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Policy Insights No. 23

June 2006

China: A Helping Hand for Latin America?

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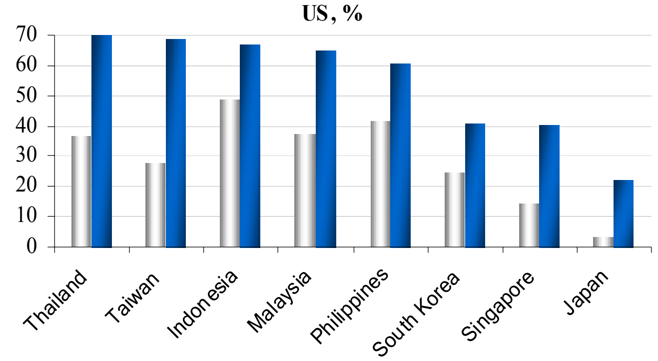
- China's trade impact on Latin America is positive via an export boom and indirectly better terms of trade.
- Its emergence is also a wake up call for the region: more reforms are needed, especially in infrastructure, in order to maintain Latin America's comparative advantage.
- The Chinese windfall brings risks of exclusion in a "raw materials corner" out of global value chains.

China's economic boom is a major global tectonic change. Over the last few years, China has expanded by leaps and bounds to become both a threat to and an opportunity for emerging markets. In the context of Latin American economies, China looks more like a "trade angel" and a "helping hand". Competition with the Chinese market in the US is much lower for Latin American than for Asian countries (see graphs).

of which 15 were Latin American countries. Venezuela, Bolivia and Chile have the lowest indexes among the 34 and are thus those that suffer least from Chinese trade competition. Brazil, Colombia and Peru are in an intermediate position. The countries that are most exposed to Chinese competition in the United States are the Central American countries and Mexico.

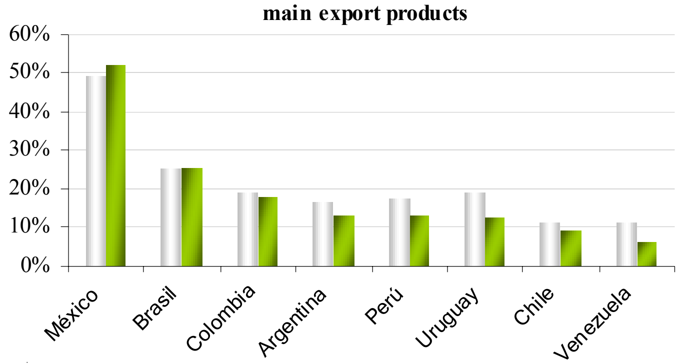
Asian countries competition* vs. Chinese exports to US, %



* Value of exports to the US from China in same product categories as country's exports, as % of country's total exports to the US.

Source: C.HJ.Kwan, Nomura Institute of Capital Markets Research.

Latin American countries competition* vs. Chinese main export products



*Arithmetic average of the following indexes: CC= $\frac{\sum_n a_{it}^n a_{jt}^n}{\sqrt{\sum_n (a_{it}^n)^2 \sum_n (a_{jt}^n)^2}}$ and CS= $1-\frac{1}{2}\sum_n \left|a_{it}^n - a_{jt}^n\right|$

where ajt and ait equals the share of item "n" over total exports of countries j (China) and i in time t.

Source: Blázquez, Rodríguez and Santiso (2006).

Latin America is a clear trade winner from Chinese global integration. An analysis of China's import and export structures offers an indication of its trade impact on world economies. A database of 620 different goods allows two indexes of trade competition to be constructed in order to compare China's impact over the period 1998-2004 on 34 different economies,

But China's emergence is a wake-up call. Countries like Mexico will have to boost reforms in order to remain in the competitiveness race. Labour costs will clearly not provide the competitive advantage, at least in the medium term. Proximity to the United States is a major strategic asset. Improving the efficiency of roads, ports, railways and airports in order to lower transaction and transportation costs is clearly the priority. For other Latin American countries, China remains a trade angel. Not surprisingly, the countries that mainly export commodities face lower competition. This is only to be expected bearing in mind that China is a net importer of raw materials. In 2003, Chinese imports of nickel doubled, its copper imports grew by 15 per cent, oil by 30 per cent and soy beans by 70 per cent. China was propelled forth as the world's leading consumer of copper, zinc, platinum, iron and steel.

Most Latin American countries are witnessing a tremendous increase in their exports to China. They are commodity-oriented exporters and are well able to fulfil the needs of Chinese growing demand. For example, 47 per cent of world exports of soy beans and 40 per cent of world exports of copper are concentrated in the region. Therefore, Latin American exports towards China jumped by impressive numbers in nominal terms.

However, even for the winners there are setbacks. China has become Brazil's second and fastest-growing export market but 75 per cent of these exports are concentrated on five commodities. Soy beans are the major item, both for Brazil and Argentina. For Chile and Peru the bulk of exports to China are concentrated on a single commodity: copper. The challenge, therefore, will in the medium term to avoid being pushed into a "raw materials corner". A more strategic challenge will also be to increase Latin American integration into the value chain of global production.

Despite this concentration on a few commodities, China's strong demand for raw material is good news for Latin America. In economic terms, this trend could be considered as a positive demand shock. From 2000 to 2005, China represented nearly 40 per cent of the total growth in world oil demand. China's growing thirst for oil has been driving oil prices up and boosting trade surpluses of oil exporters like Venezuela and Colombia. The surge of Chinese imports of copper over the last few years also pushed prices up and has been a boost for Chile and Peru, two other economies that will be registering record trade surpluses in 2004 and 2005.

China is not only a "trade angel" for Latin America. During this decade, it might well also become a helping and visible hand in terms of capital flows. Latin America may once again be well placed to attract Chinese interests. The region has a surplus commodity endowment that boosts synergies with China's need and strategy to secure food and energy imports in order to avoid shortages. Chinese investments will not only be in agri-business and commodity-related industries but also in infrastructures, roads and ports.

In 2003, China's outward investment more than doubled (although it is still at a low level) and Latin America received a third of world Chinese FDI. The following year, nearly 50 per cent of Chinese outward FDI went to Latin America. While this share declined the two following years, the region remained in the radar screens of Chinese companies. The need to secure food and commodities resources is boosting FDI through strategic international partnerships.

In Mexico, China is already setting up manufacturing companies and Chinese interests in Argentina's railway construction or agribusiness-related projects are also on the rise. Some of the biggest investments carried out abroad by Chinese companies are already located in Latin America, namely in Brazil in the steel and iron industry. In 2005, Codelco, the Chilean copper giant signed an historical trade contract with China with Brazilian CVRD pushed ahead its trade links with new Asian partner.

Latin America is looking towards China and Asia - and this is reciprocal. It is a major shift: for the first time in its history Latin America can benefit from not one but three major world engines of growth. Until the 1980s the United States was the major trade partner of the region. Later, a second pillar emerged with the boom of European investments in the region during the 1990s. Now, with this new decade and century, the emergence of China, and above all Asia, is bringing a third pillar of growth for Latin America.

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Further reading:

Jorge Blázquez, Javier Rodríguez and Javier Santiso, "Angel or Devil? Chinese Trade Impact on Latin American Emerging Markets", OECD Development Centre, Working Paper No. 252, June 2006.

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