybeans. As Table 1 shows, from 2011 to 2015, these five commodity exports accounted for over two-thirds of total LAC exports to China over the most recent five years when sector-level data is available. All of them were raw or near-raw agricultural or extractive products. In contrast, LAC imports from China have been much more diversified. The top five imports accounted for less than one-fourth of the total, and they are all high-technology manufactured goods.

TABLE 1: Top 5 LAC-China Exports and Imports, 2011-2015

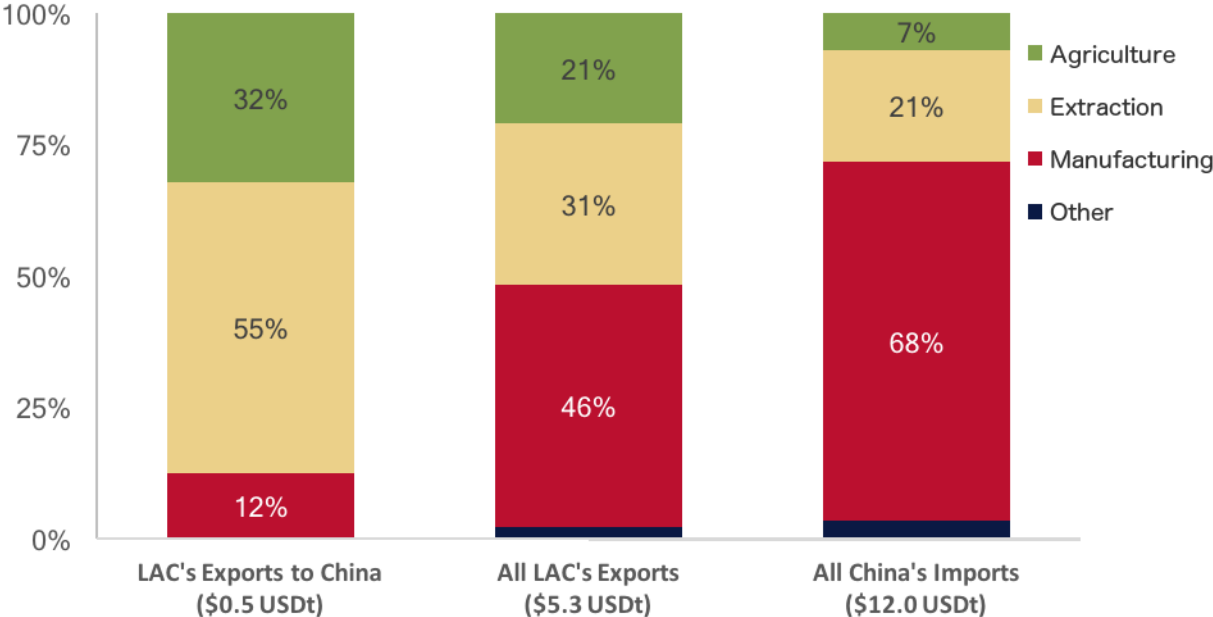
<i>LAC Exports to China</i>		<i>LAC Imports from China</i>	
1. Soybeans and other oilseeds	19.2%	Telecommunications equipment	9.7%
2. Iron ore and concentrates	16.8%	Data processing machines	3.8%
3. Crude petroleum	11.8%	Optical instruments, apparatus	3.3%
4. Copper	11.4%	Ships, boats, floating structures	3.3%
5. Copper ores, concentrates	10.0%	Other electrical equipment	2.3%
Total, top 5	69.2%	Total, top 5	22.5%

Source: UN Comtrade.

This heavy concentration in primary commodities is not normal for LAC exports. As Figure 4 shows, while manufactured goods accounted for only 12 percent of LAC-China exports over the last five years, they accounted for nearly half of all LAC exports to the world. Moreover, the concentrated nature of LAC-China exports is also atypical for China's trade with other regions. Among all products bound for China, worldwide, manufacturing accounts for over two-thirds of

the total. Thus, the concentration of raw materials in LAC exports to China are not simply a result of LAC endowments or of China’s demand for raw materials. Instead, it is the result of a strategic partnership between these countries.

