



East Asia-Latin America Taskforce
Pacific Basin Research Center,
Soka University of America



The Opportunities and Challenges of Growing East Asian-Latin American Economic Relations¹

**Report of the Task Force on East Asian-Latin American
Economic Relations**

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¹ Prepared for the Pacific Basin Research Center, Soka University of America. Contact: William Ascher (william.ascher@cmc.edu).

Executive Summary

East Asian economic interaction with Latin America and the Caribbean (LAC)—investment, trade, labor migration, and foreign assistance—has reached unprecedented levels. The profound changes in the Chinese economy have led China to become not only an exporter of capital, but also an exporter of industrial capacity. Even so, the magnitude and impact of Chinese investment in LAC are widely exaggerated; Chinese foreign direct investment (FDI) in LAC, excluding Chinese assets in off-shore tax havens that is unlikely to be devoted to LAC countries, is less than a third of non-tax-haven U.S. FDI, and, equally important, the purchase of minority stakes in Latin American extractive industries, accounting for roughly three-quarters of Chinese FDI in LAC, has minimal impact on the region.

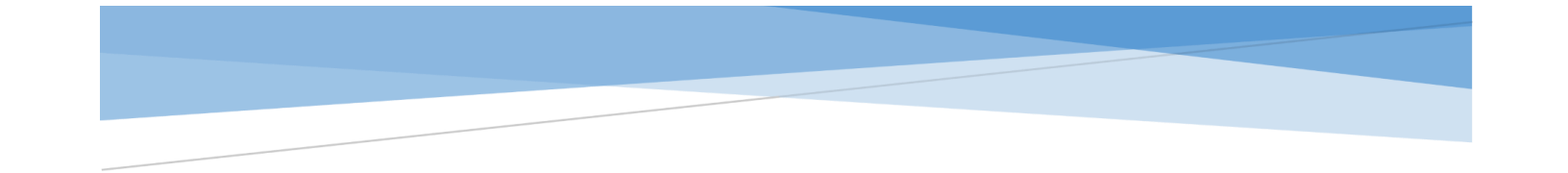
The slow-down of the Chinese economy, and its reduced hunger for raw materials, pose serious transition challenges for LAC countries. This is largely due to the reduced demand for raw materials from the heavily raw-material-export dependent countries—the price of copper from Chile, Peru, and other LAC countries has declined by more than a quarter; the price of oil from Venezuela, Brazil, and other countries has dropped even more.² But it also reflects the faltering investment from China to LAC, and the decline in demand for LAC exports beyond raw materials. A World Bank analysis estimates that for every one percent decline in Chinese economic growth, LAC's overall growth rate is reduced by 0.6 percent.³ The knife-edge state of the Japanese economy—that is, the fate of Abenomics—may significantly increase *or* reduce the Japanese presence in LAC. Meanwhile, with much less drama, Korea has more than tripled its investment in LAC since 2010, effectively using its industrial beachhead in Mexico to penetrate the North American markets. These developments pose fundamentally different opportunities and risks to the major LAC countries and the United States.

The implications for LAC are both important and uncertain, as the trade patterns may contribute to the de-industrialization of some LAC countries, but the shift to market-seeking and infrastructure investment may stimulate robust growth of others. Further, China has emerged as the only source of consistent financing for the LAC countries with the least sound economic policies, making them even more vulnerable to dramatic collapse. This Report also moves beyond focusing solely on China to evaluate the ever-changing economic relationships between other East Asian countries and LAC. Although clouded with uncertainty, Japan's economic policies under Abenomics may also entail dramatic changes in the relationship between Japan and a select number of LAC countries. All of these changing relations pose challenges to the United States and Canada, generating increased competition as well as allowing LAC countries opportunities to step out of a U.S.-dominated sphere.

The United States, while still dominant in LAC trade and investment, can gain in trade and investment opportunities if it leads the emerging Trans-Pacific Partnership (TPP) to encompass more LAC and Asian countries. The short- and medium-term prospects of Chinese involvement in the TPP are very low. However, this does not mean that U.S. policymakers should try to use the TPP as a

² Eduardo Porter, “Slowdown in China Bruises Economy in Latin America, New York Times, DEC. 16, 2014. http://www.nytimes.com/2014/12/17/business/international/slowdown-in-china-bruises-economy-in-latin-america.html?_r=0.

³ Mauricio Cruz, Young Il Choi, and Raju Huidrom, Effects of China's slowdown on Latin America and the Caribbean (Washington, DC: World Bank, 2015). <http://vox.lacca.org/?q=blog/china-slowdown-lac>



weapon in a trade war with China, because the prospects of U.S.-Chinese joint ventures should not be undermined.

For the LAC countries that benefited from the commodity boom, economic policies need to be reformed to ensure that these resources are invested soundly. While the fears of LAC de-industrialization have been overblown, the weaknesses of many LAC-owned industrial firms, and the continued reliance on raw-material exports in part due to Chinese investment in LAC infrastructure related to resource extraction, require careful policies by LAC governments to reduce the de-industrialization risks. The opportunities to enter into trade pacts with East Asian countries provide a rationale to accomplish this through the “policy harmonization” necessary for free-trade agreements to work. The governments that have persisted with economically unsustainable policies—especially Argentina and Venezuela, propped up by massive Chinese loans, need to re-think whether this is in the long-term interest of their countries.

Mexico faces the greatest risks and opportunities. Its privileged trade status within NAFTA has provided the attraction for foreign investment to penetrate the entire North American market, yet Mexico has the greatest exposure to manufactures competition and the erosion of its privileged status.

The three East Asian countries need to avoid the historic pattern of over-paying for assets in the Americas in general, and, particularly for China, to avoid making loans to fiscally irresponsible LAC governments that may be forced to default. The environmental performance of East Asian firms involved in extractive industries needs to be improved, both for the sake of LAC’s ecosystems and in order to mitigate the backlash against East Asian firms. East Asian employers in LAC must also be more careful in the treatment and prospects of promotion of LAC employees.

I: Introduction

The rise of China and continued prosperity of other East Asian countries has fundamentally altered the global economy. The so-called ‘miracle economies’, most notably Japan, South Korea, and China, have reshaped the global economic environment and created extraordinary opportunities and challenges for LAC. Each of the Asian “miracles” in succession has led to a global wave of demand for raw materials, then a wave of FDI and portfolio investment, and then broader economic interaction, including demand for things other than raw materials. While previous studies on China in LAC have fixated on this first wave—on China as a seeker of natural resources in LAC—we find that China’s economic imperative has changed dramatically in just the past few years towards a need to maintain economic growth by exporting its industries into other world regions.


The primary impact of these successive waves on LAC thus far has been to increase trade, GDP, and GDP per capita; and to diversify LAC’s trade, FDI, portfolio investment and sources of economic growth away from overwhelming dependence on the United States. However, there are potential pitfalls that must be anticipated to be avoided, arising from how particular LAC, East Asian, and North American countries respond to the newly emerging patterns of interaction.

This Task Force report examines these trends and their implications in order to find the path to mutual gain among East Asian, LAC, and North American countries, and to minimize unnecessary conflict—while recognizing that some degree of rivalry, both economic and geopolitical, is inevitable. Although the major new drivers of the relations among East Asia, LAC, and the United States are both dramatic and clear, the possible consequences are not, both because of the complexity of the dynamics and the impact of policy choices made by all of the relevant governments. Therefore the purpose of our Task Force is to scan the full range of trends and to assess, in a preliminary fashion, their possible consequences. Despite the uncertainty however, some robust recommendations emerge from this overview.

In the next section we examine these evolving economic ties with a focus on the relationship between the eight largest economies (Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, and Venezuela) and China, Japan, and Korea.⁴ We begin with a review of FDI flows from these East Asian countries toward LAC; we then turn to East-West commercial exchange, with an analysis of the nature and magnitude of trade flows back and forth across the Pacific, as well as the kinds of institutional arrangements that have emerged. We finish with a profile of aid, lending, and migration patterns, which are also mainly an East-to-West phenomenon. Throughout, we seek to analyze these economic trends against the backdrop of U.S. economic ties to LAC and to glean policy lessons through this comparison. Section III engages the implications of these growing ties, including dispelling some of the overblown concerns while also identifying serious risks and opportunities. Section IV presents recommendations to be considered for pursuing mutual gain among East Asian, LAC, and North American countries.

This Task Force formed at the initiative of the Pacific Basin Research Center of Soka University of America. The co-chairs of the Task Force are Thomas McLain, an expert on legal and business affairs in East Asia, Director of Southern California’s Asia Society, and of counsel to Hogan

⁴ We exclude Taiwan for several reasons: 1) although Taiwan has a robust economy, its relatively small population dictates that its overall trade and investment levels are fairly modest compared to China, Japan, and South Korea; 2) Taiwan has not focused much effort on expanding its trade or investment on Latin America—Taiwan’s trade with Latin America, with imports and exports each around US\$8 billion, and only three percent of Taiwan’s outward FDI flowing into Latin America; 3) some of the apparent Taiwanese investment into Latin America is redirected to other regions via the offshore tax havens of the British West Indies and the Cayman Islands.



Lovells LLC; and William Overholt, Senior Fellow at Harvard's Asia Center and former President of the Fung Global Institute in Hong Kong. The other Task Force members were drawn from a variety of regional, academic, and policy spheres. The members include:

Garry D. Brewer, Frederick K. Weyerhaeuser Professor Emeritus, Yale University School of Management; member, Royal Swedish Academy

Roberto Hernández Hernández, head of the Department of International Studies, University Science Center, Universidad de Guadalajara

Michael Lofchie, Professor of Political Science, and Chair, International Development Studies Program, University of California, Los Angeles

José Luís León-Manríquez, Professor of International and East Asian studies, Universidad Autónoma Metropolitana in Mexico City

Saori N. Katada, Associate Professor of International Relations, University of Southern California

Charles Wolf, Jr., Distinguished Chair in International Economics and Professor, Pardee Graduate School, RAND Corporation

Oversight of the background research and preparation for the Report was conducted by William Ascher and Shane Barter. The Task Force initiative began with gathering the broadest possible range of trends that signal the drivers of both the interactions between particular East Asian and LAC countries, and the recent shifts in these trends. This allowed us to generate a range of possible scenarios, and, with several face-to-face discussions and iterations of the report, enabled us to identify the most important opportunities and challenges. These Task Force interactions also yielded greater understanding of the nuances of East Asian-LAC interactions as well as timely recommendations that appear to be robust, despite the uncertainties we have identified.

II: The Expansion of Trans-Pacific Economic Ties in the 2000s

Foreign Direct Investment

The greatest promise that interaction with East Asian nations can provide to LAC is sound investment in industry and infrastructure. Together, China, Japan, and Korea have accumulated an unprecedented amount of foreign exchange, with China alone accounting for some 25 percent of world reserves, some of which—if things go well—can be soundly invested in LAC's industrial capacity. China has quickly joined Japan and Korea in experiencing levels of wages and pollution that call for exporting industry, in addition to securing markets and materials. A sizable portion of this capital has gone into LAC. Japan's presence in LAC is longstanding, especially in Brazil and Peru where Japanese immigration has deep historical roots. It is the dramatic entry of China into the ranks of capital exporters to LAC—in January 2015 the Chinese government announced plans to invest US\$250 billion in LAC over the next decade—alongside of rapidly increasing Korean investment, that changes the investment opportunities among LAC countries.

LAC countries have attracted greater investment flows from East Asia over the past two decades. However, the magnitude of investment and its impacts on LAC economies are not nearly as great as the statistics seem to imply.

China. It is just in the past several years that China has crossed over into the ranks of a capital exporter. In light of its huge foreign reserve buildup, China is expected to become one of the world's largest sources of FDI in years to come. The first substantial investment flows from China first reached LAC in 2010. However, the figures that seem to reflect a flood of investment—the UN Economic Commission for Latin America and the Caribbean highlights that 13 percent of Chinese outward FDI is directed to LAC—are highly misleading. Much of Chinese (and Korean) assets have been parked in the offshore tax havens of the Cayman Islands and the British Virgin Islands⁵. Moreover, China's *current* FDI that can be traced to specific investments within major LAC countries has little bearing on future opportunities and risks, and in fact has had minimal impact except in the sphere of physical infrastructure.

⁵ The non-haven LAC stock is only one percent of China's outward FDI stock, compared to over 70 percent for Asia and nearly four percent for Africa. The proportion of assets controlled by all subsidiaries registered in the major LAC off-shore tax havens (Bahamas, Bermuda, British Virgin Islands, and the Cayman Islands) that are invested other LAC countries is quite small—less than 7 percent as calculated from the UNCTAD bilateral investment data (<http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx>). More than half of the outward stock of Bahamian entities reported for the 2008-2012 period was in Singapore; more than half the assets controlled by Bermudan entities were in Hong Kong and Singapore; 80 percent of the assets controlled by BVI entities were in China and Hong Kong; and more than half of the Cayman Islands entities' assets were in China, Hong Kong, Singapore, and Macao. It is more likely that the U.S. subsidiaries, rather than East Asian subsidiaries, account for the modest proportions of the assets actually invested in LAC countries.

Table 1. Chinese Foreign Direct Investment 2005 through mid-2014, Major LAC Countries, in US\$ billions

	Energy	Metals	Agriculture	Transport	Other*	Total
Argentina	8.8	...	1.5	2.6	1.8	14.8
Brazil	21.5	4.4	1.7	1.4	2.4	31.4
Chile	1.6	2.5	...	...	...	4.0
Colombia	1.7	...	...	...	...	1.7
Ecuador	6.8	2.7	...	...	...	9.5
Mexico	...	0.3	...	0.2	...	0.5
Peru	2.6	13.0	0.8	...	...	16.5
Venezuela	6.0	0.9	0.4	8.8	1.4	17.5
8-country total	49.0	23.8	4.4	13.0	5.6	95.9

Other: technology, real estate, finance, “other”

Source: Heritage-AEI China Global Investment Tracker

<http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map>, as of March 25, 2015

The first thing to understand is that Chinese FDI in these countries is still far below the U.S. investment stock (i.e., the assets of U.S.-headquartered companies), which has been estimated at roughly US\$350 billion (US\$339 billion in the eight major countries as of 2013) in *historical value*, not counting the assets in the offshore financial centers.⁶ The *current* value of U.S. FDI in LAC is undoubtedly a substantial multiple of the US\$350 billion.⁷

Second, more than half of the Chinese FDI has been in buying stakes in energy companies and oil fields; these are likely to be undergo exploration and production regardless of whether Chinese companies are involved. The same is largely true for the investments in mining, which took up more than a quarter of China’s total LAC investment. Insofar as these investments replace the stakes of firms from other countries, in holdings that are likely to be exploited regardless, the impact on LAC economies has been modest. For example, the fact that the Chinese state energy company Sinochem has a 40 percent stake in Brazil’s Peregrino off-shore oilfield, purchased from Norway’s Statoil in 2010, has little impact on Brazil, even though this purchase represented a US\$3.1 billion Chinese investment.⁸ The bulk of these purchases have been made by Chinese state-owned enterprises, which overall have constituted more than two-thirds of Chinese FDI in LAC.⁹

⁶ 2013 estimate by the U.S. Bureau of Economic Analysis, U.S. Direct Investment Position Abroad on a Historical-Cost Basis, Latin America and other Western Hemisphere, Excluding Canada. <http://www.bea.gov/international/factsheet/factsheet.cfm?Area=299>.

⁷ Official sources eschew estimates of current-cost or market-value FDI stock, because “detailed statistics by country and industry are available only on a historical-costs basis”, Marilyn Ibarra-Caton and Raymond Matalonii, Jr., Direct Investment Positions for 2013,” Washington, DC: U.S. Commerce Department Bureau of Economic Analysis, July 2014. http://www.bea.gov/scb/pdf/2014/07%20July/0714_direct_investment_positions.pdf

⁸ A solid analysis of China’s energy engagement in Latin America can be found in Jakob Koch-Weser, Chinese Energy Engagement with Latin America: A Review of Recent Findings, Washington, DC: Inter-American Dialogue, January 2015.

⁹ Ibid.; Rebecca Ray and Kevin Gallagher, “2013 China-Latin America Economic Bulletin (Boston: Boston University Global Economic Governance Initiative, 2014), p. 18; and Taotao Chen and Miguel Pérez Ludeña, “Chinese Foreign Direct Investment in Latin America and the Caribbean”

Moreover, the past pattern of Chinese investment in LAC, and its impact, may well be highly misleading as an indicator of the future. To be sure, China's voracious demands for raw materials, aided to some degree by Chinese investment in related infrastructure investment, magnified the trade revenues of numerous LAC countries since 2000: hydrocarbons (from Brazil, Colombia and Argentina), copper, iron ore and other metals (from Brazil, Chile, and Peru), soybeans (from Argentina and Brazil), and fishmeal (from Chile and Peru). China (as well as other industrial or industrializing countries) will continue to import energy, raw industrial inputs, and foodstuffs, though probably at a slower rate, yet still providing capital to LAC economies. Even so, the Chinese government and Chinese firms will learn that buying stakes in raw material enterprises has little distinctive advantage.

