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*China's Growing Interest in Latin America*

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## China's Growing Interest in Latin America

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### Summary

Over the past year, increasing attention has focused on China's growing interest in Latin America. Most analysts appear to agree that China's primary interest in the region is to gain greater access to needed resources — such as oil, copper, and iron — through increased trade and investment. Some also believe Beijing's additional goal is to isolate Taiwan by luring the 12 Latin American and Caribbean nations still maintaining diplomatic relations with Taiwan to shift their diplomatic recognition to China. Some analysts maintain that China's involvement in the region could pose a future threat to U.S. influence. Others assert that China's inroads in Latin America are marginal and likely to remain overwhelmed by the economic and geographic advantage of the U.S. market. Although many Latin American countries welcome the new Chinese investment, some view China as an economic threat, and are concerned that both their domestic industries and their U.S. export markets will be overwhelmed by cheap Chinese imports. This report will not be updated. For further information, see CRS Report RL32804, *China-U.S. Relations: Current Issues and Implications for U.S. Policy*.

### Introduction

China's interest in Latin America is a fairly new phenomenon that has developed over the past four years. Beginning in April 2001 with President Jiang Zemin's 13-day tour of Latin America and followed most recently with high-profile visits by President Hu Jintao (November 2004) and Vice-President Zeng Qinghong (March 2005), Chinese officials have continued to court regional governments. While Beijing's interests in the region appear largely economic, they also have a political and diplomatic dimension and may have longer-term implications for U.S. interests.

### Economic Linkages

Much of China's interest in Latin America — especially in South America — is economically motivated, with Beijing eager for access to such commodities as iron and other ores, soybeans and soybean oil, copper, iron and steel, integrated circuits and other electrical machinery, and oil in order to meet the demands of China's booming economy.

China's imports from Latin America grew from almost \$3 billion in 1999 to \$21.7 billion in 2004, a more than 600% increase in five years.<sup>1</sup> Because of this growth in imports, China has run a trade deficit with the region for the past two years. While imports from Latin America are just a small percentage of China's overall imports, they grew from 1.81% of total Chinese imports in 1999 to 3.88% in 2004. China's top five import markets in Latin America in 2004 were Brazil (\$8.7 billion), Chile (\$3.7 billion), Argentina (\$3.3 billion), Mexico (\$2.1 billion), and Peru (\$1.5 billion).

China's exports to Latin America have also grown considerably in the last five years, from \$5.3 billion in 1999 to \$18.3 billion in 2004, with major exports including electrical appliances; woven and knit apparel; computers, office machinery, and other machinery; and mineral fuels and oil. During this period, the overall share of China's exports to the region as percentage of its worldwide exports, although small, increased slightly from 2.71% in 1999 to 3.09% in 2004. China's top five export destinations in Latin America in 2004 were Mexico (\$5 billion), Brazil (\$3.7 billion), Panama (\$2.2 billion), Chile (\$1.7 billion), and Argentina (\$852 million).

While China's trade flows have increased dramatically, both globally and with Latin America, Chinese foreign direct investment (FDI) abroad has not been significant. China's cumulative FDI worldwide amounted to \$33.2 billion at the end of 2003 — just 0.48% of global FDI stock — with 41% concentrated in Hong Kong, United States, Japan, and Germany. Turning to yearly investment flows, China's foreign investment flows for 2003 amounted to \$2.85 billion, with \$1.04 billion of that — more than one-third — going to Latin America.<sup>2</sup> Chinese investment in Latin America has focused on the extraction and production of national resources, but also has included investment in manufacturing assembly, telecommunications, and textiles. China's FDI in the region has been concentrated in Brazil, Mexico, Chile, Argentina, Peru, and Venezuela.<sup>3</sup> Since the entry into force of the North American Free Trade Agreement (NAFTA) in 1994, China has viewed Mexico as an access point to the U.S. market.

The visit of Chinese President Hu to several Latin American countries in November 2004 raised expectations of a substantial increase in Chinese investment in the region in coming years. During a speech to the Brazilian Congress, Hu stated that China would invest \$100 billion in Latin America over the next 10 years. In Argentina alone, China reportedly would invest \$20 billion in the next decade. Given the overall decline in net FDI flows to Latin America in recent years — from \$78 billion in 2000 to \$36 billion in 2003<sup>4</sup> — many Latin American nations welcome the increase in foreign capital that the Chinese are promising.