FIGURE 4: Sector Distribution of Exports and Imports, 2011-2015



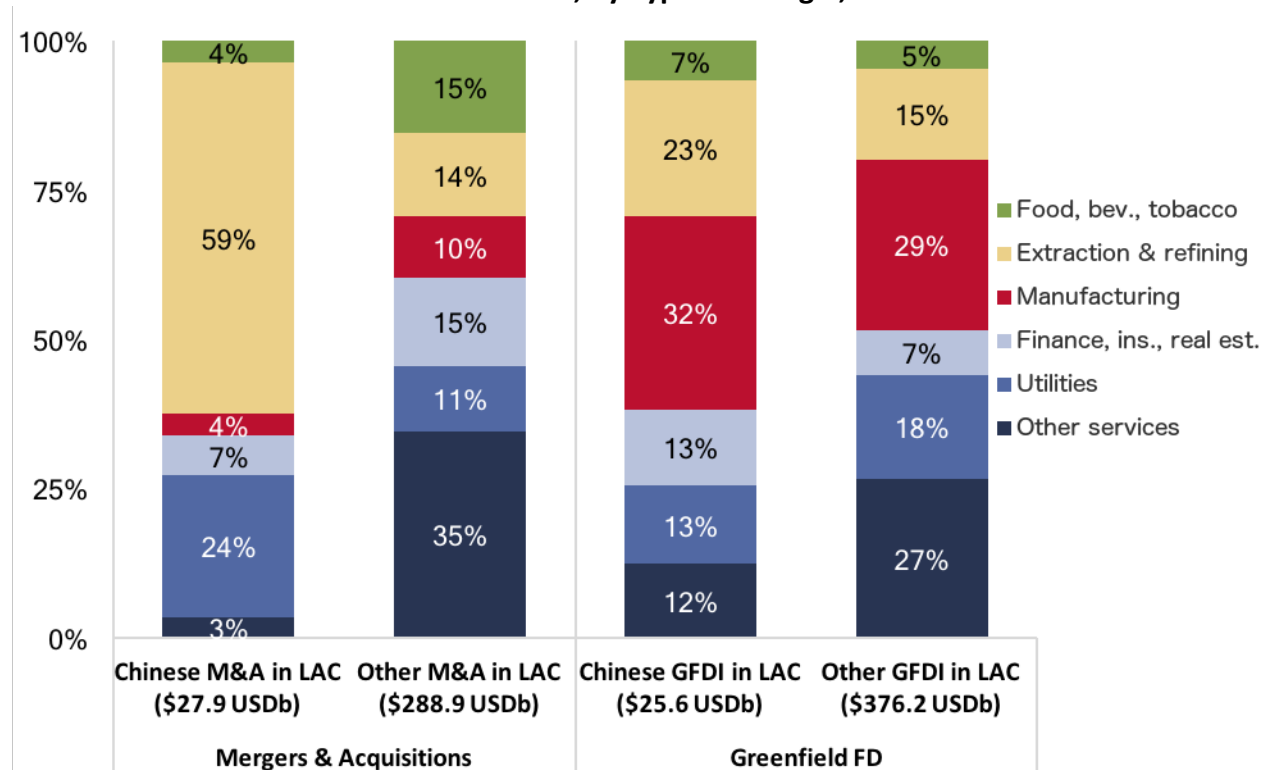
Source: UN Comtrade.

Investment

In 2016, Chinese companies invested \$3.3 billion in new (greenfield) FDI in LAC, down from \$4.8 billion in 2015. However, Chinese companies spent a much larger amount on mergers and acquisitions (M&As) in the region: \$12.4 billion, more than twice 2015’s figure of \$5.1 billion. This jump in M&As is largely due to one large acquisition deal: the State Grid Corporation of China spent \$8.4 billion to acquire a controlling share of the Brazilian CPFL Energia, the largest private power generation and distribution company in the country.

Figure 5 shows the sector distribution of FDI in LAC, divided by LAC type: M&As as well as new projects, known as Greenfield FDI (GFDI). In a continuation of the trend discussed in the trade section above, Chinese investment has given special emphasis to extraction. As Figure 5 shows, over half of Chinese M&As in LAC over the last five years were in the sector of extraction and refining, compared to just 14% of other M&As in the region. GFDI is more diversified than M&As in general, but Chinese GFDIs was still more heavily concentrated in extraction, with 23% in that sector, than other GFDI, which had just 15% there.