However, the potential for dramatic changes in the investment relations between China and LAC is certainly greater than the prospects for Japan or Korea. China's economic situation has changed drastically over the past five years, because of both the accumulation of capital and the continuing rise in Chinese wages. After decades of attracting capital for export-oriented manufacturing, with its competitiveness based on competitively low wages, China is now in a position to seek competitive advantage by exporting its capital to other countries. Along with the capital, China also is exporting some of its workers—as well as some of its pollution.

The root of the change is the growing shortage of low-wage Chinese labor that could be absorbed into China-based industry. In January 2014, New York Times analyst Keith Bradsher noted:

Blue-collar pay has soared between fivefold and ninefold in dollar terms in the last decade, wrecking China's reputation as a low-wage place for export-oriented manufacturing. Rocketing wages and benefits reflect an acute shortage of manufacturing labor, as a younger generation goes to college instead of heading for factories and as rural China has mostly run out of young adults to send to the cities.¹⁰

More specifically for manufacturing, official statistics show that manufacturing wages in China doubled from January 2008 to January 2013.¹¹ Moreover, the current Five Year Plan states that the minimum wage is required to rise a minimum of 13.1 percent per year. In addition, the growth of Chinese workers' fringe benefits has outstripped the growth in the rate of manufacturing value.

However, even if China will be exporting capital for industry, it does not necessarily mean that impactful capital will be directed to LAC. To be sure, in January 2015 President Xi Jinping pledged US\$250 billion for LAC investment over the next decade.¹² Yet previous ambitious investment plans for LAC announced by Chinese leaders have not been fulfilled, the practice of investing in stakes of oil and mining companies simply replaces the previous minority partner with a Chinese minority partner, and other targets for Chinese investment are closer to home or more malleable. Thus far the export of manufacturing industries such as steel, cement, and glass has largely targeted low-wage Asian and Sub-Saharan African countries. The potential advantage of siting metal-processing (e.g., steel factories and copper refining) close by the raw material sources, which would entail major capital investment, is negated by the over-capacity of such facilities already existing in China.

(Santiago, Chile: UN Economic Commission for Latin America), p. 10

¹⁰ Keith Bradsher, "Even as Wages Rise, China Exports Grow," New York Times, January 9, 2014.

¹¹ www.tradingeconomics.com/china/wages-in-manufacturing.

¹² Megha Rajagopalan, "Update 2-China's Xi woos Latin America with \$250 bln investments," Reuters, January 8, 2015, <http://www.reuters.com/article/2015/01/08/china-latam-idUSL3N0UN1CP20150108>

The potential for truly impactful Chinese investments in LAC will be in physical infrastructure and industrial production. The attraction of very large-scale infrastructure initiatives lies in addressing some of the over-capacity of China's steel and rail industries, the opportunity to employ Chinese engineers who have less work in the slowing Chinese domestic economy, the control the Chinese government can have through direct agreements with LAC governments on megaprojects and by using state-owned enterprises, and minimizing regulatory burdens because of governmental involvement on the LAC side.¹³ The loans in the billions would put some of China's accumulated capital reserves to work, and the world prices of raw commodities would also be moderated insofar as highway, rail, and port infrastructure improvements lead to both greater resource extraction and less costly transport. Chinese leaders have been in discussions of such initiatives with leaders of Brazil, Chile, Colombia, Mexico, and Peru.

As will be assessed in greater depth later in this report, the prospects of China's future industrial investments in LAC are cloudier. This is in part due to the unfavorable investment conditions discussed below, but also because of the difficulties of breaking into the highly competitive consumer durables subsectors. As Table 1 reveals, Chinese FDI, concentrated largely in Argentina, Brazil, Peru, and Venezuela, does not yet reflect the diversification strategies into manufacturing and finance that the Chinese government has been urging. The concentration of Chinese FDI in LAC in mining (copper and iron ore) and petroleum reflected the country's enormous need for raw materials for China's domestic industry. Because heavy Chinese demand for these primary materials has pushed commodity prices to a new high in the 2000s, Chinese FDI in these sectors represented an effort to lock in supply and hedge against higher prices. The strategic nature of this approach is indicated by the fact that Chinese FDI in raw materials had primarily been carried out by Chinese state-owned enterprises.¹⁴

Japan. Between 2003 and 2013 Japanese FDI into LAC added nearly US\$53 billion to the already substantial industrial operations in the automotive and other industrial sub-sectors.¹⁵ Japanese investors have led the way with an increasingly diverse and capital-intensive array of investments. In contrast to the over 90 percent concentration of Chinese investment in LAC's natural-resource

¹³ Lucy Hornby and Andres Schipani, "China tilts towards liberal Latin American economies", *Financial Times* May 11, 2015. <http://www.ft.com/intl/cms/s/0/b73a606c-f46b-11e4-bd16-00144feab7de.html#axzz3ZwiNu2HC>.

¹⁴ During the decade of the 2000s, the world price for commodities, broadly defined, increased by more than 170 percent; prices for minerals and metals jumped by more than 200 percent. For the 2000-2010 period, Latin America, with its abundance in minerals and other raw materials, has enjoyed a commodity price boom not seen since the early 20th century. The region's exports grew in volume by nearly 45 percent, and in price by nearly 65 percent during the first decade of the 2000s. Argentina, Brazil, Chile, Colombia and Peru have been the main winners. Oil prices have led the way and this can be partly attributed to heightened domestic uncertainties within some of the world's largest oil-producing countries (e.g., Iran, Iraq, Ecuador, and Venezuela). But China's voracious demand for petroleum, copper, iron ore, soybeans, and fishmeal in the 2000s has been the biggest boon for the LAC countries. Having reached a new phase in its ambitious export-led growth model in the late 1990s, the maintenance of Chinese growth required precisely the kinds of raw materials with which LAC countries are generously endowed (see Table 5).

¹⁵ Invest in Bogotá, "Bogota explores markets in Japan and China to attract investment", April 22, 2014 [Invest in Bogota is a quasi-governmental entity; the estimates were from its Market Intelligence Group]. <http://en.investinbogota.org/news/bogota-explores-markets-japan-and-china-attract-investment>.

extraction and related infrastructure, Japanese FDI in LAC has gradually diversified away from commodities and labor-intensive operations and the flows are currently more evenly distributed across economic sectors (e.g., for 2012: 35 percent in services, 34 percent in manufacturing, and 28 percent in primary commodities).¹⁶ Japanese investments in LAC, though representing a small share of the world total in terms of the number of firms, employees, and sales (Japanese affiliates in LAC represent merely 5 percent of total subsidiaries worldwide), generate almost 13 percent of total current profits from Japanese overseas affiliates.¹⁷ This high profit-to-affiliate margin demonstrates the increasing appeal for East Asian companies to set up high value-added and capital-intensive operations—automobiles, auto components and systems, and other high-tech products. However, Japanese FDI is concentrated heavily in just a few countries such as Brazil, Chile, Colombia, and Mexico.¹⁸

Korea. Korean investment in LAC has increased by a factor of ten over the past decade. Since the 1990s Korean FDI has branched out from commodities and labor-intensive activities and into capital and technology-intensive industries. With roughly US\$7 billion of reported assets in particular LAC countries and a similar amount in the off-shore accounts, Korea trails Japan's FDI presence in LAC substantially (recall that Japan added nearly US\$53 billion to its LAC assets in the 2003-2013 period). Korean companies predominantly are involved in vehicles, electronics, textiles and apparel, petroleum, and iron and steel. The most recent Inter-American Development Bank assessment of Korea's economic interactions with LAC notes that "Korea's investments in LAC have been overwhelmingly in manufacturing"; and that these investments are "distinguishing Korea's FDI from that of China and providing a solid basis for diversifying the economic relationship".¹⁹ About half of Korea's LAC FDI is destined for Mexico and Brazil; by the end of 2014, Korean FDI amounted to US\$3.8 billion in Brazil and US\$1.6 billion in Mexico. However, Mexico has now become the dominant target of new Korean FDI: in 2003-2006, Brazil had half of announced Korean FDI; by 2011-2014, Mexico's share had increased to 55 percent from 35 percent, while Brazil's had shrunk to under a quarter.²⁰ As early as 2010, more than 1,400 South Korean firms were operating in Mexico, employing 40,000 local workers; in 2014 Kia, following other international auto manufacturers, announced a US\$ one billion plan to manufacture cars in Mexico. This is just one indication of how Mexico's membership in the North American Free Trade Agreement is a major FDI draw, reflected further by the fact that some of what is reported as Korean exports to Mexico are actually inputs for assembly and re-export to the United States and Canada. A 2012 report from the Korean Economic Institute estimated that "around 70% of Mexican imports from Korea are inputs that would be assembled into final goods for export to the U.S."²¹

¹⁶ Inter-American Development Bank, *Japan and Latin America and the Caribbean: Building a sustainable trans-Pacific relationship* (Washington, DC: Inter-American Development Bank, 2013), p. 22.

¹⁷ Ibid. pp. 5-6.

¹⁸ Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Direct Investment in Latin America and the Caribbean, 2013*, Santiago, Chile, 2014.

¹⁹ Antoni Estevadeordal, Mauricio Mesquita Moreira, and Theodore Kahn, *Korea and Latin America and the Caribbean: striving for a diverse and dynamic relationship*, Washington, DC: Inter-American Development Bank, 2015, pp. vii, 1, 17. <http://publications.iadb.org/bitstream/handle/11319/6830/Korea-and-Latin-America-and-the-Caribbean.pdf-ENG?sequence=1>.

²⁰ Ibid. p 17. <http://publications.iadb.org/bitstream/handle/11319/6830/Korea-and-Latin-America-and-the-Caribbean.pdf-ENG?sequence=1>.

²¹ Juan Felipe López, "Korea's Engagement in Latin America," *Korea Compass*, Washington, DC: Korean Economic Institute, March 2012.

What Are the Emerging Attractions of Investment in LAC?

Just as the East Asian countries have had different profiles of their LAC investments to this point, LAC countries differ considerably in terms of the investment attractiveness of different sectors and overall investment climate, because of both very different economic policy regimes and different resource endowments, whether natural resources, human resources, proximity to markets, etc.

Argentina, Brazil, and Chile are balanced in terms of raw material production and manufacturing, even if the most recent East Asian investments in Brazil and Chile have been in energy and mining. For non-energy raw-material investments, soybeans and other grains have been attracting Chinese, Japanese, and Korean investments in both cropland and processing, primarily in Brazil and Argentina.²² For foreign land acquisitions from 2000 to 2010, Brazil ranked eighth overall in the area of land purchased by foreign investors; with Argentina eleventh, behind sub-Saharan African and Southeast Asian countries. Chinese companies were by far the largest land purchasers, with nearly 11 million hectares reported as purchased; Korea was fifth, with 5 million hectares, Japan a distant nineteenth.²³ In contrast to energy investments, there is little concern about over-supply of foodstuffs.

Colombia, Ecuador, Peru, and Venezuela have largely been attractive to FDI in general only in their raw material potentials, although long-standing Japanese connections with Peru had resulted in some industrial investment. With the exception of Venezuela, with its toxic atmosphere for sound investment for the foreseeable future, these countries have considerably lower per capita purchasing power than Argentina, Brazil, Chile, or Mexico.

In many ways, Mexico is in a class by itself, with its special trade and border relationship with the United States but its lack of major natural-resource surpluses. Because of the disarray of Mexico's state oil company PEMEX for decades, Mexico missed out on a major part of the commodity boom. However, Mexico's NAFTA membership makes it very attractive for investment for goods directed to the U.S. and Canadian markets. Both Japan (with a free trade agreement with Mexico) and Korea (without such an agreement) have major investments in Mexican manufacturing. Nearly a quarter of Mexico's automobile exports, sold in South America, the United States, and the European Union, are produced by Japanese factories located within Mexico.²⁴ Even without a Korean-Mexican FTA, the Mexican industrial sector (if not the domestically-owned sub-sector) has benefited from the NAFTA free trade agreement.

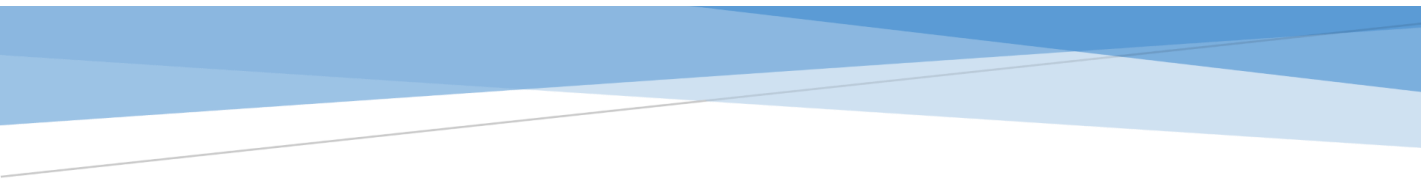
Most troubling for Mexico is the overlap between Mexican and Chinese export categories, due to the fact that over 80 percent of Mexican exports are manufactures.²⁵ A 2015 World Bank study

²² Kelly Hearn, China plants bitter seeds in South American farmland: Culture clash seen with wave of investments, Washington Times, February 1, 2012. <http://www.washingtontimes.com/news/2012/feb/1/china-plants-bitter-seeds-in-south-american-farmla/?page=all>; Aya Takada, Japan to Promote Farm Investment Overseas for Food Security, Bloomberg.com, April 26, 2009.

²³ Ward Anseeuw, Mathieu Boche, Thomas Breu, Markus Giger, Jann Lay, Peter Messerli and Kerstin Nolte, Transnational Land Deals for Agriculture in the Global South Analytical Report based on the Land Matrix Database, April 2012. CDE/CIRAD/GIGA, Bern/Montpellier/Hamburg, pp. 9, 21. These figures do not document where each investor country's purchases were.

²⁴ IDB (2013), p. 12.

²⁵ According to the Banco de Mexico, Compilación de Informes Trimestrales Correspondientes al Año 2013, p. 334, manufacturing accounted for 83 percent in 2013. Some estimates find the China-Mexico export similarity index to exceed 50 percent. Enrique Dussel Peters, "A Study of the Impact of China's Global Expansion on Mexico: Mexico's Economic Relationship with China: Heading for



estimates that competition with Chinese manufactures is costing Mexico 11 percent of its manufactured exports.²⁶ To be sure, as Chinese wages rise, energy costs increase, and production costs rise due to more stringent environmental regulations, China-based industries will become less competitive. Any industrial promotion by the Mexican government must take into account that China will become an even fiercer competitor as Chinese manufactures diversify.

What would make LAC attractive for constructive investment from all three major East Asian countries? It is clearly not LAC's wage levels (i.e., the "efficiency seeking" attraction, narrowly defined as the cost of labor). Table 2 demonstrates that for now, LAC labor costs are considerably higher than those of the poorer countries of Asia and Africa.

conflict? Working Paper No. 4. Norwich, UK: School of Development Studies/Overseas Development Group, December 2008.

²⁶ Erhan Artuç, Daniel Lederman, and Diego Rojas, The Rise of China and Labor Market Adjustments in Latin America, Policy Research Working Paper 7155, Washington, DC: World Bank, January 2015.

Table 2. Formal-Sector Wages in Select Countries, 2013-2015, US\$²⁷

Argentina	\$1,357
South Africa	\$1,218
Mexico	\$1,017
Brazil	\$1,009
Chile	\$1,006
Peru	\$673
Ecuador	\$490
Botswana	\$486
Venezuela	\$437
Thailand	\$418
Colombia	\$370
Philippines	\$288
7 W. African cities ²⁸	\$225
Pakistan	\$122
India	\$117
Bangladesh	\$77

Obviously, if Chinese, Japanese, and Korean firms want to benefit from low labor costs, LAC has no particular attraction. However, Table 3 demonstrates the surprisingly greater potential purchasing power than all other developing regions except for East Asia and the Pacific—which includes China. LAC has much greater overall gross national income despite a far smaller population than South Asia and Sub-Saharan Africa, and the highest per capita gross national income of all developing areas.

²⁷ Sources: The Occupational Wages around the World: Update for 1983-2008, Background Paper for the World Development Report 2013. Washington, DC: World Bank; TRADINGECONOMICS.com; International Labour Organization, ILOSTAT; François Roubaud and Constance Torelli, “Employment, Unemployment, and Working Conditions in the Urban Labor Markets of Sub-Saharan Africa: Main Stylized Facts”, in Philippe De Vreyer and François Roubaud, eds., *Urban Labor Markets in Sub-Saharan Africa* Washington, DC: World Bank, 2013.

²⁸ Abidjan, Bamako, Cotonou, Dakar, Lomé, Niamey, Ouagadougou; formal private-sector employment.

Table 3. Gross National Income and Gross National Income Per Capita, Developing Areas, 2013

	Population millions	Gross National Income (GNI) US\$ billion	GNI per capita US\$
East Asia & Pacific	2,006	11,105	5,536
Europe & Central Asia	272	1,938	7,114
LAC & Caribbean	588	5,611	9,542
South Asia	1,671	2,478	1,483
Sub-Saharan Africa	936	1,579	1,686

Source: World Bank, *World Development Indicators 2015*. Estimate by Atlas method—more meaningful for trade than Purchasing Power Parity adjustments.

We can therefore expect LAC to be a prime target for *market-seeking* investment. This has the fortuitous potential of attracting higher value-added industries that are also less polluting than processing industries such as steel and cement. Compared to the South Asian and poorest Southeast Asian countries, LAC nations have the demand profile and the skills to attract finished-product manufacturing. But maximizing this opportunity depends on four conditions.