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<sup>1</sup> Trade statistics are from the World Trade Atlas, which uses official Chinese government data.

<sup>2</sup> "China Pours More Money Overseas," China Daily, October 22, 2004, as found at the website of the Embassy of the PRC in the United States (<http://www.china-embassy.org/eng/>).

<sup>3</sup> Inter-American Development Bank, "The Emergence of China: Opportunities and Challenges for Latin America and the Caribbean," Draft discussion, October 1, 2004, p. 117.

<sup>4</sup> Economic Commission for Latin America and the Caribbean, "Foreign Investment in Latin America and the Caribbean, 2003," May 2004, p. 13.

Among the investment pledges highlighted in the press during President Hu's trip to Latin America were: railway, oil exploration, and construction projects in Argentina; a nickel plant in Cuba; copper mining projects in Chile; and a steel mill, railway, and oil exploration projects in Brazil. In January 2005, Venezuelan President Hugo Chávez traveled to China to sign some 19 cooperation agreements, including plans for Chinese investment in oil and gas exploration. Colombia President Álvaro Uribe traveled to China in mid-April 2005 promoting increased investment in his country. In addition to China's plans for increased investment, China and Chile announced in 2004 that they would be negotiating a bilateral free trade agreement. In response to China's requests, many Latin American nations — including Argentina, Brazil, Chile, Peru, and Venezuela — have conferred on China the status of market economy, decreasing the potential impact that anti-dumping measures may have on cheap Chinese imports.<sup>5</sup> China has also designated many nations throughout Latin America and the Caribbean as official tourism destinations for Chinese citizens, allowing Chinese citizens to visit for the first time.

While most recent press accounts focus on Latin American countries welcoming Chinese trade and investment, this view is not shared by all countries in the region. Mexico has viewed China as a competitor, in terms of supplying assembled goods to the U.S. market and as a competitor for foreign direct investment in the maquiladora or export assembly sector. It fears losing its U.S. market share to China. Fear of competition from Chinese apparel and textile exports also was a major factor for Central American nations and the Dominican Republic in negotiating the DR-CAFTA agreement with the United States. In addition, there are some concerns in the region about the way China has managed its foreign investments. Chinese companies reportedly have developed a reputation for insularity by not interacting with local businesses and services, and have faced challenges from local labor unions for conditions in their enterprises.<sup>6</sup>

## Energy Issues

Energy concerns play an especially important role in China's Latin-American diplomacy. China announced a \$10 billion energy deal in Brazil in November 2004.<sup>7</sup> Brazil's state-owned oil company, Petrobras, and China's National Offshore Oil company reportedly also are studying the feasibility of joint operations in exploration, refining, and pipeline construction around the world. The PRC is also exploring energy deals in Ecuador, Bolivia, Peru, and Colombia, as well as offshore projects in Argentina.

Some observers are particularly concerned about China's recent activities in Venezuela, which supplied about 12% of U.S. crude oil imports in 2003. As a consequence of Venezuelan President Hugo Chávez's visit to Beijing in December 2004 and PRC Vice-President Zeng Qinghong's visit to Venezuela in January 2005, the two countries on January 29, 2005 signed a series of energy-related agreements. Among other

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<sup>5</sup> Adam Thomson, "Granting of Market-Economy Status to China Opens Argentina's Door to Investment," *Financial Times*, November 18, 2004; "Chinese Vice President's Visit Promote Ties with Latin America," *BBC Monitoring International Reports*, February 5, 2005.

<sup>6</sup> Joel Millman and Peter Wonacott, "For China, a Cautionary Tale — Insularity, Unfamiliar Ways Strain Investments in South America," *Wall Street Journal*, January 11, 2005.

<sup>7</sup> The PRC is also investing in energy deals in Ecuador and in offshore projects in Argentina.

things, the agreements commit the China National Petroleum Corporation, which already operates two Venezuelan oil fields, to spend over \$400 million in developing Venezuelan oil and gas reserves.<sup>8</sup> Given the current poor state of U.S.-Venezuelan relations under the Chávez government, American observers worry that Venezuelan energy agreements with China ultimately may serve to divert oil from the United States. While Venezuelan energy officials have denied this, in December 2004, President Chávez was reported to have referred to Venezuela's long oil-producing history as "100 years of domination by the United States." He asserted that "Now we are free, and place this oil at the disposal of the great Chinese fatherland."<sup>9</sup> In another development of interest to some U.S. policymakers, a team from Venezuela's state oil company (Petroleos de Venezuela) is reportedly going to London to receive training from Iranian experts on how to improve Venezuela's access to Asian oil markets. Iran, Venezuela's closest partner in OPEC, has long had a cooperative relationship with the PRC.