FIGURE 5: Sector Distribution of FDI in LAC, by Type and Origin, 2011-2016



Source: DeaLogic and fDIMarkets. Note: This figure does not include the Chinese GFDI project of the Grand Canal of Nicaragua, the funds for which have only just begun to be disbursed. If the Canal were included, Chinese GFDI in LAC would be 61% infrastructure, with the other sectors reduced accordingly.

This emphasis on extraction among Chinese investment in LAC is not new; it echoes the findings of Ray et al (2017), as well as Dollar (2017) and Dussel Peters and Ortiz Velásquez (2016). However, that emphasis may be beginning to weaken. As the projection section below shows, there are signs that Chinese investment in LAC is beginning to shift toward downstream industries.

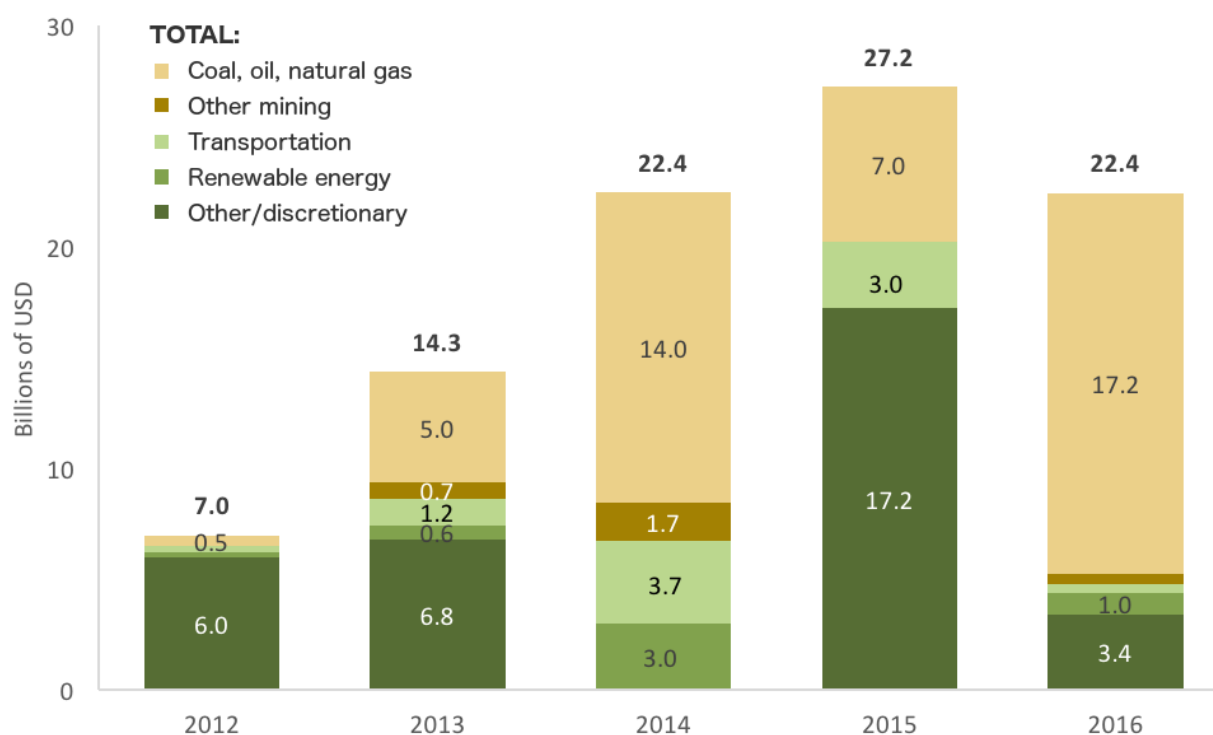
This past year also saw progress on some of the larger projects mentioned in previous versions of the *Bulletin*. For example:

- The Nicaragua Canal project has finished its archeological surveying process, clearing the way for the project to move forward. The HKND Group has announced that it expects to begin construction work this year (“Obras” 2017).
- A Chinese government space-monitoring base is nearing completion in Patagonia, Argentina. The People’s Liberation Army hopes to use the base to support an upcoming lunar mission as early as 2017 (Lee, 2016).