First, the economic policies must ensure that sound investments can pay off. The relatively low capital formation²⁹ in most LAC countries reflects the recognition by investors that these countries have suffered from growth-stifling macroeconomic and regulatory policies. The huge holdings still in the Brazilian Central Bank, resulting from the commodity price boom, are a strong indication of the lack of attractive investment opportunities in other sectors of the economy. Korean critics assert that many LAC governments have a “lack of an effective economic policy for industrial upgrading”³⁰. Yet in addition to the currently weak economic policies, the disincentive to invest is worsened by the risk of government policies that would undermine the viability of initiatives after investment decisions are made, by draining the profits through higher taxes, input-price manipulations, contract cancellation, or direct expropriation. For example, many LAC governments have engaged in “resource nationalism” takeovers of foreign-owned electric companies, mining and hydrocarbon operations, or forestry holdings.

Second, because of cumbersome regulations, bureaucratic delay, and corruption, some LAC countries have very high costs of doing business. In the most recent World Bank rankings of the “ease of doing business”, Ecuador’s rank is 115th out of 189 countries; Brazil’s 120th; Argentina’s 124th; and

²⁹ With the exception of the 1970s, gross fixed capital formation as a percent of Latin America’s GDP was below 19 percent for all of the other periods between 1950 and 2008. This calculation is based on data from CEPAL, *América Latina y el Caribe: Series históricas de estadísticas económicas 1950-2008*.

³⁰ Juan Felipe López, “Korea’s Engagement in Latin America, Korea Compass. Seoul: Korea Economic Institute, 2012, p. 2.

Venezuela's 182nd.³¹ LAC nations on average have by far the highest costs of establishing new businesses.³² On the other hand, reforms have elevated other major LAC countries in overall ease of doing business: Colombia (34th), Peru (35th), Mexico (39th) and Chile (41st). While the ease of doing business certainly does not guarantee high economic growth (e.g., Mexico has grown at only two percent for the past 30 years), a poor reputation for investment friendliness can be a major deterrent to FDI. The poor rankings of five of the eight major countries may have little bearing on the profitability of globalized industries such as the automotive sector, but other sectors that suffer from excessive regulation and corruption, or slow processing of licenses and permits, may be unattractive to both international and domestic investors.

The most telling indication of how investment-friendly or -unfriendly policies and practices impact FDI decisions is the September-October investor-confidence survey of Japanese executives by the Japan External Trade Organization, comparing LAC and Asia. The summary points are:

- “Business confidence in Mexico and Colombia remarkably high, compared to major Asian emerging countries...”
- Business confidence in Brazil to be improved, yet gap with Mexico expanding...
- Japanese-affiliated firms show stronger motivation to expand business in Mexico than in China, ASEAN and India...
- Large gap in recognition of investment-environment risks between Pacific Alliance and MERCOSUR...
- Investment environments [are] relatively good in Mexico, while Brazilian business still needs to overcome obstacles...
- High local procurement rate of raw materials and parts in Brazil, while Mexico's procurement provided by supply chain from North America.
- Colombia draws attention as growing consumer market, while Venezuela and Argentina still in tough business environments.”³³

It is worth noting that Mexican policies were dramatically reformed in preparation for entry into the North American Trade Agreement. This “harmonization,” though causing considerable turmoil in Mexico, goes far in explaining the superior investor confidence. Colombia also underwent liberalization reforms to join a free trade agreement with the United States; this harmonization has qualified Colombia to enter into FTA negotiations with Japan.

Third, even if investments are devoted to turnkey manufacturing (e.g., an auto assembly factory) ensuring the physical efficiency of the operation, efficiency of LAC production rests on finding reliable input suppliers, sufficient infrastructure, and labor regulations that avoid firms having to retain redundant workers or pay out exorbitant severance packages. These concerns are reflected in the weak progress in manufacturing competitiveness across LAC. A 2014 assessment by BBVA³⁴ concluded that

³¹ World Bank *Doing Business 2014* (Washington, DC: World Bank).

³² World Bank *Doing Business 2013*, (Washington, DC: World Bank), p. 58

³³ Japan External Trade Organization, “2014 Survey on Business Conditions of Japanese Firms in Latin America”, Tokyo: Japan External Trade Organization, 2015 <https://www.jetro.go.jp/en/news/releases/2015/20150205995-news.html>

³⁴ Alicia García-Herrero, Enestor Dos Santos, Pablo Urbiola, Marcos Dal Bianco, Fernando Soto, Mauricio Hernández, Arnulfo Rodríguez, and Rosario Sánchez, Competitiveness in the Latin American manufacturing sector: Trends and determinants, BBVA Working Paper No. 14/11 Madrid,

After relatively favourable progress between 2002 and 2007, the manufacturing sector's competitiveness as shown by international trade data went down on the whole between 2007 and 2012 in Latin America. This recent deterioration, which has been more pronounced in countries like Brazil and Colombia, is linked to a continued higher exchange rate, labour cost pressures and not enough labour productivity gains. The main exception to these regional trends is Mexico, where competitiveness gains in the manufacturing sector continued beyond 2007, partly because the exchange rate was more depreciated and both labour costs and labour productivity performed more favourably than in South American countries. Nevertheless, from 2011 the reversal of these trends has been making it difficult for the Mexican manufacturing sector to gain competitiveness.

Fourth, trade liberalization, though bringing the obvious promise of expanded export potential, also poses the risk that East Asian (or other international) firms facing lower LAC trade restrictions, may bring in imports from lower-wage regions, such as South Asia or Sub-Saharan Africa. This depends not only on tariff levels, but also on factors facing considerable uncertainty, such as shipping costs, wage-level changes, other production costs, product quality, etc. This last condition poses an acute predicament for navigating through the complexities of bilateral and multilateral trade agreements, as explained in the section on trade.

Prospective East Asian Investment

The other side of the investment equation is, of course, the capacity and willingness of the East Asian companies to export capital to LAC.

China. The ambition of China's ventures in LAC going beyond the stakes in resource extraction will depend on the success of Xi Jinping's economic policy reforms. From 2003-2012 economic and political reform stagnated in China. Were the trends of that decade to continue, China would eventually have stagnated like Japan, but at a lower level of income that would have ensured political discontent and possible upheaval. Xi Jinping is now attempting to re-ignite market-oriented economic reform. That plan is meeting massive resistance; current betting is that the resistance will largely be overcome, but that is still a bet, not a sure thing. Non-performing loans, corporate profits heavily dependent on subsidies³⁵, and over-capacity ranging from metals to housing require far more discipline in the lending that has propelled China's industrial expansion.

Japan. The prospects of Japanese FDI expansion into LAC depend on whether Japan can surmount its economic stagnation. Uncertainty about the fate of Prime Minister Abe's stimulus initiatives is extremely high, especially because the fiscal stimulus and monetary expansion have not had the hoped-for impact, and the structural reforms have thus far been successfully resisted by interest groups. The International Monetary Fund just released a rather skeptical assessment, "Can Abenomics Succeed? : Overcoming the Legacy of Japan's Lost Decades"³⁶, which argues that all "three

March 2014, p. 68.

³⁵"Subsidies accounted for four-fifths of the profits reported by Chinese steel companies in the first half of [2014]...A total of 2,235 firms, or 88 percent of Chinese listed companies, received government subsidies totaling 32.2 billion yuan (\$5.24 billion) in the first half of 2014..." Fayen Wong, "Steel Industry on Subsidy Life-support as China Economy Slows, Reuters, September 18, 2014, <http://www.reuters.com/article/2014/09/19/us-china-economy-steel-idUSKBN0HD2LC20140919>

³⁶ Dennis P J Botman, Stephan Danninger, and Jerald Alan Schiff, *Can Abenomics Succeed? : Overcoming the Legacy of Japan's Lost Decades*, Washington, DC: International Monetary Fund, 2015.

arrows”—monetary easing, fiscal stimulus, and structural and financial sector reforms—are essential for Japan to resume acceptable levels of economic growth, while some, particularly the Third Arrow of structural and financial sector reforms, have so far been weakly implemented. Japanese policymakers may be hoping that the harmonization necessary to enact a strong Trans-Pacific Partnership (more on this in the following section on trade) would reinforce these changes. “Abenomics” as implemented thus far is a bet that monetary stimulus can create confidence, and that confidence will create sustained growth, in the absence of significant structural reform.³⁷ The monetary expansion has led to the depreciation of the yen, with little effect thus far, and the depreciation has reduced outward FDI from Japan and has increased repatriation of foreign assets back into Japan—neither is good for LAC. One possible scenario is that, if Abenomics fails, Japan’s financial collapse a few years hence could bring on a new global crisis. Given the financial fragility of much of the world, the world economy could evolve into a very different structure. A less dire but still pessimistic scenario is that if Abenomics does not produce sustainable results, and Japan begins to borrow more from abroad, the pressure on international interest rates would make it more difficult for LAC countries to borrow, in addition to the faltering of FDI.

Korea. Although the Korean economy has been far more dynamic than the Japanese economy over the past decade, Korea faces parallel challenges to stimulate the economy while undergoing policy reforms. The massive mid-2014 stimulus package had little impact; the labor, pension, regulatory, and public-sector restructuring reforms face opposition; and the indebtedness of state enterprises must also be addressed.³⁸ However, Korean exports have been expanding, in the context of stagnant domestic demand held back by high levels of personal debt. One implication is that Korean firms have strong incentives to seek international markets, whether through market-seeking FDI or export promotion.

Korea’s relationship with Mexico is particularly complex. As mentioned above, Mexico’s obvious advantage for market-seeking investment is the U.S. and Canadian markets via the North American Free Trade Agreement, accounting for the large portion of Korean exports to Mexico that are inputs for Mexican assembly. This is beneficial for both Korean firms and the overall Mexican economy, as long as sufficient value added is generated and dumping charges cannot be imposed by the U.S. or Canadian governments. The value-added assembly has prompted the Mexican government to overlook the growing trade deficit.³⁹ However, the Mexican business sector indeed does see the trade deficit as a problem, and it has been one of the reasons for lobbying against closer trade relations with Korea.

United States. How do the destinations of FDI from East Asia match up with U.S. FDI in LAC? The bulk of the U.S. LAC assets, aside from the funds parked in the offshore tax havens, is concentrated in manufacturing⁴⁰, the mirror image of China’s FDI profile in LAC over the past decade, with its 80 percent presence in minerals, oil and other raw materials, even excluding infrastructure investment for resource extraction. In contrast with the quite concentrated East Asian FDI

³⁷ Fiscal stimulus was implemented, then offset by tax increases. Structural reforms are always listed as part of the plan, but largely unimplemented because of overwhelming interest group resistance.

³⁸ UK Trade and Investment Office, South Korea – Economy in 2015 – Prospects, January 22, 2015. <https://www.gov.uk/government/publications/south-korea-economy-in-2015-prospects/south-korea-economy-in-2015-prospects>

³⁹ Juan Felipe López, “Korea’s Engagement in Latin America,” *Korea Compass*, Washington, DC: Korean Economic Institute, March 2012.

⁴⁰ U.S. Bureau of Economic Analysis, U.S. Direct Investment Position Abroad on a Historical-Cost Basis, Latin America and other Western Hemisphere. <http://www.bea.gov/international/factsheet/factsheet.cfm?>

investments in a few countries, the reach of U.S. FDI is further spread across LAC, although Mexico, with just over US\$100 billion, holds just under 30 percent of this investment, and Brazil, with just over US\$78 billion, holds over 20 percent. As the next section will show, the United States is similarly dominant in the trading realm, although China is now nipping closely at its heels in some South American countries.

East Asian-LAC Trade: Patterns and Pacts

Over the past decade, LAC's trade with the Asia-Pacific region grew more briskly than its trade with other major partners. As Table 4 demonstrates, Chinese trade with LAC has increased by more than a factor of five over a single decade. Japanese exports increased by half, and imports doubled; Korean exports more than doubled, and imports nearly tripled. Yet U.S. trade greatly outweighs the East Asian countries, with more than double the exports and imports of all three combined. U.S. exports doubled, and imports increased by nearly half.

Table 4. East Asian and U.S. Trade in Goods with the “Western Hemisphere” (excluding Canada & the U.S.), US\$ billions, 2005-14

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
China	exports	22.8	34.5	50.0	69.7	55.6	90.5	120.5	133.7	132.3	134.3
	imports	26.2	33.5	49.8	70.3	63.2	89.7	117.8	124.3	125.5	126.4
Japan	exports	22.6	28.7	33.1	39.3	31.3	42.2	42.2	41.1	34.5	31.8
	imports	14.6	18.6	22.6	26.5	18.7	26.9	33.1	33.5	31.7	28.5
Korea	exports	14.8	20.2	25.4	32.8	26.5	35.9	39.8	36.4	36.0	35.6
	imports	6.8	9.6	11.1	13.6	11.5	14.4	19.9	19.4	18.1	18.0
USA	exports	191.7	222.7	243.3	288.0	237.8	300.8	365.1	398.7	408.4	423.8
	imports	302.5	341.1	354.5	385.3	291.6	368.1	443.9	457.5	447.0	444.5

Source: International Monetary Fund, Direction of Trade Statistics.

<http://elibrary-data.imf.org/>

From the perspective of the LAC countries, East Asia represented new and welcome market opportunities. Between 2006 and 2010, LAC exports to the Asia-Pacific countries expanded at more than three times the rate of the region's exports to the rest of the world. These were largely raw material exports, reversing the trend that by the late 1990s had made manufactures the majority of the region's exports. However, this was primarily a reflection of the commodity boom rather than a decline in manufactured exports. Table 5 reveals the remarkable rise of oil, metals, and basic foodstuffs, which even in the depths of the Great Recession were far higher than in the earlier 2000s.

Table 5. Annual Commodity Price Trends in Real Dollars, 2000-2013

	Copper (\$/metric ton)	Petroleum (\$/barrel)	Soybeans (\$/metric ton)	Iron Ore (\$/dry metric ton unit)	Fishmeal (\$/metric ton)
2000	2,279	35	266	36	519
2001	2,061	32	256	39	636
2002	2,061	33	281	39	801
2003	2,235	36	332	40	767
2004	3,371	44	360	45	763
2005	4,195	61	313	74	833
2006	7,475	71	299	77	1,297
2007	7,459	75	402	129	1,234
2008	6,764	94	508	152	1,102
2009	5,339	64	452.94	83	1,275
2010	7,535	79	449.80	146	1,688
2011	8,104	95	496.29	154	1,411
2012	7,400	98	549.67	119	1,448
2013	6,913	98	507.66	128	1,647

Source: Source: World Bank Global Economic Monitor (GEM) Commodities

<http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=global-economic-monitor-%28gem%29-commodities>.

Table 6. China-LAC Trade 1995-2013, Millions US\$

	Total Exports to China	Total Imports from China		Total Exports to China	Total Imports from China
	1995			2010	
Argentina	\$370	\$274	Argentina	\$6,804	\$6,116
Brazil	\$1,232	\$759	Brazil	\$38,099	\$24,461
Chile	\$230	\$410	Chile	\$17,935	\$8,025
Colombia	\$14	\$52	Colombia	\$2,103	\$3,820
Ecuador	\$29	\$45	Ecuador	\$507	\$1,496
Mexico	\$194	\$195	Mexico	\$6,875	\$17,873
Peru	\$460	\$146	Peru	\$6,368	\$3,550
Venezuela	\$16	\$69	Venezuela	\$6,699	\$3,649
	2000			2013	
Argentina	\$930	\$610	Argentina	\$6,086	\$8,750
Brazil	\$1,621	\$1,224	Brazil	\$54,299	\$35,895
Chile	\$1,339	\$784	Chile	\$29,708	\$13,105
Colombia	\$32	\$156	Colombia	\$3,620	\$6,826
Ecuador	\$80	\$75	Ecuador	\$775	\$2,967
Mexico	\$488	\$1,335	Mexico	\$10,238	\$28,966
Peru	\$560	\$144	Peru	\$8,408	\$6,189
Venezuela	\$95	\$256	Venezuela	\$13,120	\$6,065
	2005				
Argentina	\$3,799	\$1,324			
Brazil	\$9,992	\$4,827			
Chile	\$4,992	\$2,149			
Colombia	\$205	\$930			
Ecuador	\$43	\$467			
Mexico	\$2,225	\$5,538			
Peru	\$2,278	\$609			
Venezuela	\$1,234	\$908			