## Taiwan Factor

There is also a political dynamic in China's expanding economic and trade relationships with Latin America and the Caribbean, since the region contains 12 of the 25 countries that still maintain official diplomatic relations with Taiwan. This number is down from 14 in 2004, as Grenada and Dominica switched diplomatic recognition to the PRC in the last 12 months.<sup>10</sup> Taiwan's official relations in the region now include all seven Central American countries — Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama; four Caribbean countries — the Dominican Republic, Haiti, St. Kitts and Nevis, and St. Vincent and the Grenadines; and one South American country — Paraguay.

Taiwan, for decades a consistent provider of financial assistance and investment in Latin America and the Caribbean to nurture its remaining official relationships, is now hard-pressed to compete against the growing economic and political clout of China — what one official in Taiwan referred to as China's "dollar diplomacy." As an example, in 2004, Dominica severed relations with Taiwan after Beijing trumped Taiwan's \$9 million in assistance with a pledge of \$122 million in assistance to the tiny country over six years.<sup>11</sup> In September 2004, China sent a "special police" peacekeeping contingent to Haiti, another of Taiwan's official relationships, marking Beijing's first deployment of forces ever in the Western Hemisphere. The PRC's ability to develop and expand contacts with Taiwan's friends in the region undoubtedly has been facilitated by a decision by the Organization of American States' (OAS) on May 26, 2004, to accept China as a formal observer in the OAS. The OAS has 35 members, including the United States and all 12 of the countries conferring diplomatic relations on Taiwan. Meanwhile, Beijing has strongly objected to Taiwan's efforts to seek OAS observer status. Some

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<sup>8</sup> Chietigi Bajpae, "China's Quest for Energy Security," *Power and Interest News Report*, February 25, 2005, online at [<http://www.pinr.com/>].

<sup>9</sup> Juan Forero, "China's oil diplomacy in Latin America," *New York Times*, March 1, 2005, attributing the comment to a Chávez statement to Chinese businessmen in December 2004.

<sup>10</sup> On January 20, 2005, Grenada formally ended its diplomatic relations with Taiwan and established diplomatic relations with the PRC. Dominica did so on March 29, 2004.

<sup>11</sup> "Dominica severs ties with Taiwan," *BBC Caribbean*, March 29, 2004.

observers suggest that if China succeeds in its quest to steal away Taiwan's Latin American and Caribbean relationships, the diminishment of Taiwan's ability to act on the world stage could seriously affect Taiwan's international status.

## U.S. Policy Approaches

On April 6, 2005, the Western Hemisphere Subcommittee of the House International Relations Committee held hearings on China's growing Latin American involvement. Witnesses reflected the range of debate on the implications of China's regional contacts.<sup>12</sup>

Some observers believe increased Chinese interest and economic linkages with Latin America constitute a significant future threat to U.S. influence and interests in Latin America. They maintain that China "is using Latin America to challenge United States supremacy in the western hemisphere and to build a third world coalition of nations with interests that may well be at variance or even inimical to American interests and values."<sup>13</sup> According to this view, the assertive Chinese commercial interest demonstrated at the November 2004 Asia Pacific Economic Cooperation (APEC) forum meeting in Chile should serve as a wake-up call to U.S. policymakers to focus more attention on China's growing role in the region.<sup>14</sup> China's regional presence, they say, ultimately could have significant strategic implications for the United States when China begins to take action to protect its interests in the region.<sup>15</sup> Some observers who are wary of PRC initiatives in the Western Hemisphere contend that the Chinese government is attempting to exploit weaknesses left by U.S. inattentiveness to the region. According to this view, the United States should adopt a new strategy in Latin America — including "expanding its own free trade network, helping friendly nations develop strong market economies, fostering closer, more cooperative security relationships" — in order to deflect the China challenge.<sup>16</sup>

Other observers contend that Chinese activity in Latin America is one of relatively benign expansion, confined to seeking out trade and investment opportunities.<sup>17</sup> They say that the inroads China has made into the region are marginal compared with longstanding

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<sup>12</sup> "China's Influence in the Western Hemisphere," Hearing of the Western Hemisphere Subcommittee of the House International Relations Committee, April 6, 2005, Federal News Service. In addition, the U.S.-China Economic and Security Review Commission, established by Congress, has scheduled hearings in July 2005 on China's global expansion, including in the Western Hemisphere.