Finance

Chinese public-sector lending in LAC fell in 2016, from \$27.2 to \$22.4 billion. However, lending for coal, oil, and natural gas rose dramatically, to a record-setting \$17.2 billion. This category includes just a few large loans, all from the China Development Bank: a total of \$15.0 billion to Brazilian state-owned oil company Petrobras, and \$2.2 billion to Venezuelan state-owned oil company PDVSA. Both countries are struggling economically, and over the last several years they have borrowed from Chinese lenders during times of falling oil prices, when other financing has been scarce. Non-oil lending, in contrast, has shrunk to its lowest level in eight years.

FIGURE 6: Public-Sector Chinese Finance to LAC, 2012-2016, by Sector



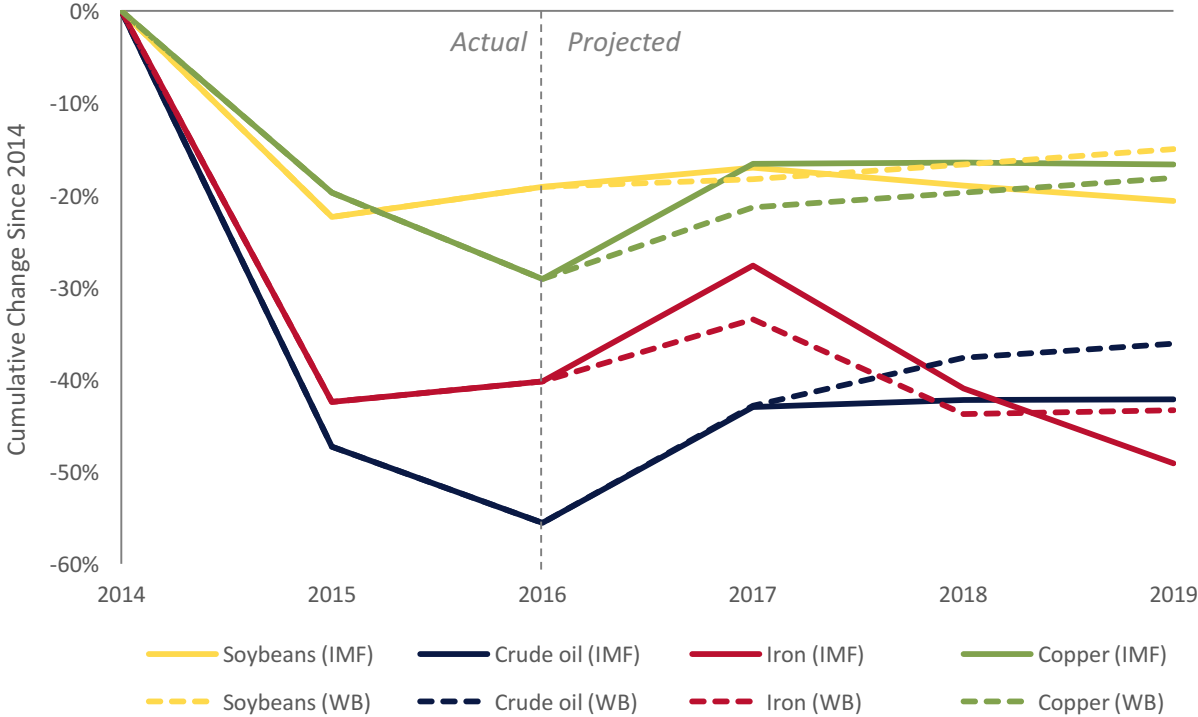
Note: These data do not perfectly match the data in Gallagher and Myers (2017), because the latter limit their analysis to development banks: the China Development Bank and the Export-Import Bank of China. For this paper, it is more relevant to include all Chinese public-sector sources of financing, including state-owned commercial banks and state-owned enterprises.