Table 7. Japan-LAC Trade, 1995-2013, Millions US\$

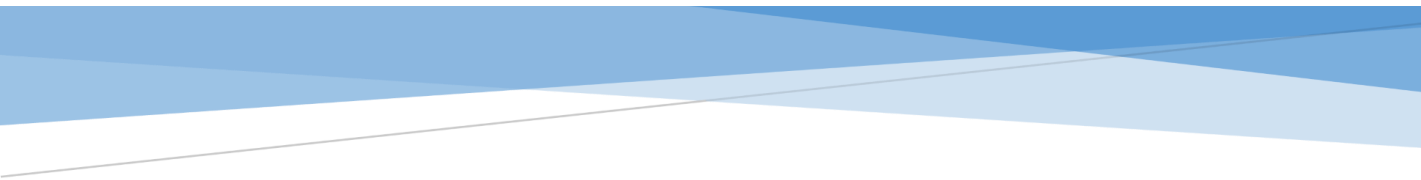
Table 7: Japan-EAC Trade, 1995-2013, millions US\$				Total exports to Japan	Total imports from Japan	
Total Exports to Japan		Total Imports from Japan				
				2010		
		1995		Argentina	\$998	\$855
Argentina	\$428		\$466	Brazil	\$9,817	\$6,201
Brazil	\$3,942		\$2,584	Chile	\$7,746	\$2,712
Chile	\$3,166		\$914	Colombia	\$540	\$7,712
Colombia	\$414		\$1,091	Ecuador	\$291	\$682
Ecuador	\$195		\$331	Mexico	\$3,480	\$9,574
Mexico	\$1,496		\$3,576	Peru	\$2,182	\$997
Peru	\$537		\$297	Venezuela	\$105	\$616
Venezuela	\$468		\$500			
				2013		
		2000		Argentina	\$1,848	\$1,112
Argentina	\$453		\$728	Brazil	\$11,136	\$5,660
Brazil	\$2,996		\$2,522	Chile	\$8,020	\$1,699
Chile	\$2,842		\$659	Colombia	\$440	\$1,228
Colombia	\$264		\$556	Ecuador	\$1.09	\$528
Ecuador	\$258		\$208	Mexico	\$4,230	\$9,691
Mexico	\$2,385		\$5,210	Peru	\$2,645	\$989
Peru	\$352		\$352	Venezuela	\$506	\$677
Venezuela	\$275		\$508			
		2005				
Argentina	\$327		\$543			
Brazil	\$4,421		\$2,713			
Chile	\$5,121		\$942			
Colombia	\$371		\$793			
Ecuador	\$138		\$341			
Mexico	\$2,515		\$6,930			
Peru	\$704		\$274			
Venezuela	\$301		\$773			

Source: UN Comtrade

Table 8. Korea-LAC Trade 1995-2013, Millions US\$

	Total Exports to Korea	Total Imports from Korea		Total Exports to Korea	Total Imports from Korea
	1995			2010	
Argentina	\$132	\$362	Argentina	\$795	\$909
Brazil	\$1,388	\$1,519	Brazil	\$4,712	\$7,753
Chile	\$1,021	\$637	Chile	\$4,221	\$2,947
Colombia	\$57	\$218	Colombia	\$432	\$1,389
Ecuador	\$312	\$93	Ecuador	\$12	\$887
Mexico	\$308	\$941	Mexico	\$1,521	\$8,846
Peru	\$130	\$194	Peru	\$2,182	\$997
Venezuela	\$68	\$117	Venezuela	\$125	\$644
	2000			2013	
Argentina	\$191	\$533	Argentina	\$1,195	\$1,075
Brazil	\$935	\$1,742	Brazil	\$5,573	\$9,668
Chile	\$902	\$593	Chile	\$4,658	\$2,458
Colombia	\$53	\$201	Colombia	\$207	\$1,342
Ecuador	\$324	\$84	Ecuador	\$48	\$920
Mexico	\$378	\$2,391	Mexico	\$2,300	\$9,727
Peru	\$116	\$213	Peru	\$1,983	\$1,440
Venezuela	\$26	\$380	Venezuela	\$51	\$443
	2005				
Argentina	\$371	\$309			
Brazil	\$2,501	\$2,411			
Chile	\$2,279	\$1,151			
Colombia	\$206	\$913			
Ecuador	\$29	\$344			
Mexico	\$798	\$6,285			
Peru	\$676	\$6,285			
Venezuela	\$212	\$571			

Source: UN Comtrade



As Tables 6 through 8 reveal, LAC's imports from the Asia-Pacific countries have grown more rapidly than overall LAC exports. However, specific country patterns demonstrate considerable variation in trade balances. Among the major LAC countries, Mexico's trade deficit stands out. However, the broader picture clarifies that what appears to be a problem for Mexico is actually part of Mexico's pattern of importing parts to be assembled and exported to the United States and Canada. Mexico's 2014 export value of US\$299.8 billion greatly exceeds the US\$187.8 billion of import value; and Mexico had a mild trade surplus with Canada of US\$10.4 billion of exports vs. US\$9.8 billion of imports.⁴¹

The Tale of the Two Giants

Brazil and Mexico, LAC's industrial powerhouses, have been able to maintain their technology-based exports in trade with the United States, yet to a much lesser extent with the East Asian countries. As Table 9 indicates, Brazil has been able to sell machinery and aircraft in the United States; Mexico's border assembly ("maquiladoras"), auto factories, and general manufacturing complement the raw materials exports to the United States.

⁴¹ UN Comtrade

Table 9. Composition of Brazilian and Mexican Exports, 2014, US\$ billions

	<u>to China</u>	<u>to Japan</u>	<u>to Korea</u>	<u>to the United States</u>
Brazil				
	oil seed \$16.6	ores \$2.5	ores \$1.4	iron & steel \$3.8
	ores \$12.7	meat \$1.1	food waste/fodder \$0.4	oil \$3.6
	oil \$3.5	coffee, tea, spices \$0.5	cereals \$0.4	machines \$3.6
	woodpulp \$1.7	aluminum \$0.4	alcoholic bev \$0.2	aircraft & spacecraft \$2.2
	sugar \$0.9	iron & steel \$0.3	oil seed \$0.2	coffee, tea & spices \$1.3
	hides \$0.8	oil seed \$0.3	iron & steel \$0.2	woodpulp \$1.0
	iron & steel \$0.5	cereals \$0.2	cotton \$0.2	stone, plaster, & cement \$0.9
	meat \$0.5	prepared veg/fruit \$0.1	organic chemicals \$0.1	organic chemicals \$0.9
	fats & oils \$0.4	machines \$0.1	meat \$0.1	wood \$0.8
	tobacco \$0.3	wood \$0.1	hides \$0.1	electronics \$0.8
Mexico				
	ores \$1.8	meat \$0.5	ores \$1.1	electronics \$66.5
	vehicles \$1.6	electronics \$0.4	vehicles \$0.2	vehicles \$61.9
	oil \$0.7	vehicles \$0.2	oil \$0.2	machines \$47.4
	electronics \$0.7	machines \$0.2	machines \$0.1	oil \$36.1
	copper \$0.5	fruits & nuts \$0.1	electronics \$0.1	med/tech equip. \$11.7
	machines \$0.3	ores \$0.1	rubber \$0.06	furniture & lighting \$7.7
	plastics \$0.2	gems/prec. metals \$0.1	copper \$0.05	gems/prec. metals \$7.4
	org. chemicals \$0.1	stone/cement/salt \$0.1	iron & steel \$0.03	plastics \$5.5
	cotton \$0.1	fish \$0.1	meat \$0.03	vegetables \$5.1
	med/tech equip \$0.07	plastics \$0.1	med/tech equip. \$0.02	iron & steel products \$4.0

The Complex Connections between Trade and Investment

Although the bulk of the attention on East Asian-LAC economic relations has focused on direct trade and investment, the neglected issue is how investment can open up new trading opportunities, and what impact opening up trade would have on investment. Recall that East Asian investment, aside from physical infrastructure and stakes in resource extraction, is likely to be market-seeking—meaning the Western Hemisphere. The intra-regional trade that would make market-seeking investment in LAC most attractive is still quite limited. Table 10 reveals that even the exports of the major manufacturing nations, Brazil and Mexico, are predominantly oriented to North America and China. Only 12.2 percent of Brazilian exports went to LAC; only 5.2 percent of Mexican exports did so.

Table 10. Top Destinations of Brazilian and Mexican Exports, 2014, US\$ billions

Brazilian Exports	value	percent	Mexican Exports	value	percent
China	\$40.6	18.0%	United States	\$319.3	80.3%
United States	\$27.1	12.1%	Canada	\$10.7	2.7%
Argentina	\$14.3	6.3%	China	\$6.0	1.5%
Netherlands	\$13.0	5.8%	Spain	\$5.9	1.5%
Japan	\$6.7	3.0%	Brazil	\$4.7	1.2%
Germany	\$6.6	2.9%	Colombia	\$4.7	1.2%
Chile	\$5.0	2.2%	Germany	\$3.5	0.9%
India	\$4.8	2.1%	India	\$2.7	0.7%
Venezuela	\$4.6	2.1%	Japan	\$2.6	0.7%
Italy	\$4.0	1.8%	Netherlands	\$2.3	0.6%
United Kingdom	\$3.9	1.7%	Chile	\$2.1	0.5%
South Korea	\$3.8	1.7%	South Korea	\$2.0	0.5%
Russia	\$3.8	1.7%	United Kingdom	\$1.8	0.5%
Mexico	\$3.7	1.6%	Guatemala	\$1.8	0.4%
Singapore	\$3.3	1.5%	Peru	\$1.7	0.4%
Uruguay	\$2.9	1.3%	Venezuela	\$1.6	0.4%
Colombia	\$2.4	1.1%	Argentina	\$1.3	0.3%
Peru	\$1.8	0.8%	Costa Rica	\$1.0	0.2%
Bolivia	\$1.6	0.7%	Panama	\$1.0	0.2%
Ecuador	\$0.8	0.4%	Ecuador	\$0.9	0.2%
Trinidad & Tobago	\$0.5	0.2%	Cuba	\$0.4	0.1%
Cuba	\$0.5	0.2%	Uruguay	\$0.3	0.1%

Source: UN Comtrade

Expanding LAC production, employment, and income by taking advantage of East Asian market-seeking investment depends on East Asian firms finding the combination of investment and sales within LAC to be more profitable than exporting from the home country or from countries with lower wages than in LAC. The profitability of the alternative approaches depends importantly on import duty levels, import quotas, local content requirements, and other non-tariff barriers, as well as

incentives. In late 2014 China Daily USA noted that “[t]o encourage foreign automobile companies to build plants in Brazil, the government enacted a series of policies such as the 30-percent increase in tax on imported cars in 2012. That year Brazil also applied Inovar-Auto, which provides a 30-percent discount in the excise tax for locally produced cars.”⁴² If the market in a LAC country and its regional free-trade partners is sufficiently large, a firm can circumvent the restrictions by manufacturing or assembling in that country. The *intra-regional* FTA magnifies the attraction. LAC leaders have long aspired to a comprehensive regional free trade zone, which would not only enhance trade of goods and services financed by LAC firms, but would also add to the attractiveness of non-LAC investment to take advantage of the capacity to export throughout the LAC region.

China is establishing auto manufacturing facilities in Brazil (e.g., Chery’s US\$540 million Jacarei plants, already producing vehicles for the huge Brazilian auto market, the world’s fourth largest, with the potential for export to other Mercosur countries). Chinese firms have also established car and truck assembly plants in Paraguay and Uruguay destined largely for export to Mercosur partners Argentina and Brazil. Shortell notes that: “The auto sector accounted for nearly 20 percent of all Chinese greenfield investments in LAC between 2008 and 2012, and 17 percent of new Chinese investments in Brazil in 2012 alone. Rather than import prefabricated vehicles from China, companies such as JAC Motors, Chery, Geely, Lifan, and Dongfeng have established or plan to operate production centers in the region. New factories located in LAC will trim costs associated with transportation and logistics and reduce import duties on Chinese auto products in certain countries.”⁴³

But if *intra-regional* FTEs make investment in LAC more attractive to firms outside of the region, some argue that *inter-regional* free trade increases the incentives for non-LAC firms to export goods—produced either in the home countries or in cheap-labor countries in Asia or Africa—rather than invest in LAC. For LAC policymakers, this poses the classic dilemma of protectionism to try to stimulate industry, vs. free trade to open up foreign markets, subject existing industry to pressures to become more efficient, and to make imports more affordable.

The wisdom of discouraging extra-regional imports hinges on the commitment and strength of LAC governments to resist the pressures to protect and subsidize inefficient domestic enterprises. Most LAC countries do not have a particularly good record on this. In addition to the checkered record on ease of doing business, mentioned above, LAC countries’ rankings in competitiveness are at best mediocre; and Argentina and Venezuela are ranked alongside some of the poorest countries of South Asia and Sub-Saharan Africa.⁴⁴

⁴² Zhang Fan, “Chery opens new auto plant in Brazil,” China Daily USA, September 1, 2014. http://usa.chinadaily.com.cn/world/2014-09/01/content_18519696.htm.

⁴³ Paul Shortell, “Chinese Automakers in Latin America Shift into High Gear”, Inter-American Dialogue, July 22, 2014. <http://chinaandlatinamerica.com/2014/07/22/chinese-automakers-in-latin-america-shift-into-high-gear/>

⁴⁴ Even worse, Bolivia, Paraguay and Haiti are ranked below Argentina, and no LAC country is ranked above Chile’s ranking of 33rd.

Table 11. Competitive Index Rankings of Major LAC, East Asian, and North American Countries, 2014

	Competitiveness Index Rank (out of 144 countries) 2014
Argentina	104
Brazil	57
Chile	33
Colombia	66
Ecuador	71*
Mexico	61
Peru	65
Venezuela	131
<i>Canada</i>	15
<i>China</i>	28
<i>Japan</i>	6
<i>Korea</i>	26
<i>United States</i>	3

*2013 figure—data not available for 2014

Source: World Economic Forum, The Global Competitiveness Report 2014-2015, Full Data Edition, Geneva, Switzerland

http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf

The disappointing performance of LAC countries reflects the widespread if not universal failure to carry out reforms that would have rooted out “rent-seeking” (special treatment through policies and their application), fiscal and monetary stability, and effective taxation. Sebastian Edwards provides this scathing indictment:

Contrary to the generalized view among analysts, journalists, and academics, during the 1990s and 2000s most Latin American countries made only limited progress in modernizing their economies. In most nations economic reforms have been incomplete, and thus it is not surprising that they have not transformed Latin America into an economic powerhouse.

A detailed analysis of the evidence shows that in spite of all the media attention, the so-called Washington Consensus reforms only scratched the surface of Latin America’s inefficient policy environment. In fact, most Latin American national economies continue to be among the most regulated, distorted, and protectionist in the world.⁴⁵

However, Edwards does note promising possibilities, noting that even the “moderate left” (as of his writing in 2010, Presidents Cardoso of Brazil, Lagos and Bachelet in Chile, Garcia in Peru, and

⁴⁵ Sebastian Edwards, *Left Behind: Latin America and the False Promise of Populism* (Chicago: University of Chicago Press, 2010), p. 8.

Vázquez of Uruguay) “understand the importance of the market...and acknowledge that innovation and efficiency are at the core of economic success.”⁴⁶ The pivotal premise is that “if politicians and voters recognize the need to modernize policies and institutions, if they are able to defeat the inertia and blocking tactics of entrenched interests groups, then LAC will take off.”⁴⁷

The Trans-Pacific Partnership. These considerations are central to the fate of the most prominent inter-regional free trade initiative, the Trans-Pacific Partnership (TPP). Thus far twelve countries across the Asia-Pacific, North America, and LAC (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam) are exploring the feasibility of a comprehensive “21st century” trade agreement. Colombia and Costa Rica may soon join the TPP initiative. Korea has requested membership, but has been put off until the U.S. administration, concerned about Congressional opposition and the challenges of negotiating the initial agreements, secures passage of the fast-track authority and establishes ground rules of competition (e.g., disallowing competitive advantages of government-backed firms).⁴⁸ Influential American analysts, such as Jeffrey Schott of the Peterson Institute for International Economics, strongly favor Korea’s prompt entry into the TPP: “After an assessment of Korea’s options, we conclude that Korea should seek to join the TPP as soon as possible.”⁴⁹

The TPP would be an “open” trading bloc that, like the World Trade Organization, would admit new members that meet trade liberalization commitments (in contrast to a “closed bloc”, such as the Mercosur bloc of Argentina, Brazil, Uruguay, and Venezuela, that requires agreement of all existing members to admit new members). A broad agreement could make progress on both the old trade agenda (agriculture, market access) and the new agenda (services, investment and intellectual property) originally taken up by the Doha Development Round overseen by the World Trade Organization but in limbo since 2006. Of course, an agreement to negotiate is far more modest than an agreement on the specifics of particular trade openings, and the foci of negotiation are on the difficult issues that have stymied the broader WTO-orchestrated negotiations. Skepticism on the part of members of the U.S. Congress, both Republican and Democratic, has already been voiced over threats to U.S. jobs, and, ironically, a prevalent concern in China is that the TPP is a U.S. strategy to isolate China from both East Asian and LAC trading partners.

Numerous bilateral or limited multilateral agreements underpin the broader multilateral TPP initiative. In addition to the myriad FTAs within LAC⁵⁰, Mexico has an FTA with Japan as well the crucial North American Trade Agreement with Canada and the United States. Peru has FTAs with Japan, Korea, Singapore, and the United States; Chile has a trade agreement with all of the TPP negotiating countries. China is, at this point, conspicuously absent. Although the Chinese reaction to the TPP initiative when it was launched in 2005 was first indifference and then criticism when the United States became the prime mover, since 2013 the Chinese Ministry of Commerce announced its

⁴⁶ Ibid. p. 3.

⁴⁷ Ibid. p. 236.

⁴⁸ Anna Fifield, “South Korea asks to join Pacific trade deal. Washington says not so fast,” Washington Post, April 15, 2015. http://www.washingtonpost.com/world/asia_pacific/south-korea-asks-to-join-pacific-trade-deal-washington-says-not-so-fast/2015/04/15/85d7396a-e39e-11e4-ac0f-f8c46aa8c3a4_story.html.

