China and Latin America: Historic Opportunity

Latin America should seize this historic opportunity and take advantage of the unexpected boom in natural resource prices to strengthen technological and production linkages with China.

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THERE IS LITTLE doubt in the Americas that China is revolutionizing world demand for raw materials and changing the map of global competitiveness. (...)

At the same time, many Latin American countries welcome Chinese capital and imports as a means to generate much needed economic growth in the short-term. South America, in particular, has benefited from increased Chinese demand for commodities and lower prices for manufactures it purchases from China, enjoying four consecutive years of surpluses with China. Meanwhile, in Central America and Mexico trade deficits keep widening as countries face fiercer competition from China in textiles and maquila products in the United States market. (...)

Growing Latin American and Caribbean relations in trade and investment with China have led to the establishment of socalled “strategic partnerships” with key countries in the Americas. This includes Argentina, Brazil and Mexico, and Venezuela with a “strategic partnership for common development”.

China’s relationship with Chile, although not officially designated as such, can also be considered of a strategic nature not only in light of the strong trade relationship in minerals, and the recent signing of a free-trade agreement (China’s first in the Americas), but also due to Chile’s high-volume deepwater Pacific ports through which goods can flow to and from China. Ties with other countries such as Cuba, Bolivia, Colombia, Ecuador, and Peru fall under the category of “all-round” cooperative relationships. The potential exists for these to be upgraded to “strategic partner” status, as China’s interest in their energy resources is well known. (...)

MEXICO AND VENEZUELA

Overall, there seems to be a sharp contrast in the Sino-Mexican relationship between cooperative political dialogue on the one hand, and tense economic relations on the other. Shared views of international affairs, similar stances in multilateral bodies, and the fact that several Chinese leaders studied at the Colegio de Mexico and speak Spanish fluently, are some of the elements that have contributed to a good political understanding between the two countries.

Mexico was a driving force behind China's attainment of observer status at the Organization of American States, and currently supports the Chinese bid to formally join the Inter-American Development Bank. Protecting this positive dimension of bilateral relations from strained economic relations over allegations of Chinese dumping and piracy is an ongoing challenge for the Mexican Ministry of Foreign Affairs. (...)

Venezuela...is arguably China's closest political ally in South America. (...) A Strategic Energy Plan that extends until 2011, which commits Venezuela to increase oil exports to China, binds the two countries. In addition to the two oil fields currently operated by China (Intercampo Norte and Caracola blocks), in 2004 President Chavez sealed oil and gas deals that allowed Chinese companies to invest $350 million in 15 oil fields located in eastern Venezuela, as well as an additional $60 million investment in natural gas projects. (...)

BRAZIL

Home to half of South America's population and GDP, Brazil's stable and diversified economy, and solid institutions are well placed to handle growing interaction with China. Evidence of this is Brazil's enforcement of transparent practices such as public biddings and of limitations in the importation of foreign nationals to work in Chinese infrastructure projects, common in Chinese operations in Africa and in other Latin American countries. As a result, Chinese investment in Brazil has been considerably less than expected.

While some observers have attached ideological significance to Sino-Brazilian relations mainly given the Third World rhetoric shared by the respective leaders and joint action at the WTO, pragmatic economic interests appear to be foremost in the minds of Brazilian government officials dealing with China. This said, extensive Sino-Brazilian cooperation in satellite technology has raised alarms in the US given the possible military applications associated with high-resolution satellite imagery.

CENTRAL AMERICA

This is the arena where China and Taiwan are playing their competitive game of "dollar-diplomacy" in the Americas. Another factor pressing Central American and Caribbean governments is concern over chronic balance of payments (BoP) deficit positions with the world. In Africa, China has forgiven $1.3bn in debt relief in 31 countries, and has agreed to abolish tariffs on 190 imported goods from 25 African countries. While overtures of this kind have not been seen in the Americas, calculations over increased purchases from China seem to be weighing in Central American capitals.