Beyond PDVSA and Petrobras, China also continued to lend substantially to Ecuador. In 2016, Ecuador borrowed \$970 million from the state-owned Industrial and Commercial Bank of China and \$1.5 billion from the China Development Bank (CDB) for discretionary spending, in addition to \$500 million from CDB for infrastructure projects. However, this represents a drop of more than 50% compared to 2015, when Ecuador borrowed a total of \$7.5 billion from China.

Looking Forward: Short-Term Pain, Long-Term Change?

The next few years promise to be difficult ones for exporters of raw materials. The price declines that began in late 2014 show no signs of reversing soon. Figure 7 shows the prices of LAC’s four top commodity exports to China: soybeans, petroleum, iron, and copper. Since 2014, these four commodities have lost between one-fifth and one-half of their value. According to the IMF and the World Bank, they aren’t expected to return to their 2014 levels for the next several years. If prices follow these projections, LAC’s terms of trade with China will suffer, along with its ability to continue to attract Chinese FDI, and LAC oil companies may seek to borrow more from China in the coming years.

FIGURE 7: IMF and World Bank Projections for Commodity Prices



Source: IMF and World Bank.

However, the impact of these low prices may be blunted somewhat if LAC begins to diversify away from relying on raw materials. In November of 2016, China released a new “Policy Paper on Latin America and the Caribbean” to guide the next several years of their relationship (Ministry of Foreign Affairs 2016). It foresees a transition toward upstream and downstream industries with these traditional sectors, in order to export “high added-value, and technology-intensive products.” The policy paper expands on this point:

China wishes to expand and deepen cooperation in the fields of energy and resources with Latin American and Caribbean countries based on the principle of win-win cooperation and sustainable development. Efforts will be made to bring cooperation to

upstream business such as exploration and development, so as to consolidate the foundation for cooperation and expand resources potentials; and at the same time, cooperation will be extended to downstream and supporting industries such as smelting, processing, logistics trade and equipment manufacturing, so as to improve added value of products.

The policy paper also prioritizes infrastructure investment, in order “to build production lines and maintenance service bases in the region for construction materials, non-ferrous metals, engineering machinery, locomotives and rolling stock, electric power and communication equipment.” Ultimately, the report envisions these infrastructure investments allowing the relationship to diversify, to include “automobiles, new energy equipment, motorcycles and chemical industry.”

Will these ideas come to fruition? Early signs seem to indicate that they may. The top Chinese investment deals in LAC in 2016 mostly follow the pattern set out in China’s policy paper. While they focus on raw materials and energy, they also include upstream and downstream investments that could contribute to the development of supply chains. For example, the top five Chinese GFDI projects include a steel and iron mill, an automobile factory, and a pre-fabricated house factory, as shown in Table 2.

TABLE 2: Top Chinese FDI Deals in LAC in 2016, by Type

No.	Investing Company	Project Country	Project description	Sector	Size (USDm)
Greenfield FDI Projects					
1	Petrolera Sinovensa ¹	Venez.	Oil dehydration and desalination plant	Refining	\$549
2	Sinosteel	Bolivia	Siderúrgica del Mutún	Steel, iron mill	\$450
3	Zotye Holdings	Brazil	Automobile factory	Manufacturing	\$307
4	Jinko Solar	Mexico	188 MWac solar farm	Alt. energy	\$224
5	Sany Heavy Industry	Argent.	Pre-fabricated house factory	Manufacturing	\$133
Mergers and Acquisitions					
1	State Grid Corp. of China	Brazil	CPFL Energia (29% stake increase) ²	Energy (divers.)	\$8,421
2	China Molybdenum	Brazil	Anglo American’s niobium and phosphates business	Mining, refining, and chemicals	\$1,687
3	China Three Gorges Corp.	Brazil	Duke Energy’s assets	Hydropower	\$1,200
4	Jiunquan Iron and Steel	Jamaica	Alumina Partners of Jamaica, from UC Rusal	Refining	\$299
5	Hunan Dakang Int’l. Food and Agriculture Co.	Brazil	Fiagrill Ltda (57% stake)	Agricultural supplies	\$200

Source: fDiMarkets, DeaLogic.