⁴⁹ Jeffery J. Schott and Cathleen Cimino, “Should Korea Join the Trans-Pacific Partnership?” Peterson Institute for International Economics Policy Brief PB14-22, September 2014. <http://www.iie.com/publications/pb/pb14-22.pdf>, p. 15.

⁵⁰ For example, the “Pacific Alliance” members are Chile, Colombia, Costa Rica, Mexico, and Peru; Chile has FTAs with all Central American countries except for Belize; with Mexico, and with Mercosur.

exploration of the feasibility of TPP membership.⁵¹ Nevertheless, the chances of China joining the TPP in the foreseeable future seem to be remote, if not because of the U.S. motive to form a trading bloc to rival China's influence, then because of the policy standards that the TPP would require of members.

The breadth and effectiveness of the TPP to bring LAC into closer trading relations with the East Asian nations depends, of course, on whether the U.S. Congress permits TPP negotiations to proceed, and whether Korea (and possibly China) will become TPP members. But its breadth also depends on whether industrial-protection policies, especially through non-tariff barriers such as local-content provisions, are restrained enough to permit the entry of more LAC countries, or permit agreements in key industries. For example, would Brazilian insistence on protecting its auto industry keep Brazil out of the TPP even if the Brazilian government would wish to join? How narrow will the range of effective agreements be? In short, even if the TPP goes into effect, with whatever range of LAC involvement emerges, like the WTO negotiations it is subject to the reluctance of members to give up the protections that government leaders believe to be most politically compelling.

Moreover, the benefits of TPP for current and potential participants are varied, uncertain, and controversial. In addition to the aforementioned point that the TPP provisions would depend on negotiations conducted in a politically charged context, the gains for particular countries depend on how prepared they are to take advantage of trade and investment opportunities, and how vulnerable they are to less protection of domestic industries. The forecasts of TPP impacts vary widely; *The Economist* notes that "Advocates claim [the TPP] it would boost their output by nearly \$300 billion in a decade. Critics say it would make little or no difference"⁵²

Outside of the TPP, China's Loan-Investment-Trade Approach

China's only LAC FTAs are bilateral agreements with Chile, Costa Rica, and Peru; and only one other potential FTA—with Colombia—is in the formal consideration phase.⁵³ China's major multilateral trading bloc initiatives, simply do not include LAC countries. He and Yang note that:

The Regional Comprehensive Economic Partnership (RCEP) may be seen as a rival to TPP, in the sense that China is not included in the TPP but it plays a vital role in RCEP. Beyond these two mega agreements, the upgrading of China–ASEAN Free Trade Area, China–Japan–Korea Free Trade Area (CJK FTA), and China–Australia Free Trade Area, among others, are all under negotiation. These newly emerged regional trade negotiations, to some extent, can be seen as a reaction to the ambitious goal of the US TPP strategy.”⁵⁴

Instead, China's economic relations with LAC countries are typically cemented with less formally structured packages of investment, loans, and trade. Whereas the TPP encompasses the

⁵¹ Fan He and Panpan Yang, "China's Role in Asia's Free Trade Agreements", *Asia & the Pacific Policy Studies* 2(2) (May 2015): 416-424. <http://onlinelibrary.wiley.com/doi/10.1002/app5.66/full>

⁵² *The Economist*, May 30, 2015, p. 77; see also Jeffery J. Schott and Cathleen Cimino, "Should Korea Join the Trans-Pacific Partnership?" Peterson Institute for International Economics Policy Brief PB14-22, September 2014. <http://www.iie.com/publications/pb/pb14-22.pdf>

⁵³ People's Republic of China Ministry of Commerce, "China FTA Network", May 30, 2015. <http://fta.mofcom.gov.cn/english/index.shtml>

⁵⁴ Fan He and Panpan Yang, *op. cit.*

more liberalized LAC countries, the strongest Chinese partnerships are with the less liberalized, more protectionist nations: Argentina, Brazil, Ecuador, and Venezuela. These relationships are driven to a large extent by the importance of the raw materials exported by these countries. Yet the non-obvious aspect of the exchange is the huge volume of loans, some to secure future shipments of raw materials, but all tightening the links between China and each of these countries. China's loans to LAC over the 2005-2011 period are estimated at \$75 billion. Gallagher, Irwin, and Koleski point out that Chinese loans over this period exceeded those of the World Bank, the Inter-American Development Bank, the U.S. Export-Import Bank combined.⁵⁵ Roughly \$60 billion was devoted to oil and gas or mining, and some has been tied to repayment in commodities, especially oil. The bulk of the loans went to Venezuela, Brazil, Argentina and Ecuador.⁵⁶ It is significant that Argentina, Ecuador, and Venezuela have been finding it difficult to secure international loans from other lenders. By 2014, Chinese loans to Venezuela since 2005 amounted to US\$56.3 billion to Venezuela; US\$22 billion to Brazil; US\$19 billion to Argentina US\$19 billion; and US\$10.8 billion to Ecuador. While total Chinese loans to LAC were roughly US\$119 billion, no other LAC country had borrowed more than \$3 billion.⁵⁷

However, four factors are likely to limit, for the foreseeable future, Chinese lending to LAC governments that is untied to projects: 1) the major borrowers (especially Venezuela and Argentina) appear to be increasingly shaky in terms of repayment; 2) the slow-down of the Chinese economy reduces the foreign exchange surplus that China has available to lend, exacerbated by the fact that the heavy international borrowing of Chinese firms is creating a major debt repayment burden; 3) much of the capital that Chinese leaders would be willing to direct to Latin America would be tied up in the major infrastructure projects, which (as mentioned above) are tied to Chinese equipment and provide work for Chinese engineers; 4) the capital that China is devoting to the AIIB (\$100 billion jointly financed by its 57 member countries) and the "BRICS Bank" (US\$100 billion jointly financed by Brazil, Russia, India, China, and South Africa for infrastructure projects within these countries), and the financing requirements of the infrastructure and financing initiative for the Eurasian Silk Road Fund ("One Belt One Road") regional initiative⁵⁸, to be capitalized at US\$62 billion, will also require China's foreign exchange.

Chinese lending now greatly exceeds Japanese and Korean lending, in both volume and diversity of motive. Japanese lending to LAC, approximately US\$60 billion in outstanding loans, has gone primarily to Brazil and Mexico, avoiding Argentina and Venezuela.⁵⁹ For Japanese commercial banks, the lending is attractive not because of geopolitical concerns, but rather because LAC interest rates are higher than in Japan or in Japanese banks' stakes in U.S.-based banks operating in LAC. Japanese official lending, through the Japan Export-Import Bank (now labeled the Japan Bank for International Cooperation (JBIC)), is also primarily for commercial purposes: to promote Japanese exports and to support Japanese corporations operating in LAC. Like Japanese lending, official

⁵⁵ Kevin Gallagher, Amos Irwin, and Katherine Koleski, "The New Banks in Town: Chinese Finance in Latin America," Inter-American Dialogue, February 2012, p. 5.

⁵⁶ Ibid. p. 5. They report that just over 90 percent of total Chinese loans went to these four countries.

⁵⁷ Kevin Gallagher and Margaret Myers, "China-Latin America Finance Database", Washington, DC: Inter-American Dialogue 2014.

⁵⁸ Scott Kennedy and David A. Parker, Building China's "One Belt, One Road" Washington, DC: Center for Strategic and International Studies, April 3, 2015. <http://csis.org/publication/building-chinas-one-belt-one-road>.

⁵⁹ Paul Shortell, *op. cit.*

Korean lending, at roughly US\$37 billion, also largely controlled through the Export-Import Bank, similarly has been in the service of supporting exports and home companies operating in LAC.⁶⁰

Thus the striking difference between the Chinese approach and that of both Japan and Korea is the Chinese approach of betting on the more problematic countries. One possible explanation, beyond the dubious motive of securing raw materials bilaterally rather than through the global market, is the opportunity to get a better deal from countries shunned by the international system. Another is that China is working to establish a distinctive axis of economic and potentially political partners. The four countries receiving the lion's share of Chinese investment as well as loans account for 56 percent of the GDP of LAC and the Caribbean.⁶¹

Foreign Aid

All three East Asian nations have been providing foreign assistance to LAC. Foreign assistance represents a means to establish and maintain good relations in general, but also provides geopolitical and commercial influence. In contrast to Japan and Korea, which are committed to minimizing the tied-aid aspect of their foreign assistance, China still uses tied aid broadly. Wolf, Wang, and Warner note that “Chinese concessional loans also include a stipulation that at least 50 percent of the loan is tied to the purchase of Chinese goods.”⁶² However, China has also committed sizable amounts to the Inter-American Development Bank, which has a commitment to untied aid.

Japan's grants to LAC amounted to US\$356 million in 2012 and US\$234 million in 2013.⁶³ This represents roughly five percent of Japanese official grant disbursements and 1.5 percent of concessional loan disbursements (and loan recovery has exceeded new disbursements in the 2009-2013 period). The overall volume of Japanese foreign assistance has been fluctuating throughout the past decade, reaching a high of just over \$1 billion in 2006 and nearly that volume in 2010, but averaging only half that volume in the other years from 2006 to 2012. Brazil and Peru have been the major recipients during that period.

Korean foreign assistance, relatively new worldwide, is very modest compared to Japan. However, Korean aid to LAC has been growing. At US\$25.6 million in 2006, Korean bilateral aid disbursements averaged US\$64 million from 2008 to 2011, and reached US\$96.5 million in 2013.⁶⁴ The Korean foreign assistance commitments to LAC have also increased, from US\$68.6 million in 2005 to US\$210 million in 2011.⁶⁵ Nicaragua, and the Andean countries of Ecuador, Peru, and Bolivia,

⁶⁰ Amos Irwin and Kevin Gallagher, *op. cit.*, 9. The Korean proportion was 0.38 percent; China's was 0.31 percent and 0.26 percent for Japan.

⁶¹ Economic Commission for Latin America and the Caribbean, “Economic Survey of Latin America and the Caribbean 2014,” Santiago, Chile, p. 174. Data on GDP are for 2013.

⁶² Charles Wolf, Jr., Xiao Wang, and Eric Warner, “China's Foreign Aid and Government-Sponsored Investment Activities,” (Santa Monica, CA: RAND Corporation), p. 7.

⁶³ That is, “grant aid” and “technical cooperation; both labeled “grants” in the Ministry of Foreign Affairs compilations. Japan Ministry of Foreign Affairs, Japan's Official Development Assistance White Paper 2013: List of Charts Presented in the White Paper http://www.mofa.go.jp/policy/oda/page_000044.html

⁶⁴ Organisation for Economic Co-operation and Development, “Geographical Distribution of Financial Flows to Developing Countries 2015: Disbursements, Commitments, Country Indicators,” Korea.

http://www.keepeek.com/Digital-Asset-Management/oecd/development/geographical-distribution-of-financial-flows-to-developing-countries-2015_fin_flows_dev-2015-en-fr#page52

⁶⁵ Jae Sung Kwak, “The Rising Importance of South-South Cooperation in Asia-LAC Economic Relations, Institute for the Integration of Latin America and the Caribbean,” Washington, DC: Inter-

have been the major recipients. In 2012, Korea pledged US\$40 million over five years to a fund for poverty alleviation and growth administered by the Inter-American Development Bank.

The magnitude of Chinese foreign assistance is far more difficult to gauge and compare with aid levels from other donor countries, because official Chinese statistics do not conform to the standard “Official Development Assistance” (ODA) definition of foreign aid.⁶⁶ The reported “foreign aid and government-sponsored investment activities” (FAGIA) includes state-directed investments, some of the loans reported above, and concessional aid. Chinese FAGIA in LAC exceeded that of any other world region over the 2001-2011 period; in 2009-2011, as part of China’s global effort to expand access to natural resources, it averaged roughly \$60 billion pledged annually. The aid/investment combination has concentrated on resource-rich Argentina, Brazil, Chile, Ecuador, and Venezuela, the same nations receiving the bulk of Chinese loans. However, because so much of the capital goes into long-term infrastructure and resource extraction projects, the “delivered” aid/investment is still far less, at roughly \$8 billion annually in 2010-2011. Yet since 95 percent of aid/investment pledges have come after 2008, delivered aid/investment is clearly on the upswing.⁶⁷

Yet the differences between ODA and Chinese FAGIA may be less than the labels imply, because the ODA designation requires only a 25 percent grant element. The distinction may indeed be even smaller insofar as the interest rates on many Chinese loans to LAC governments are significantly lower than the loans offered by other funding sources, and some LAC loans are forgiven. Chinese officials have also recently proposed a US\$20 billion “Regional Development Fund” for infrastructure projects, though it would still, unlike the OECD-DAC commitment to open bidding and competitive procurement, be tied to Chinese companies and workers.⁶⁸

Finally, the prospects of bilateral foreign assistance from East Asian nations are colored by the growing conflicts among these nations over the South China Sea and other territorial disputes that have been exacerbated by the increased importance of access to natural resources. Insofar as East Asian countries are seeking to strengthen their alliances within the broader East and Southeast Asia region, it is likely that their foreign assistance will be even more concentrated closer to home. However, the uncertainties of securing natural resources in this region may increase the attractiveness of securing these resources in LAC, in part by offering foreign assistance as an incentive for preferred access.

The latest *multilateral* foreign assistance initiative is the Chinese-led Asian Infrastructure Investment Bank (AIIB), with initial capitalization of US\$50 billion (and planned capitalization of US\$100 billion). Despite the name, LAC countries are eligible for loans from the AIIB. After other developed countries decided to join, the U.S. official position has shifted from opposition to cautious support, reflecting recognition that the physical infrastructure needs of LAC and other developing regions are great, and that the Chinese reserves could be instrumental in overcoming the infrastructure

American Development Bank, 2013, p. 43.

⁶⁶ Wolf, Wang, and Warner, *op cit.*, pp. 3-4, note: “Official development assistance (ODA) consists of technical aid, official grants, or loans promoting economic development and welfare, and having concessional terms, with a grant element of at least 25 percent... Official development finance (ODF) consists of “non-concessional development lending by multilateral financial institutions” and “other official flows for development purposes (including refinancing loans) which have too low a grant element to qualify as ODA.”

⁶⁷ Ibid. p. 25-26.

⁶⁸ R. Evan Ellis, “China Fills the Vacuum Left by the United States in Latin America,” Perspectives on the Americas, Miami FL: University of Miami Center for Hemispheric Policy, 2014, p. 2.

shortfalls; yet there is concern that procurement and environmental protection will be problematic.⁶⁹ The World Bank and regional development banks enforce competitive procurement, largely neutralizing the obligations of borrowing countries to the political agendas of donors, and OECD members have largely eschewed tied aid⁷⁰. It is difficult to anticipate whether the AIIB will operate this way. However, 57 countries are represented and there would be intense resistance to tie most of the projects to Chinese interests.

Yet for developing-country governments, much of the attraction of undertaking infrastructure projects with Chinese financing is the speed of completion due to lighter requirements for environmental assessments, socio-economic impact studies, monitoring to guard against corruption, and other time-consuming requirements. This is obviously cause for concern among environmentalists and advocates for populations adversely affected by major infrastructure projects.

Immigration

The spotty data on East Asian immigrants in LAC, based on censuses conducted in various years, nevertheless clearly shows that Brazil has the greatest numbers of *reported* native-born Japanese, Chinese, and Koreans. The Argentine census reported the same order of magnitude of Chinese immigrants, but far fewer Japanese. Mexico has the largest reported number of East Asian immigrants after Brazil and Argentina, although the much older Venezuelan census reported a larger number of Chinese immigrants than in Mexico.

⁶⁹ Joseph E. Stiglitz, “Why America Doesn’t Welcome China’s New Infrastructure Bank, *The World Post* May 20 2015 http://www.huffingtonpost.com/joseph-e-stiglitz/america-china-investment-bank_b_7055222.html; Ian Talley, “U.S. Looks to Work With China-Led Infrastructure Fund,” *Wall Street Journal*, March 22, 2015. <http://www.wsj.com/articles/u-s-to-look-collaboration-with-china-led-asian-infrastructure-investment-bank-1427057486>.

⁷⁰ Jan-Henrick Petermann, *Between Export Promotion and Poverty Reduction: The Foreign Economic Policy of Untying Official Development Assistance* (Dordrecht: Springer, 2013).

Table 12. Foreign-born East Asians in Major LAC Countries, latest censuses (2000 to 2010)

	China	Japan	Korea
Argentina	13,000	4,000	n.a.
Brazil	19,400	49,000	8,600
Chile	1,600	1,000	1,100
Colombia	1,600	600	200
Ecuador	1,200	300	350
Mexico	7,300	3,000	4,000
Peru	3,700	4,000	600
Venezuela	9,400	450	250

However, the actual number of migrants is extremely difficult to gauge, because of the likelihood of large numbers of unregistered immigrants. For example, Ellis estimates that there are 180,000 unregistered Chinese in Venezuela⁷¹, but there is no way to confirm this or any other estimates of illegal immigration. Another estimate of Chinese in Argentina reported a doubling of the population from 2005 to 2010, to 120,000, many involved in the roughly 10,000 Chinese-owned grocery stores in Buenos Aires.⁷²

The immigrants have a wide range of circumstances and roles, including laborers on physical infrastructure projects, people using LAC as an intermediate step in trying to enter the United States, managers and technicians of East Asian-based firms, and small-scale entrepreneurs.⁷³ Significant resentment against Chinese has been reported in several Latin American countries, for reasons ranging from criminal gang activity to dominating small-scale retail.⁷⁴

Section III: The Implications of East Asian-LAC Ties in the 2000s

This section begins by pointing out that several worries triggered by the growing awareness of increased East Asian (and particularly Chinese) economic involvement in LAC have been greatly overblown. It then identifies some of the actual opportunities and risks that arise from the increase intensity of investment, trade, and other aspects of interaction.