Guatemala and El Salvador appear most likely to change official diplomatic ties, with the business community in each lobbying for access to the Chinese market. Honduras and Nicaragua could also be considered likely candidates – especially if the Sandinistas win presidential elections in Nicaragua later this year.

Conversely, Panama and Costa Rica, with relatively smaller BoP deficits, would seem under less pressure to alter their stance. In the Caribbean, the Dominican Republic has drastically improved its BoP position in recent years. (...)

Central America sees China as a direct threat to its economic interests. Chinese competition in textiles and the maquila industries in US markets will cost this region tens of thousands of jobs. (...)

FREQUENT VISITS

Much of the increased economic linkages were given a boost by an April 2001, 13-day tour to Chile, Argentina, Brazil, Venezuela and Cuba by former Chinese President Jiang Zemin.(...)

More recently, current President Hu Jintao was in Latin America in November 2004 in conjunction with an APEC summit in Santiago, Chile. Prior to the summit, President Hu visited Argentina, Brazil, Chile, and Cuba, reaching agreements in a wide range of sectors from energy cooperation, to infrastructure financing, to commodity purchasing contracts, to deals in telecommunications, education, and tourism sectors. (...)

Similar to the Jiang tour of 2001, Hu's trip was followed with Vice President Zeng Qinghong's visit in January and February 2005 to Mexico, Venezuela, Peru, Trinidad and Tobago and Jamaica. At the last location, he attended the first ministerial meeting of the China-Caribbean Economic and Trade Cooperation Forum, initiated by China in 2004. During this trip, Zeng signed about 50 cooperation agreements in energy, economic cooperation, transport, telecommunications, and other fields, following up on the President's recent footsteps.

President Hu was also recently in Mexico for a two-day visit on September 11, 2005, as part of his trip to NAFTA countries in conjunction with the UN General Secretary Meeting on UN reforms. This flurry of Chinese diplomacy has not been one-sided in any way. Key Latin American leaders have led several high-level trade and investment delegations to China, including Bolivian President Morales in January 2006, Brazilian President da Silva in May 2004, Argentine President Kirchner in November 2004, and Venezuelan President Chavez in December 2004.

In contrast, US President George Bush, for his part, spent limited time in Santiago, before departing for a four-hour stay on an island off the Colombian coast. More recently, the Summit of the Americas in Argentina in early November 2005 also included stopovers for President Bush in Brazil and Panama over the same weekend. Overall in 2004, President Hu spent more time in Latin America than President Bush. Moreover, Chinese vice-president, Zeng Qinghong has spent more time in the region in the past few months than has his US counterpart Dick Cheney over the past four years. Going back even further, [Hoover

Institution fellow William] Ratliff notes, “Indeed, Hu’s predecessor, Jiang Zemin, took two long trips to Latin America, in 1999 and 2001, and in all probability spent more time there than any serving U.S. president in history.” (..)

CHINESE THREAT

As Mexico and Costa Rica, respectively, are increasingly integrated into global supply chains managed by multinational corporations, and hold disproportionate shares of non-resource based manufactures within Latin America as a whole, they are much more susceptible to the impact of falling trade costs that make distant locations look more attractive. Thus, as China continually upgrades its production capabilities, certain higher technology production facilities in Mexico and Central America may find lower-cost China hard to resist. This said, there might be other factors, such as intellectual property rights, influencing business decisions. For example, it has been reported that companies such as Bombardier, Hewlett- Packard and Motorala are switching operations from China back to Mexico allegedly because of better intellectual property protection.

With respect to China’s impact on NAFTA relations, Mexico holds clear advantages in some sectors, such as in the US motor vehicle import market, where China’s share was 0 between 1998-2002. In other sectors such as: auto parts, television receivers and video monitors, measuring, testing, and controlling instruments, electric motors, generators, and related equipment, Mexico continues to hold strong market share in higher value sectors despite startling but still modest Chinese inroads. However, in lower technology goods such as footwear, toys, dolls, etc. and apparel (to a lesser extent), China has a much stronger if not dominating share in the respective US markets over Mexico.