Notes: 1. Petrolera Sinovensa is a subsidiary of the state-owned China National Petroleum Corporation (CNPC). This project is an expansion of a current plant. 2. State Grid Corp. of China’s stake increase in CPFL Energy was announced in 2016, but not completed until 2017.

If these initial steps toward diversification materialize, it may signal China's willingness to collaborate with LAC on a new approach to the region's longstanding goal of industrialization. Lin and Wang (2016) refer to this new approach as "new structural economics" of Chinese cooperation. This new approach, which they also dub "development economics 3.0" in a reference to the past waves of import substitution industrialization and neoliberalism, refers to developing industries within countries' traditional areas of comparative advantage. At least one of the projects in Table 2, Sinosteel's investment in Bolivia's Siderúrgica del Mutún, represents such an approach. In that approach, The Export-Import Bank of China provided 85% of the finance for this steel mill, with the remaining financing coming from the government of Bolivia. Sinosteel plans to begin building the steel mill this year, and then have a one-year concession after it is completed before turning the plant over to the Bolivian government. The plant is planned next to an existing iron mine, and the government hopes that its creation will allow for exports of more refined versions of the metal (Chipana Mamani 2017 and Corz 2016).

References

Databases:

China Customs Information Center. "Customs Info." Online database, accessed February 15, 2016. <http://www.customs-info.com>.

DeaLogic. "DeaLogic Analytics." Online database, accessed February 23, 2017. <http://www.dealogic.com>.

Financial Times (No Date). "fDiMarkets." Online database, accessed January 15, 2015. <http://www.fdimarkets.com>.

United Nations Statistics Division. "UN COMTRADE: United Nations Commodity Trade Statistics Database." Online database, consulted March 26, 2015. <http://comtrade.un.org>.

World Bank. "World Development Indicators." Online database, consulted February 27, 2016. <http://databank.worldbank.org>.

Published works:

"Obras de puerto del canal de Nicaragua iniciarán en primer semestre de 2017." *El Nuevo Diario*, January 25, 2017. <http://www.elnuevodiario.com.ni/nacionales/416775-obras-puerto-canal-nicaragua-iniciaran-primer-trim/>.

Chipani Mamani, Willy (2017). "Sinosteel Alista Construcción de la Siderúrgica del Mutún." *Cambio*, January 11. <http://www.cambio.bo/?q=node/20177>.

Corz, Carlos (2016). "Gobierno Firma Contrató con la China Sinosteel para Construir la Planta del Mutún." *La Razón*, March 30. http://www.la-razon.com/index.php?url=/economia/Gobierno-Sinosteel-construir-Mutun-MM_0_2463353704.html.

Dollar, David (2017). "China's Investment in Latin America." Brookings Institution Discussion Paper. https://www.brookings.edu/wp-content/uploads/2017/01/fp_201701_china_investment_lat_am.pdf.

Dussel Peters, Enrique and Samuel Ortiz Velásquez (2017). "Monitor of China's OFDI in Mexico." Boston: BU Global Economic Governance Initiative. <http://www.dusselpeters.com/109.pdf>.

Gallagher, Kevin and Margaret Myers (2017). "China-Latin America Finance Database." Washington, DC: Inter-American Dialogue. http://www.thedialogue.org/map_list/.

Lee, Victor Robert (2016). "China Builds Space-Monitoring Base in the Americas." *The Diplomat*, May 24. <http://thediplomat.com/2016/05/china-builds-space-monitoring-base-in-the-americas/>.

Lin, Justin Yifu and Yan Wang (2016). *Going Beyond Aid: Development Cooperation for Structural Transformation*. Cambridge University Press.

Ministry of Foreign Affairs of the People's Republic of China (2016). "China's Policy Paper on Latin America and the Caribbean." Accessed February 24, 2017. http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1418254.shtml.

Ray, Rebecca, Kevin Gallagher, Cynthia Sanborn, and Andrés López (2017). *China and Sustainable Development in Latin America: The Social and Environmental Dimension*. Anthem Press.

United States International Trade Commission (2016). "Minerals and Metals." https://www.usitc.gov/research_and_analysis/trade_shifts_2015/minerals.htm.