Continued Dominance of U.S.-LAC Trade

The handwringing about U.S.-LAC trade prospects has been based on reacting to a few prominent developments: China has overtaken the United States as the top trading partner with Brazil. Chinese lending, which is often accompanied by trade agreements, has topped the combined lending of the

⁷¹ R. Evan Ellis, *China on the Ground in Latin America: Challenges for the Chinese and Impacts on the Region* (New York: Palgrave Macmillan, 2014),

⁷² Janie Hulse Najenson, "Argentina's New Melting Pot," *Americas Quarterly*, Winter 2012, p. 87.

⁷³ Maria Benavides, "Chinese Immigrants in Sao Paulo, Brazil, and in Lima, Peru: Preliminary Case Studies", in *Essays on Ethnic Chinese Abroad*, vol II. *Women, Political Participation and Area Studies*. Edited by Tsun-wu Chang & Shi-yeoung Tang: pp. 355-376 (Taipei: Overseas Chinese Association, June 2002); Gonzalo Sánchez, "La comunidad china en el país se duplicó en los últimos 5 años," *Clarín* (Buenos Aires), September 9, 2010.

⁷⁴ Ellis, *China on the Ground in Latin America*, pp. 198-195.

U.S. Export-Import Bank and the multilateral development banks. Ellis⁷⁵ argues that “the exponential expansion of Chinese trade, business, political, and military presence in the Americas since the beginning of the millennium is arguably one of the factors that has most transformed, and continues to transform, the economic and political environment of the hemisphere. However, in very important ways the U.S.-LAC trade and general economic relations are greater than ever.

Table 13 U.S.-LAC Trade in Goods and Services, LAC and other Western Hemisphere, \$US billions*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
U.S. Exports	256	296	332	386	333	409	487	523	543	556
U.S. Imports	352	398	417	461	373	453	532	546	537	547
Balance	-96	-102	-84	-75	-40	-44	-45	-23	6	8

*excludes Canada

Source: U.S. Department of Commerce Bureau of Economic Analysis, “U.S. International Trade in Goods and Services: Latin America and other Western Hemisphere”.

<http://www.bea.gov/international/factsheet/factsheet.cfm?Area=299>

Table 4 demonstrated that U.S. trade in goods increased impressively from 2000 to 2014, but a trade deficit remained. Table 13, which includes both goods *and* services, also shows impressive increases, but also reveals an emerging trade surplus. Moreover, although East Asian countries have forged bilateral FTAs with countries like Chile, Mexico, and Peru, the U.S. network of bilateral FTAs (Chile, Colombia, Panama, and Peru) and multilateral accords (NAFTA, CAFTA-DR) remains unsurpassed.

With the exception of Brazil, Costa Rica, and Mexico, U.S.-LAC trade tends to follow the same pattern of Japanese and Korean relationship: LAC exports of primary goods to the United States and the U.S. export of high-value-added manufactured goods to LAC. The major difference is the provision of services that U.S. firms provide to LAC.

The heavily energy-based U.S. demand for LAC is likely to decline as the U.S. oil and gas boom accelerates. Yet the expected modest LAC recovery (with the exception of Argentina and Venezuela)⁷⁶ means that demand for U.S. imports is unlikely to decline.

Recognizing the Global Nature of Natural-Resource Markets

The implications of Chinese efforts to secure hydrocarbons and hard minerals specifically from LAC do not, in fact, pose a risk of shortages for other countries. Chinese resource purchasers will secure energy sources and other raw commodities from a variety of regional sources. Overall Chinese demand for these resources obviously has an impact on commodity prices, but “sewing up” oil deliveries from Venezuela, engaging in oil-for-loan arrangements with Brazil’s Petrobras, etc., do not alter the fact that world supply and prices depend on overall supply and demand. In fact, Chinese investment in resource-related infrastructure increases the world supply of extracted commodities. However, recognizing that Chinese companies, particularly state-owned enterprises, overpaid for raw-material

⁷⁵ R. Evan Ellis, “The Rise of China in the Americas”, *Security and Defense Studies Review* 16 (2014) 90-105, p. 90.

⁷⁶ International Monetary Fund, *World Economic Outlook*. Washington, DC: International Monetary Fund, October 2014, pp. 56-58.

assets in Latin America as well as other world regions, a withdrawal from heavy investments in extractive industries is already underway.⁷⁷ The problems in LAC have ranged from PetroChina's stake in Brazil's scandal-ridden Petrobras oil company to oil and mining ventures in Argentina, Bolivia, Colombia, and Ecuador that have suffered major disruptions due to local resistance.⁷⁸

The Rise of the RMB

There has been growing concern that the rise of the Chinese RMB, culminating in its elevation to rival the dollar as the reserve currency, would disrupt the international monetary system, and erase the U.S. advantage in having the dominant currency. Use of the RMB as a trade settlement currency is growing rapidly and may already exceed the euro, but remains very small compared to the dollar. Denomination of commodity prices in RMB has just begun. Although over 50 countries now hold RMB reserves, the amounts are small and, barring global upheaval, it could well be mid-century before the RMB is a reserve currency comparable to the U.S. dollar.⁷⁹

Geopolitics

It is ironic that many Latin Americanists, concerned with the increasing presence of China, bemoan the lack of a highly visible U.S. policy toward LAC. In fact, while U.S. policy toward LAC has been rather low key, with few high-profile visits or summits, U.S. interactions with key LAC nations have been effective without arousing the hostility that has characterized U.S.-LAC relations in the past. U.S. interactions with some LAC nations have been intense: with U.S. help, the Colombian government greatly reduced the guerrilla/narco-trafficking threat; the ties with Mexico range from economic integration to cooperation on drug interdiction. In general, though, the political stances of LAC governments, including the provocative rhetoric from Venezuela and other leftist-populist governments, have elicited little official response from the U.S. government.

Given the nature of what East Asian governments and firms want of their interactions with LAC, it is hard to see how their increased involvement in LAC is a game changer for U.S.-LAC relations. It is not the case that the U.S. government and firms have abandoned LAC: U.S. foreign direct investment stock in LAC as of 2013—the US\$350 billion (excluding the tax havens) was around a sixth of total LAC foreign direct investment;⁸⁰ far higher than China's roughly \$100 billion of FDI stock in LAC. Japanese foreign direct investment flows into LAC are considerably smaller (though roughly a third of Japan's overseas portfolio investment is in LAC), and Korea's smaller still. Yet it is significant that because of joint ownership, joint ventures, and multilateral assistance and lending, both

⁷⁷ Wayne Arnold, "China's Global Mining Play Is Failing to Pan Out," *Wall Street Journal*, September 15, 2014. <http://www.wsj.com/articles/chinas-global-mining-play-is-failing-to-pan-out-1410402598>

⁷⁸ R. Evan Ellis, "Latin America: Challenges for China Firms," *Latinvex*, June 18, 2014. <http://latinvex.com/app/article.aspx?id=1473>.

⁷⁹ William H. Overholt, Guonan Ma, and C.K. Law, *Renminbi Rising*. London: John Wiley & Sons, forthcoming 2015.

⁸⁰ Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Direct Investment in Latin America and the Caribbean, 2013*, Santiago, Chile, 2014; and U.S. Department of Commerce Bureau of Economic Analysis, "U.S. Direct Investment Abroad - Latin America and Other Western Hemisphere".

<http://www.bea.gov/international/factsheet/factsheet.cfm?Area=299>. It should be noted that total FDI includes not only the investments from outside of LAC, but also the investments from one LAC country to another.

U.S. foreign direct investment and foreign assistance are less clearly associated with the United States. Insofar as LAC nations can diversify their investment, trade, borrowing, and receipt of foreign assistance, their economic dependence on the United States declines, but the U.S. demands on LAC, aside from cooperation regarding drugs, currently are rather modest in general. Insofar as a high-profile U.S. presence is still a provocation for anti-U.S. sentiment and actions, the balancing of investment, trade, and lending across many countries, and the rise of both joint ownership and joint ventures, will contribute to the reduction of anti-Americanism.

It is also unclear how China's growing military might and assertiveness would engage the Western Hemisphere directly. Although it is physically possible for the Chinese navy to use LAC ports (e.g., in Venezuela) for refueling, it is unlikely that Chinese leaders, facing major confrontations over the South China Sea and increased U.S. involvement in these confrontations, would risk opening up another front vis-à-vis the United States unless U.S.-Chinese relations reached an order of magnitude greater level of conflict. In fact, there are indications that China has avoided direct confrontations with the United States even in the economic sphere by eschewing inroads in Mexico and most of Central America, concentrating instead on South America. Of course, this focus is also consistent with the greater availability of natural resources in South America.

De-Industrialization's True Meaning

While there is a legitimate concern about the possibility of LAC's decentralization, the recent worry over the rising proportion of raw material export value over manufactures export value is misguided. In 2005, LAC's manufactures-export value and primary-export value were equal; but in 2011 manufactured material-export value was only 39 percent; returning to 47 percent in 2013.⁸¹ As Table 5 depicting the trends in commodity prices demonstrated, the rise in raw-material prices can easily account for the decline in the *relative* proportion of manufactured exports. True de-industrialization would entail the shrinking of a country's industrial capacity, not simply the ratio of raw-material-export value to manufactures-export value.

Table 14. LAC Production, in constant 2010 US\$ billions, 1990-2013

	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013
Agriculture	145	165	187	219	229	239	243	237	250	254	253	267
Mining.	189	227	276	307	311	311	312	304	314	319	322	327
Manufacturing	457	516	582	649	673	704	718	669	723	748	750	763
Annual Manufacturing growth					3.6%	4.4%	1.9%	7.3%	7.5%	3.3%	0.3%	1.7%

Source: ECLAC Economic Commission for Latin America and the Caribbean

http://estadisticas.cepal.org/cepalstat/WEB_CEPALSTAT/Portada.asp

Table 14 demonstrates that LAC manufacturing did not decline during the 1990-2013 period, with only one year since 2005, namely the Great Recession year of 2009, experiencing a contraction. To be

⁸¹Comprehensive Economic, Industry and Corporate (CEIC) Data <http://www.ceicdata.com/en>; and UN Comtrade.

sure, the manufacturing growth rates are disappointing, but the trends demonstrate that manufacturing was not killed off by the commodity boom. For that matter, the growth of manufacturing value over the 1990-2013 period of 67 percent is only modestly lower than the growth of the overall value of “mining production”—which includes the whole range of subsoil extractive industries, even if the export value of raw materials increased dramatically.

Even so, compared to the growth in manufacturing of developing countries in general, it is fair to say that LAC’s industrialization has stagnated. The 1990–99 growth rate in manufacturing value for developing countries as a whole was 7.0 percent for 1990-1999 and 7.2 percent for 2000–11.⁸² In addition, because the paltry LAC manufacturing growth rate reflects the growing investment and production of foreign-owned industries, the growth of LAC-owned firms is even more modest.

Infrastructure

Concerns expressed over the nature of East Asian-financed physical infrastructure in LAC are based on the fact that roughly half of this infrastructure is directed to raw-material extraction. For example, in 2014 the Chinese government proposed co-funding a transcontinental railway from Brazil to coastal Peru to ease the transport of Brazilian soy to China. Much of this infrastructure development has required co-financing by LAC governments (e.g., through the debt service on loans). However, the potential for diverting physical infrastructure from what is best for the LAC countries is mitigated by the multiple uses of so many infrastructure elements: ports, electricity grids, roads, and railroads. In addition, the speed of Chinese infrastructure projects, in particular, is typically so much greater than projects financed solely by LAC governments, or by other bilateral or multilateral foreign assistance. Chinese construction planning and execution may give short shrift to environmental impact assessment, but the sheer magnitude of Chinese-financed and executed infrastructure development can offset the possibility that the extraction-devoted infrastructure configuration is not ideal for the country as a whole.

Opportunities and Risks for LAC Countries

General Economic Policies

Many LAC countries have been struggling to define economic policy strategies that could best take advantage of global trade and investment trends, which pose both huge opportunities and risks for these countries in terms of growth as well as income distribution. As with other world regions, the debate centers on the role of the state in directing investment and trade. Most LAC countries have gone through cycles of heavy state intervention and liberalization. Earlier periods of failed protectionism have largely discredited the “import substitution industrialization” strategy; protectionism through tariffs and non-tariff barriers has been much reduced through the combination of general free-trade agreements overseen by the World Trade Organization (although further liberalization through the WTO has been stalled for more than a decade) and specific free-trade agreements of a bilateral or narrower multilateral nature. However, the remaining “industrial strategy” question looms large: to what extent should LAC governments directly fund, or otherwise promote, the growth of particular industries that show significantly greater export potential? This promotion can be confined to “enabling conditions” that could help a broad range of industries (e.g., through under-valued exchange rates, maintaining low interest rates, reducing the red tape of exporting, funding of incubators, etc.), or can subsidizing specific industries believed to be most promising. How sound would the choices be, following a rigorous examination of potential market opportunities?

A related set of questions revolves around the distribution of income in LAC countries, and how governments should address the fact that overall, LAC has the highest levels of income inequality

⁸² International Labour Organization, *The World of Work Report 2014* (Geneva: International Labour Organization, 2014), p. 23.

of any world region. The ideological polarization of many LAC countries, and the persistent appeal of populist leaders, is fed by the outdated belief that incomes are becoming even more unequal. In fact, 14 of the 17 countries whose national income distributions are reported in the Economic Commission for LAC and the Caribbean *Statistical Yearbook for Latin America and the Caribbean 2014* experienced declines in income inequality between 2000/01 and 2019/13. Substantial improvements occurred in Brazil, Chile, Colombia, Ecuador, Mexico, Peru, and Venezuela.⁸³ Nevertheless, the perceptions of intolerable levels of inequality persist, exacerbated by sharp regional differences within countries, such as the far wealthier Brazilian South vs. the Brazilian North, or the far wealthier Mexican North vs. the Mexican South.

LAC has two crucial potential advantages over rivals for attracting investment in high-value manufacturing. As argued above, while the low-income countries of Asia and Africa have an important labor-cost advantage, industry sited in LAC has a market-seeking advantage, due to both LAC's higher levels of disposable income and the relative ease of access to the U.S. and Canadian markets. Second, many LAC nations have advantages in infrastructure and skill over less developed nations of Asia and Africa. However, at this time these market-seeking and capacity-seeking advantages are more potentials than reality. While a number of LAC countries have prospered because of East Asian—especially Chinese—investment and commodity purchases, and some regimes with questionable economic management have been able to ride the crest of prosperity, yet the booms increased Latin Americans' appetite for imports and demands for continued growth. This has made LAC regimes more vulnerable to dissatisfaction during downturns. For example, despite the post-2008 downturn, the annual Brazilian GDP growth for the entire 2004-14 period was nearly four percent, and yet the disruptions in the wake of the post-2008 recession nearly brought down the formerly highly popular President Dilma Rouseff. And the possibility of another major downturn resulting from an extreme slump of the Chinese economy cannot be dismissed.⁸⁴ LAC was rather fortunate that the impact of the Great Recession was blunted by the expansion of Chinese-led natural-resource purchases and related development (yet the revenues from commodity booms may increase the risk that LAC governments will be able to resist needed but unpopular tax reforms to overcome the weak tax effort of most LAC countries⁸⁵). The perfect storm would occur if the Chinese economy stalls at the same time as the next global recession, revealing the brittleness of LAC economies and politics. Buffering against the boom-and-bust cycles is a crucial challenge (See Section IV).

General Investment

As the second largest recipient of Chinese foreign direct investment during the 2000-11 period, LAC economies have been, and will continue to be, significantly shaped by the foci of these investments. Second only to the United States in new FDI into LAC, the impact of Chinese investment on the structures of major LAC economies will depend on whether these investments continue to be so heavily concentrated on natural resources. The bulk of the investment, particularly on the part of Chinese state enterprises, has been driven by the Chinese government's strategy to secure raw material and energy access. Some Chinese FDI, particularly from private firms, has focused on manufacturing, especially in automotive joint ventures. To the degree that Chinese FDI converges with that of Japan

⁸³ Economic Commission for Latin America and the Caribbean (ECLAC), *Statistical Yearbook 2014*, Santiago, Chile, 2014, p. 89. The metric was the Gini coefficient. No national figures were reported for Argentina, although a decline in urban inequality was reported.