Insofar as much of the Latin American region has hitherto failed to diversify its production structure into dynamic areas of growth, it may face a more serious threat as specialization in resource-based and primary products combined with rapid Chinese growth in labour-intensive manufactures may further constrain such efforts. Nevertheless, the American market seems to be the main China-Latin American competitive arena to keep an eye on. (..)

The impact of China’s clothing exports to the US following the end of the Multi-Fibre Agreement’s (MFA) quota system on textile and clothing sectors in January 2005 [shows that] China’s share is estimated to have more than doubled since 2003 to 56 percent, Mexico’s has fallen to 3 percent (down 7 percent), while the share from ‘Other LAC’, presumably including many Central American countries, has also declined by 11 percent, capturing a 5 percent share in the early post-MFA era. A November 2005 agreement between the US and China setting limits on China’s exports of 34 types of clothing until 2008, should provide a respite to Central American textile producers. (...)

VENEZUELAN OIL

So far, Latin American energy resources has not been prominent among the current list of global oil suppliers to China, but this appears set to change given the recent bout of diplomatic activities. Although Venezuela, for instance, exports a far greater amount of oil and related products to the US (about 1.4m bpd) than to China, China's volume of 12,300 bpd in 2004 has grown to 70,000 bpd in 2005. Moreover, recent statements have set a target of 300,000 bpd in Venezuelan oil exports to China by 2012, representing 15-20 percent of Chinese oil import needs.

Recent deals support these statements as China's state-owned CNPC (China National Petroleum Corporation) has been allowed access to 15 mature oil fields in Zumano area of Anzoategui state (proven reserves of 1bn barrels, peak production of 50,000 bpd), as well as a stake in the joint development of the Orinoco tar belt with Venezuela's state oil company Petroleos de Venezuela (PdVSA) (reserves of 20bn barrels, peak production of 300,000 bpd).

The latter project has been estimated to require an investment between $3-4 billion, dwarfing the $1.5 billion already invested by China in the country. Agreements recently signed also include associated investments in natural gas extraction, construction of refineries, as well as other oil infrastructure such as a potential pipeline to connect to Colombia's pacific ports.

PETROBRAS

Along the Atlantic coast, China's Sinopec entered into cooperation agreements with Brazil's stateowned oil company Petroleo Brasileiro SA (Petrobras) for joint oil exploration, production, refining, product sales, petrochemicals, pipelines, and technical assistance. As Brazil is still a net importer of crude oil, Petrobras is hoping to boost oil shipments to China, doubling the amount to 50,000 bpd, which is equivalent to about 18m barrels per year – a stark contrast to the ambitions visible in Venezuela.

As such, the partnership seems less based on oil exports, as opposed to leveraging the individual abilities of each firm. For instance, Petrobras opened a representative office in Beijing in May 2004 during President da Silva's visit to the Chinese capital, while Sinopec has been interested in participating in the building of a new refinery, pipelines, and a natural gas liquefying plant in Brazil.

Both have signed a memorandum of understanding regarding a 1,225 km, $1.3 billion gas pipeline linking the southeast to the northeast of Brazil. More recently, however, the project has been delayed due to higher project costs cited by the Chinese partner, making the entire project less feasible for Petrobras.

With regards to exploration and production, there is a sense of specialization and skill transfer as Petrobras has been tasked with deep-sea activities in the China Sea, while Sinopec is in Brazil assisting the recovery of mature oil fields.

Moreover, the Sinopec-Petrobras agreement also allows for cooperation in third countries, including Petrobras concessions in Ecuador and Iran. CNOOC and CNPC, it should be noted, are also in talks for joint operations with Petrobras along the same lines as Sinopec's agreement.