<sup>13</sup> Hearing testimony of June Dreyer, U.S.-China Economic and Security Review Commission, Western Hemisphere Subcommittee, House International Relations Committee, April 6, 2005.

<sup>14</sup> In his first Latin America trip as President, Hu Jintao arrived at the November APEC meeting with a large delegation of government officials and business representatives. In conjunction with the meeting, Hu visited Brazil, Argentina, Chile, and Cuba, signing a total of 39 agreements.

<sup>15</sup> "China Focuses on Latin America," United States South Command, Open Source Report, November 30, 2004, prepared by Open Source Solutions.

<sup>16</sup> Hearing testimony of Peter Brookes, Heritage Foundation, Western Hemisphere Subcommittee of the House International Relations Committee, April 6, 2005.

<sup>17</sup> For example, see Guillermo R. Delamer, Lyle J. Goldstein, Jorge Eduardo Malena, and Gabriela E. Porn, "Chinese Interests in Latin America," in *Latin American Security Challenges*, edited by Paul D. Taylor, Naval War College, Newport, Rhode Island, 2004.

U.S. economic linkages, and they see evidence that Chinese officials have been restrained in their Latin American contacts.<sup>18</sup> They point out that U.S. trade and investment in Latin America dwarfs that of China's involvement in the region. (U.S. imports from Latin America amounted to \$255 billion in 2004, while U.S. cumulative direct investment in Latin America in 2003 amounted to some \$304 billion.<sup>19</sup>) Moreover, observers contend that the future growth potential of Chinese investment and trade will always be constrained by the economic advantages conferred by U.S. geographic proximity to Latin America. Furthermore, they indicate that migration patterns to the United States from Central and South American countries have given the United States greater cultural ties and longer-term economic importance to the region than China could ever have. Adherents of this view maintain that the United States should avoid overreacting to China's economic initiatives in Latin America. They assert that China's emerging presence in the region is not a threat to the United States, but is consistent with the long-standing U.S. policy of integrating China into the world system.<sup>20</sup>

**Administration Views.** In the hearing before the House Western Hemisphere Subcommittee, Administration officials appeared to downplay concerns about China's engagement with Latin American nations, although they voiced some concerns regarding potential future Chinese regional capabilities in the fields of intelligence, communications, and cyber warfare. Assistant Secretary of State for Western Hemisphere Affairs Roger Noriega testified that "China's influence in the region is minimal today," and that while China's presence in the hemisphere is growing, "it is safe to say the United States has been and will continue to be the long-term partner of preference." Nevertheless, Noriega maintained that the United States would continue to monitor China's outreach to Latin America, just as it monitors China's outreach around the world. Deputy Assistant Secretary of Defense for Western Hemisphere Affairs Rogelio Pardo-Maurer testified that there is no "evidence that Chinese military activities in the western hemisphere, including arms sales, pose a direct conventional threat to the United States."<sup>21</sup> Nevertheless, Pardo-Maurer maintained that the United States needs "to be alert to rapidly advancing Chinese capabilities, particularly in the field of intelligence, communications, and cyber warfare, and their possible application in the region." He maintained that the United States "would encourage the nations in the hemisphere to take a close look at how such activities could possibly be used against them or the United States."

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<sup>18</sup> Hearing testimony of Dr. Cynthia Watson, Western Hemisphere Subcommittee of the House International Relations Committee, April 6, 2005.

<sup>19</sup> Trade statistics are from the Department of Commerce, as presented by the World Trade Atlas; U.S. foreign investment figures are from the "Survey of Current Business," February 2005, Department of Commerce.

<sup>20</sup> Hearing testimony of Riordan Roett, School of Advanced International Studies (SAIS), Johns Hopkins University, Western Hemisphere Subcommittee of the House International Relations Committee, April 6, 2005.

<sup>21</sup> According to U.S. Government sources, China made negligible arms sales to Latin America from 2000-2003. See CRS Report RL32547, *Conventional Arms Transfers to Developing Nations, 1996-2003*, by Richard F. Grimmett.