⁸⁴ See Lawrence Summer and Lant Pritchett, *Asiaphoria Meets Regression to the Mean*, NBER Working Paper 20573, October. www.nber.org/papers/w20573, Cambridge, MA, October 2014

⁸⁵ Omar Sánchez, *Mobilizing Resources in Latin America: The Political Economy of Tax Reform* (New York: Palgrave Macmillan, 2011), p. 1, notes that “The low tax effort of most nations in the region has historically proven very damaging to their ability to successfully manage their economies”.

and Korea to concentrate on manufacturing, this could reverse the growing vulnerability of LAC economies to raw-material price volatility. However, these same economies are vulnerable to the slow-down of the Chinese economy and the resultant decline in raw-material demand. The transition from resource dependence to industry attractiveness is crucial for these nations.

The availability of ample, low-interest loans, particularly from China, may be the key to address many of the infrastructure needs throughout LAC. Tying the loans to infrastructure could overcome the prevalent infrastructure neglect that has held back LAC development. Yet very low interest rates pose an eventual default risk, even on Chinese loans, by the LAC governments that cannot or will not discipline themselves or their state enterprises against profligate borrowing.

Economic Productivity

Moreover, de-industrialization in the 1980s and 1990s in the region has resulted in the weak competitiveness of manufactures.⁸⁶ For example, the Revealed Comparative Advantage (RCA) indices of Argentina, Chile, Brazil and Peru are all below 0.8, indicating national weaknesses in manufacturer competitiveness.⁸⁷ Therefore, bolstering the investment rate and accelerating the development of manufacturing in the region, especially knowledge-intensive industries, is badly needed.⁸⁸

Regulatory uncertainty is a significant deterrent. It is significant that even though Japan's only three LAC FTAs are with the relatively business-friendly Chile, Peru, and Mexico (and the only FTA under negotiation is with Colombia), the three FTAs call for "Business Improvement Committees" to improve the business environments.

The striking discrepancies between Argentina, Brazil, Venezuela and the rest of the major LAC countries with regard to the ease of investment reflects, in part, the fact that the commodity booms experienced by these three countries have reduced the pressures for liberalizing policy reforms. Yet for Argentina and Venezuela they also reflect profound political crises that have left the governments with little flexibility to improve policies in the short and medium term.

De-Industrialization?

We have seen that LAC's overall manufacturing production has not declined in constant dollar terms, so the dire concerns about de-industrialization are at most premature. Nevertheless, many LAC countries face complex challenges with respect to manufacturing. Some of the manufacturing, whether domestically or internationally owned, is reasonably efficient; much domestically-owned manufacturing is not. Therefore some degree of streamlining would be healthy, but tighter ties with East Asia could risk de-industrialization, depending on whether government policies can enable domestically-owned industries to become more efficient, attract sound industrial FDI, and secure markets for industries for which each country has a comparative advantage.

The most obvious concern is that increased trade, facilitated by the increasing number of free-trade agreements, will undercut LAC manufactures' domestic and international markets. Chinese wage levels will remain lower than those of most of LAC for many years; and Chinese-financed manufacturing that is moving out of China is largely going to the Asian and Sub-Saharan African countries with even lower wage levels. Chinese productivity has been increasing, and now exceeds that of LAC in general; and some Chinese manufactures benefit from subsidized inputs that reduce international prices. However, this concern can also be exaggerated. For example, according to Gallagher⁸⁹, "Between 2000 and 2009, 92 percent of LAC manufacturing exports, representing 39

⁸⁶ Su and Yong (2011).

⁸⁷ Calculation based on WDI database.

⁸⁸ Su and Yong (2011).

⁸⁹ Kevin Gallagher, China discovers Latin America, *Berkeley Review of Latin American Studies*, 2010, p. 10. www.ase.tufts.edu/gdae/Pubs/rp/GallagherBRLASFall2011.pdf

percent of the region's total exports, came under threat from China. Mexico is the most vulnerable, with 97 percent of its manufacturing exports — which represent 71 percent of the national export base — under threat from China in 2009.” If Gallagher simply means that there is considerable overlap between Chinese and LAC manufactured goods, this is a far cry from the implication that Chinese exports could supplant LAC-based exports to this degree in the foreseeable future. One only has to consider the very strong position of Japanese, Korean, and American cars manufactured in LAC for the U.S., Canadian, and other markets to appreciate that the threat is not as fearsome as the quote implies.

The other major concern is that the growing predominance of raw-material exports is having multiple effects that dampen the robustness of even relatively efficient LAC manufacturing. LAC's dependence on commodities has increased by East Asian investments to expand resource extraction in hydrocarbons and hard minerals, as well as by East Asian demand for LAC agro-exports. If Chinese investment in LAC extractive industries continues to be driven by the strategy of securing raw materials beyond the profit-maximizing motivations that drive other international oil and mining companies, the weight of raw-material exports, and the focus of LAC infrastructure development, would be even more tilted in the primary resource direction. These trends pose the classic “Dutch disease” risks for the major resource-exporting countries, magnified by the massive inflows of capital via foreign direct investment and portfolio investment.⁹⁰ The consequent rise in local currency values and the diversion of capital into commodities add to the challenges facing manufacturing. In light of the relatively high labor costs of Japan and South Korea, their exports are technologically advanced, high-value products—electronics, computerized systems, home appliances, capital equipment, etc. Dosch and Goodman note that “the mainstream view as presented by the OECD and other international organisations is that, with the exception of Mexico, Latin American exports are not significantly affected by Chinese competition due to the dissimilarity of the traded goods.”⁹¹ However, various manufacturing interests in major LAC countries, such as the Argentine industrial chamber UIA and the Brazilian FIESP, argue that Chinese exports threaten their own exports. As Chinese industry becomes more sophisticated and its wages rise, Chinese exports will occupy the intermediate and upper levels of sophistication, too; manufactured items such as computers, televisions, telephones, office machine parts, and automobiles already are being exported. These products compete with LAC manufactures, produced largely in export processing zones involving joint ventures with primarily U.S. and Japanese companies.

The Aftermath of Multi-Regional Trade Pact Formation

The risk of losing investment opportunities and short-term trade advantages by embracing multi-regional FTEs becomes largely moot if and when substantial arrangements are established. The tradeoff of exposing domestic industry to greater competition in order to open up export possibilities

⁹⁰ Cárdenas and Levy-Yeyati noted (in early 2011) that “[t]he symptoms are already apparent in commodity exporting countries like Argentina, Brazil, Chile and Colombia, where the volumes of non-primary net exports have been falling rapidly and industrial output and employment are starting to dwindle despite solid GDP growth.” Yet they also note that in addition to the commodity boom enjoyed by Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay, the flood of foreign investment and portfolio investment exacerbates the problem of over-valuation (with the exception of Argentina, presumably because the financial crisis there has greatly reduced the flows). Mauricio Cárdenas and Eduardo Levy-Yeyati, *Curbing Success in Latin America*. Brookings Institution. Opinion April 14, 2011. www.brookings.edu/research/opinions/2011/04/14-curbing-success-cardenas-yeyati

⁹¹ Jörn Dosch, and. David Goodman, “China and Latin America: Complementarity, Competition, and Globalization.” *Journal of Current Chinese Affairs* 4(1): 3-19.

is matched by the trade diversion risk of remaining outside of a trading pact. Every LAC country has some trade within the region and with East Asian nations; more favorable trading terms for both the included LAC countries and the East Asian countries would divert trade away from the excluded LAC country. Staying out of a multi-country FTA also risks being dropped from providing intermediate inputs to FTA members, because the inputs from the non-member would render the finished products ineligible for favorable tariff treatment.⁹²

Using trade-pact initiatives as a vehicle for economic policy reform can be an important key to creating a more productive, investment-friendly policy. However, as indicated in the turmoil in Mexico following the liberalizations required for the North American Free Trade Agreement, harmonization can be politically risky

Immigration

The concern over immigration hinges on whether East Asian immigrants take on economic roles that arouse resentment among Latin Americans. As immigrants become shopkeepers, as is the case with the many Koreans in Mexico, resentment about perceived gouging is common. In Argentina, there have been recent violent attacks on small-scale Chinese-owned businesses, apparently because of perceived “dumping” of cheap Chinese merchandise.

Confrontations can also arise if immigrants compete with Latin Americans over jobs. Another scenario involves LAC workers who believe they have been maltreated by East Asian managers. Because East Asian firms typically maintain management in the hands of their countrymen, another basis of resentment is the lack of mobility of Latin Americans within East Asian companies. Managers of Korean assembly *maquilas* and construction companies in Mexico have been subjected to violence because of perceived acts of racism and labor abuse. Finally, staffing extractive industries can provoke conflict insofar as those industries are seen as exploiting the nation or irresponsibly polluting the local area. Extractive firms are vulnerable if they are seen as displacing local residents without adequate compensation for their operations or to make room to construct towns or housing facilities for their projects. Violent conflicts have occurred over Chinese mining operations in Argentina and Peru. However, it is possible that time and exposure to criticism will motivate and enable East Asian firms to adopt appropriate corporate social responsibility practices, in labor policies as well as environmental practices.

Aside from the firm-based conflicts, the potential for future conflict depends on the degree to which the migration will be temporary or long-term; whether immigrants will be located in separate enclaves or in proximity to LAC populations, and whether the immigrants—and the long-standing populations of East Asians—will be subjected to scapegoating in the case of economic downturns. More optimistically, the spread of East Asian cultures (such as Korean pop culture or Chinese food) may also reduce the social distance between East Asians and Latin Americans.

Environment

Several important environmental implications arise from growing East Asian involvement in resource extraction in LAC. Environmental damage that typically results from hydrocarbon, hard mineral, or timber extraction frequently generates hardship for local people as well as hostility on the part of the public and government authorities. Given its interests in primary resource extraction, and its less-than-stellar domestic environmental performance, China seems the most at-risk, although Korean and Japanese firms have poor reputations for environmental management of forestry resources, and all three countries have long legacies of environmental degradation linked to resource extraction in

⁹² Roberto Hernández Hernández, “Economic integration processes underway in Asia-Pacific: The case of TPP, RCEP and PAA: A Mexican perspective”, Universidad de Guadalajara working paper, Guadalajara, 2014.

Southeast Asia.⁹³ Chinese infrastructure construction, as mentioned above, tends to skirt environmental protection. As environmental awareness rises throughout LAC, governments are coming under increased pressure to punish or exclude firms with poor environmental records.⁹⁴ The challenge is to improve upon such practices—U.S. firms specializing in environmentally-sustainable production can benefit from collaborating in these improvements. In addition to improving their practices, Chinese firms can avoid some culpability and resentment by partnering with domestic or other international companies.

Opportunities and Risks for East Asian Countries

The major investment opportunities for East Asian countries are the potential to 1) expand manufactures sales and exports, in LAC, the United States and Canada; 2) secure raw materials; and 3) find higher-yielding industrial, financial, and portfolio investments. The opportunities for industrial investment begin with lower costs. Transport costs make production within LAC of some manufactures more economical than shipping across the Pacific. LAC wages are lower than in Japan and South Korea, while the gap between Chinese wages and LAC wages is shrinking. The opportunity to export goods tariff-free to the United States and Canada from LAC affiliates adds to the export potential, as long as sufficient content is manufactured or assembled in LAC countries to take advantage of free-trade arrangements with the United States or Canada, as well as FTAs among LAC countries.

Securing raw material supplies is facilitated by the capital needs of several LAC countries, where governments or state enterprises are willing to make long-term commitments to provide hydrocarbon fuels or hard minerals in exchange for loans or foreign assistance. Because the terms of oil-for-loans swaps are often undisclosed, it is unclear whether these arrangements lock in price advantages for the Chinese companies or the LAC governments. It would not be surprising if Venezuela's weak bargaining power results in long-term agreements at today's low oil prices. However, rising production capacity worldwide is likely to make these arrangements less compelling for securing oil and gas. An energy glut could render East Asian energy investments unprofitable.

A notable global characteristic of each wave of Asian investment has been the excesses of the novice investor. Japan's initial tsunami of investment involved overpaying for everything. In the U.S. the Japanese bought up Rockefeller Center, the best golf courses, most Los Angeles hotels, huge amounts of Hawaiian residential property, and much else, at prices far above market and then later had to sell them back at, typically, half the price originally paid. Korean portfolio investors in the mid-1990s held about 30 percent of LAC government bonds and then, in the Asian Crisis, had to unload them at huge losses. China, desperate to ensure its supply of raw materials in the face of U.S.-European dominance of all the most accessible, safest and lowest price sources, bought up the less accessible, more risky, higher price sources wherever it could find them (Sudan, Angola, Venezuela) and, convinced that prices would go on rising indefinitely, overpaid for and overstocked almost everything. During the 2011-2013 period, Chinese oil and gas companies purchased 13 upstream stakes in Argentina, Brazil, Colombia, Ecuador, and Peru; and downstream stakes in Brazil and Venezuela.⁹⁵ Yet the deep decline of energy prices is likely to make energy-production investments less attractive alongside of the declining value of energy exports. If taking this risk is

⁹³ Peter Dauvergne, *Shadows in the Forest: Japan and the Politics of Timber in Southeast Asia* (MIT Press, 1995).

⁹⁴ Rhys Jenkins, Enrique Dussel Peters, and Maurico Mesquita Moreira, "The Impact of China on Latin America and the Caribbean," *World Development* 36:2 (2008); pp. 235-253.

⁹⁵ Julie Jiang and Chen Ding, *Update on Overseas Investments by China's National Oil Companies: Achievements and Challenges since 2011*. Paris: OECD and International Energy Agency.

motivated to sew up oil and gas supplies in the long run, it is a questionable initiative, in light of the global and expanding supply of hydrocarbons. Each Asian novice investor, in turn, paid a painful price for its excesses, Japan by selling its Los Angeles hotels back at half the price paid, Korea by having to unload its LAC portfolio at fire sale prices, and China today by having to carry or liquidate enormous stocks of overpriced commodities and sources of supply. The recipient countries, including now the main LAC raw-material suppliers, have benefitted enormously from the mistakes of the novice Asian investors.

The generic risks for East Asian investment begin with the instability of some LAC governments. Ideological polarization still prevails to the point that new governments may be compelled to renege on international contracts or adopt crippling regulations. Resource nationalism has been on the rise. In general, East Asian firms face significant labor and cultural challenges operating in LAC context that are so different from those in East Asia. R. Evan Ellis notes that China's "impact on the socioeconomic dynamics of LAC states can be felt in the new social and political issues that [its] presence has spawned, including conflicts between Chinese companies and regional labor forces and subcontractors, relations with local communities, environmentalists and indigenous groups, and commercial competitors, and security challenges Chinese companies confront."⁹⁶ An example of China's exposure to the volatility of LAC economies is the ill-fated half-billion-dollar Chery automotive venture in Uruguay in partnership with Argentina's SOCMA firm. In May 2015 Chery announced its departure, six months after its last production, largely due to the sharp decline in orders from Brazil.⁹⁷

China is clearly at greatest risk, due to the massive loans to the least financially stable LAC governments, big stakes in the highly volatile energy industry, infrastructure projects that are vulnerable to cost overruns and possibly local resistance, and the billion-dollar investments in the highly competitive consumer durables industries. For Chinese industrial companies, some of the risk also stems from the combination of unfamiliarity with the LAC context and the haste of moving billions of dollars of overseas investments worldwide.

General Trade Impacts: Trade Diversion Risk for East Asian Countries

For any one of the East Asian countries, exclusion from free-trade pacts would jeopardize existing and future trade opportunities. China's entrance into the World Trade Organization leveled the playing field regarding tariffs to some extent, leading to the rapid expansion of Chinese exports to LAC, but as China comes to compete with Japan, Korea, the United States, and other industrialized countries in sophisticated manufactures, the head-to-head competition may be seriously tilted depending on which nations secure the most favorable trade arrangements. China's vast capital reserves put it in a strong position to lend at favorable rates, which may provide China an advantage in tying trade arrangements to lending. Yet the TPP initiative is a significant threat to China's ability to penetrate the markets of eventual TPP members.

⁹⁶ R. Evan Ellis, "The Rise of China in the Americas", *Security and Defense Studies Review* 16 (2014), pp. 90-105; 93.

⁹⁷ "Tras siete meses de inactividad, Chery Socma deja Uruguay", *El Observador*, May 19, 2015. <http://www.elobservador.com.uy/noticia/305464/tras-siete-meses-de-inactividad-chery-socma-deja-uruguay/>

Opportunities and Risks for the United States

The economic impact of China's global expansion has been highly positive for the United States in general. U.S. investment, technology, marketing and services have been conveyed through Chinese exports, because U.S. companies, even more than EU and Japanese companies, were at the core of the supply chain. Trade statistics obscure the reality of U.S. benefits. Analyses by the World Trade Organization and others demonstrate this. In one representative case, a suit exported from China shows up in the trade statistics as plus \$425 for China, minus \$425 for the United States, but an analysis of the actual value added shows up as 84 percent for the U.S., 6 percent for China.⁹⁸

U.S. firms have two major opportunities due to expanding East Asia-LAC trade and investment. The investment opportunities of joint ventures combining East Asian investment with U.S. technology and professional services, particularly with China because of China's still lower technological capacity compared to Japan and Korea, would obviously translate into revenues for U.S. firms even if the trade does not entail shipments from the United States into LAC. While the degree to which East Asian firms are interested in partnering with U.S. firms in general is not obvious, collaborations in the auto industry are promising signs.

The other opportunity is in providing logistics, insurance, certification, and legal services contracted by either East Asian or LAC firms to support trade and investment. U.S. FTAs with 14 LAC countries are centered on the liberalization of services and intellectual property protection. The United States is much less concerned with natural resource FDI and low-end manufacturing.