ARGENTINA AND ECUADOR

In Argentina, as part the promised package of $20 billion in Chinese investment over 10 years, President Hu has committed about $5 billion to the oil industry over five years. The tentative deal, signed during the President's November 2004 tour in the region, has Argentina's newly established state firm Energia Argentina SA (Enarsa) working with a Chinese subsidiary of the Angolan state-owned company Sonangol. The Chinese partner, China Sonangol International Holding (CSIH), will jointly explore potential new fields as well as upgrade mature wells in concessions off the coast of Argentina.

On the Pacific coast, China's energy interests are also well represented in oil assets, particularly in Ecuador and Peru. In Ecuador, for instance, the Chinese consortium Andes Petroleum, which includes both CNPC and Sinopec, successfully acquired the oil assets of a Canadian firm, Encana Corp. in Sept. 2005 for $1.42 billion. With the deal, the CNPC consortium receives about 75,000 bpd from five production blocks (Dorine oil field), with proven reserves of about 143m barrels. In addition, the consortium also takes-over Encana's 36 percent stake in the 500km long OCP (Oleducto de Crudos Pesados - Heavy Crude Pipeline) pipeline, initially spearheaded by Encana in 2001, that has a capacity of 450,000 bpd. The OCP is credited with increasing oil production in Ecuador, as its completion doubled the country's oil pipeline capacity. The pipeline is significant insofar as it is the only other pipeline in Ecuador besides the SOTE (Sistema Oleducto Trans-Ecuatoriano – Trans- Ecuadorian Pipeline) pipeline, built in the early 1970s, which is prone to natural disasters, and is run by the state-owned Petroecuador.

Overall, Ecuador holds the third-largest proven oil reserves (4.6bn barrels in 2005), and is the fifth-largest producer of oil in South America, producing 534,800 bpd oil products, of which 528,200 bpd was crude oil. With low rates of consumption, Ecuador is a significant exporter, over 50 percent of which goes the US, accounting for about 2.3 percent of total US oil imports and placing the country second, behind Venezuela, as South America's largest single source.

PERU AND BOLIVIA

In December 2003, CNPC acquired a 45 percent share of Pluspetrol Norte (PN), the Peruvian unit of Argentine firm Pluspetrol. PN is the largest foreign operator in Peru, and accounts for over one-half of Peru's entire crude oil production of about 94,120 bpd (2004). Although national production has been on a declining trend since 1980, proven reserves are estimated at 253m barrels, primarily concentrated in the northern part of the country. The acquisition expands the number of oil fields operated by CNPC subsidiary, Sapet, in offshore northern

Peru, while also positioning CNPC in planned Pluspetrol oil ventures in Ecuador, Venezuela, and Colombia. Significantly, the acquisition leaves Pluspetrol with a majority 55 percent in PN.

In Bolivia, with the second-largest natural gas reserves in South America (24.0 trillion cubic feet), Chinese interests are less focused on crude oil extraction. In December 2004, the Chinese firm Shengli Oilfield International Exploit was set to sign about seven contracts worth at leaset $1.5 billion with Bolivia's state oil company YPFB (Yacimientos Petroliferos Fascales Bolivianos) spanning: exploration and production for 10 blocks; construction of at least one thermoelectric plant, a polyethylene plant, two refineries, and a pipeline to connect the wells to these plants; 250,000 residential connections; and doubling YPFB's service station network to 80 outlets. Although the agreements have been delayed due a controversial new domestic hydrocarbons law that has yet to be resolved, sources indicate that Shengli was able to arrange these contracts because of its acceptance of a minority stake, with a controlling share of 51 percent going to YPFB. (...)

HISTORIC OPPORTUNITY

Latin America, and especially South America, should seize this historic opportunity and take advantage of the unexpected boom in natural resource prices to strengthen technological and production linkages with China through joint ventures at home and in Asia. So far, Brazil appears to have made the most strides in this regard.

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