But there is a huge risk that the United States may be pushed out of the value chain. Some changes are already underway. Chinese marketing, taking advantage of internet advances and the economies of scale provided by their own market, has been capturing more of the marketing share of value added. Chinese R&D for product and process technologies, backed by deep pockets of both state and private firms, has been advancing rapidly. Most importantly, China has been exporting products of higher technology content and is beginning to export its heavy industries. Table 15 demonstrates the declining relative importance of labor-intensive and resource-intensive products that China exports to the major LAC countries, and the rise in the proportion of high-skill, technology-intensive products in all but Mexico.⁹⁹

⁹⁸ Patrick Low, "The role of services in global value chains", in Deborah Elms and Patrick Low, eds. *Global Value Chains in a Changing World*. Geneva: World Trade Organization, 2013, pp. 61-81, especially p.65.

⁹⁹ The 1995 figures for Mexico may not have much significance, since the total exports in these categories was only US\$90 million in that year.

Table 15. Chinese Manufactured Exports to Major LAC Countries, by Technology Level, 1995-2013

Type of manufactured exports	1995	2000	2005	2010	2013
Argentina					
Labor/resource intensive	36%	22%	11%	19%	15%
Low-skill/technology intensive	11%	14%	16%	10%	14%
Medium-skill/technology intensive	28%	33%	32%	30%	29%
High-skill/technology intensive	25%	31%	41%	41%	42%
Brazil					
Labor/resource intensive	30%	18%	18%	17%	19%
Low-skill/technology intensive	11%	9%	9%	14%	12%
Medium-skill/technology intensive	29%	29%	24%	31%	34%
High-skill/technology intensive	31%	44%	49%	38%	35%
Chile					
Labor/resource intensive	55%	55%	51%	40%	39%
Low-skill/technology intensive	13%	11%	9%	14%	14%
Medium-skill/technology intensive	19%	22%	20%	22%	26%
High-skill/technology intensive	13%	12%	19%	23%	21%
Colombia					
Labor/resource intensive	27%	23%	23%	21%	22%
Low-skill/technology intensive	15%	12%	14%	115%	16%
Medium-skill/technology intensive	36%	29%	29%	32%	29%
High-skill/technology intensive	22%	35%	34%	31%	32%
Ecuador					
Labor/resource intensive	25%	24%	25%	18%	14%
Low-skill/technology intensive	29%	25%	23%	22%	23%
Medium-skill/technology intensive	31%	32%	31%	38%	41%
High-skill/technology intensive	15%	19%	21%	22%	22%
Mexico					
Labor/resource intensive	21%	30%	19%	13%	16%
Low-skill/technology intensive	6%	11%	10%	7%	9%
Medium-skill/technology intensive	18%	30%	25%	26%	26%
High-skill/technology intensive	55%	32%	45%	55%	49%
Peru					
Labor/resource intensive	13%	27%	27%	22%	26%
Low-skill/technology intensive	13%	14%	14%	22%	19%
Medium-skill/technology intensive	53%	32%	28%	30%	33%
High-skill/technology intensive	21%	26%	31%	26%	23%
Venezuela					
Labor/resource intensive	27%	36%	25%	20%	16%
Low-skill/technology intensive	23%	15%	12%	15%	22%
Medium-skill/technology intensive	27%	37%	42%	33%	35%
High-skill/technology intensive	22%	12%	21%	31%	27%

Source: Calculated from UNCTADStat, February 2015

http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,15912&sRF_Expanded=p,15912

In short, Chinese enterprises have demonstrated their capacity to compete with U.S. firms in each link of the value chain. One risk for American firms is that Chinese firms would reduce their interactions with American firms, even if the economics would favor continued collaboration. The fact that many of the major Chinese firms are partly or fully state-owned takes the decision-making on the willingness to collaborate with American firms at least partially into the realm of politics.

The second risk is that new or deepened Chinese trade pacts with Pacific Basin countries in both Asia and LAC would further exclude U.S. collaboration. This would be magnified insofar as the U.S. government rebuffs trade pact overtures. U.S. leadership in the TPP could be an historical hinge. It could enable the United States to remain one of the most significant players in the Asia-Pacific region. But if it fails, and if the next President and Congress reject trade and investment reform, then China, Korea and ASEAN could lead the world in the era of the globalization of investment, trade and consumption.

The risk to U.S. firms is made worse by higher labor, capital, or environmental-compliance costs, or due to specific trade agreements between East Asian and LAC governments. The primary competitive threats that U.S. firms face are centered in the automotive, white goods sectors, and construction engineering. Japanese and South Korean auto and appliance firms are already well established in Mexico and South America; at least four Chinese auto firms have announced plans to build plants in Brazil, and Argentina is another potential site for assembly plants. In addition, insofar as U.S. geopolitical influence declines, LAC government officials may be less inclined to purchase U.S. military or infrastructure equipment.

However, the potential loss of business is mitigated by the fact that U.S. auto firms, with their strong technology infrastructures and brand-name recognition, are sought-after partners for joint ventures (e.g., Shanghai Automotive Industry Corporation and General Motors; Changan Motors and Ford). In addition, with the important exception of high-value manufactures, as U.S. companies refocus from manufacturing to services (e.g., IBM, Johnson Controls, Federal Express), their global risk of losing business to lower-cost competitors declines. Services such as technology development, business consulting, banking, environmental services, control systems, logistics, insurance, accounting, and legal services provide U.S. firms with important intermediary opportunities.

Trade Diversion Risk for the United States

Just as the NAFTA trade pact has made European goods less attractive to Mexico, Canada, and the United States, a free-trade pact that excludes the United States would make U.S. exports less attractive in the trade-pact countries. If the Trans-Pacific Partnership (TPP) emerges as a serious trade pact with significant tariff reductions, the absence of the United States from the TPP could certainly reduce U.S. trade with both East Asia and LAC. However, even if the United States joins in more significant trade pacts with LAC nations, U.S. manufactures exports are still threatened if East Asian exports simply beat U.S. exports on a pricing basis. This risk can be offset if the United States has trade pacts with LAC countries that do not include East Asian nations within the pacts. China's eschewing of the TPP negotiations provides an important opportunity for the United States to counter China's growing attractiveness. However, if China warms to the TPP, this could provide an opportunity for the United States to orchestrate a grand alliance that would preserve U.S.-Chinese collaboration.

Competition from East Asian Countries Taking Advantage of U.S.-LAC Trade Pacts

As Chinese companies move to higher-value manufacturing, the lower wages in China in the manufacture of pre-assembled components and in LAC for components and assembly provide a rationale for seeking manufacturing investments in LAC countries with zero- or low-tariff agreements with the United States and Canada. Korean and Japanese firms already have demonstrated the effectiveness of this strategy, aided by the lack of stringency in NAFTA rules. For example, Korea's LG refrigerator and washing machine factories in Mexico provide a large proportion of these appliances sold in the United States. Although East Asian companies vow to find local component suppliers, a large share of the components are manufactured in the home country. However, tariff-free entry is not guaranteed, if the U.S. government invokes dumping, as was the case with Korean companies' Mexican-assembled refrigerators in 2011 and washing machines in 2012.¹⁰⁰ By 2012, exports to the United States of Mexican-assembled Korean appliances declined substantially. In the automotive sub-sector, "knock-down kits" (ready to assemble part kits) manufactured in East Asia (or other sites where East Asian firms manufacture) can be assembled in LAC and sold in the United States at reduced tariff rates.

Section IV: Considerations and Recommendations

1. Many aspects of LAC economic policies and institutions—excessive red tape, special privileging of favorite firms or individuals, weak and investment-distorting tax effort, volatile fiscal and monetary policies—need to be improved in order to reduce the threat of financial meltdowns, to direct capital more effectively, and to inspire greater confidence for FDI. In terms of the banking systems, LAC nations have made different degrees of progress in stabilizing their banking systems; Chile leads the way.
2. The LAC governments of countries that still have serious impediments to the ease of doing business need to streamline their processes and requirements. As demonstrated by the selectivity of Japanese government in reaching FTAs only with LAC nations with relatively business-friendly environments, trade advantages are at stake as well as overall investment attractiveness. In general, LAC governments should take advantage of the harmonization preparations required to enter FTAs, in order to improve economic efficiency.
3. Even for those LAC countries in which institutional and political constraints would bring into question the wisdom of government subsidies and protection of new "infant industries", the governments ought to invest in the knowledge infrastructure needed to enhance domestic knowledge-based industries and to attract FDI searching for skill and value-chain clusters.
4. Given that the most promising motivation for sound East Asian investment in LAC is market-seeking, LAC countries have a strong incentive to engage in intra-regional trade pacts in order to expand the market size for the output of these investments. The decline of Mercosur (Argentina, Brazil, Uruguay, Venezuela, and formerly Paraguay), the disarray of the Andean Pact with the withdrawal of Venezuela, and the halting steps toward full regional integration demonstrate how challenging the formation of trade pacts continues to be. Yet sub-regional protectionism, even if it spurs investment in a narrow range of industries such as the automotive sector, sacrifices the greater advantages of inter-regional trade pacts such as the TPP.

¹⁰⁰ Anon, U.S. Plans to Impose Tariffs on Appliances from South Korea and Mexico. *Appliance Magazine.com*, July 31, 2012.

www.appliancemagazine.com/news.php?article=1601814

5. LAC governments should reduce the other policy impediments to a more efficient economy, in order to provide greater incentives for LAC (and other) investors to deploy the large stocks of accumulated capital into productive investments. This would enable LAC countries to develop more sustainable industry, lessen the chances of excessive de-industrialization, and create the clusters that would induce East Asian (and other) investment to be devoted to sectors other than natural resources and its associated infrastructure. It would also make trade pacts more sustainable, by reducing the imbalances caused by over-valued currencies and sudden devaluations. Sound monetary and exchange-rate policies are crucial, and LAC governments must resist the politically popular pressure to protect inefficient industries, which currently are under greater pressure due to competition from East Asian products.
6. The lack of infrastructure in LAC has challenged East Asian FDI in LAC to inspire the same industrial and technological success experienced in the East Asian economies.¹⁰¹ According to critical investors, LAC must construct infrastructure and optimize utilization of capital to achieve high rates of return, thereby encouraging further East Asian FDI to enhance diverse LAC sectors. To take advantage of capital that can be devoted to physical infrastructure development, LAC governments should encourage East Asian investment to invest in Build, Operate, Transfer (BOT) public-private partnerships, so that the infrastructure development conforms more closely to the overall needs of the LAC countries rather than primarily to strengthen the raw-materials supply chains. BOT arrangements in other world regions, such as Southeast Asia, demonstrate the potentials.
7. LAC governments dependent on extractive resource exports must increase their capacity to capture appropriate levels of royalties. The challenge to do so is exacerbated by the involvement of state enterprises, which typically have fiscal arrangements with their governments that make it very difficult to determine the value of the natural-resource rent and operate under perverse incentives in terms of efficiency. Enacting a revenue-sharing formula to channel some of the resource royalties with local communities is another imperative.
8. LAC governments of raw-material exporting countries ought to establish stabilization funds to smooth out the macroeconomic impacts of commodity booms and busts.
9. Because East Asian investment and trade are not zero-sum with the growing U.S. presence, LAC nations can afford to maintain diverse relationships to balance interests and hedge against regional downturns.
10. East Asian companies operating in LAC ought to engage trainers to teach East Asian managers and other workers to work more harmoniously with Latinos, and to do parallel training of Latinos working in these companies. Some of these trainers can be from the United States, or at least their companies can be U.S. firms.
11. Chinese resource-extraction firms need to partner with local resource extraction firms and monitor labor relations.
12. U.S. extractive industries companies (e.g., oil, gas, hard minerals) ought to form more alliances with LAC extractive industry firms in order to maintain some control over the relevant resources in the face of East Asian efforts to capture the disposition of the resources.
13. U.S. firms offering financial and other services should make vigorous efforts to collaborate with East Asian firms expanding their operations in LAC.
14. The United States ought to continue in the negotiations over the TPP and eventually ratify it. Currently, the partial free-trade regime in which the United States participates does not protect the United States from manipulations by countries with no, or limited, trade agreements with the

¹⁰¹ Ibid. KEI (2012).

United States. For example, Japanese and Korean manufacturers are penetrating the U.S. market via NAFTA.

15. A diversification of Chinese FDI in LAC could help to reduce the intensity of trade friction and perhaps ease the pressure of unfavorable public opinion toward China in LAC.¹⁰²

Final Thoughts

To understand the rapidly evolving impacts of East Asia's economic interactions with Latin America, it is important to separate the myths from the realities. First, the much heralded expansion of Chinese investment in LAC countries has not had a major impact on LAC economies, because so much of what is counted as Chinese FDI has been in buying minority stakes in existing extractive-industry ventures. Nor does it make much difference to the Chinese economy or other economies that Chinese enterprises have "sewn up" the oil of a particular oil-exporting country in the context of a global oil market.

Another myth is that Chinese trade and investment have overtaken the U.S. economic dominance in LAC. It is true that China has become Brazil's largest trading partner, but Chinese imports from Brazil are declining as the Chinese economy slows, and U.S.-LAC trade in goods is more than three times greater than China's, while U.S.-LAC trade in services, at over US\$200 billion, dwarfs Chinese-LAC trade in services. By the same token, U.S. FDI stock in LAC, which has appreciated over many decades, is far greater than the more recent Chinese investments, as is Japan's.

For those who are unaware of China's dramatic recent wage escalation, the myth persists that China is still expanding as the world's labor-intensive behemoth. This outdated perception misses the momentous shift to exporting Chinese capital for manufacturing. On the other side of the East Asia-LAC economic relationship, a widely prevalent myth is that LAC's basic international role is, and will continue to be, as a raw material exporter. This underestimates the industrial potential of LAC as a region with high market demand for manufactures that could be produced within Latin America, financed in part by East Asian investment. Perhaps the most potentially destructive myth is that deeper LAC involvement with China is highly likely to erode LAC's industrial capacity. This fatalistic view assumes that LAC is more vulnerable to a trade imbalance in manufacturing goods than it is primed to take advantage of investment opportunities, as demonstrated by several of the major Latin American countries.

However, as a broad generalization, LAC countries have not built the economic and physical infrastructures, nor conducted the economic reforms, adequate to benefit from the globalization of production in the way East Asian economies did; they mainly provided raw materials for the industrialization boom and squandered the enormous resources provided by that boom. Mexico adapted best to the era of the globalization of production, but its reforms and value added have been modest compared to the Asian countries and its benefits (heavily coming from a role as assembler) correspondingly limited. As a region, LAC is poorly placed for the generation that is going to be dominated by the globalization of consumption, because most of the region's economies have developed neither distinctive value-added roles in production (like Malaysia and Singapore in electronics) nor distinctive technologies, companies and products (Apple, Samsung, WeChat, Taobao, Alibaba, Huawei) that would provide dynamic growth from the era of globalized consumption. Following the popping of the natural resource bubble, LAC countries will continue to benefit from steady normal growth in demand for minerals, energy and agriculture, but the huge windfalls will be few and far between. Some LAC countries, with appropriate connection to the

¹⁰² See Khadija Sharife, "China's New Colonialism," *Foreign Policy*, September 25, 2009. www.foreignpolicy.com/articles/2009/09/25/chinas_new_colonialism.

global economy and investment-friendly policies, will capture residual benefits from the era of the globalization of production. The region will benefit from diversification of trade, FDI, portfolio investment, aid, finance, and ideas, but without major reforms this growth will be modest, even more mal-distributed than in the past, and dissatisfying. The continual loss of global market share may increase political discontent, resulting either in more self-destructive economic policies or in serious reform.

What LAC governments need to learn is that countries that have become the core parts of highly differentiated, increasingly integrated and extraordinarily efficient global supply chains (including Australia, Indonesia, Malaysia, New Zealand, Singapore, and Thailand as well as China, Japan, and Korea) experienced historically extraordinary economic growth. It does not require high wealth to accomplish this—the latest example of such an exploitation of the opportunity is Ethiopia, currently the world's fastest growing economy after coaching by the World Bank and Chinese experts. The most important trend of the past generation was the globalization of production, and these countries were the primary beneficiaries. Some LAC governments, most notably in Chile and Costa Rica, have embraced these opportunities, but many have far to go to find the most productive ways to engage in the inevitable advance of globalization.

With the broad opportunities for gains through the emerging inter-regional trade agreements come the risks of losing domestic LAC intra-regional markets to East Asian exports. The concerns of East Asian trade competition and de-industrialization, as well as labor relations, must be addressed, even if they have been exaggerated to this point. However, although it is tempting for LAC leaders to try to take advantage of the growing LAC market for manufactures by permitting only East Asian investment rather than finished products, the trade restrictions and intra-regional trade blocs to accomplish this face a legacy of inefficiency and abortive intra-regional integration efforts.

The Latin American leaders who learn how to navigate this new globalized context will be able to take productive advantage of the increased East Asian economic interactions, especially China's new need to export industries, even if the assessments of impactful East Asian investment thus far have been overblown. Truly impactful investment would come to those LAC countries that strengthen policies to create an attractive investment climate for physical infrastructure and market-seeking manufacturing. Through enhanced industrial efficiency and investment-friendly economic policies, resource-dependent LAC countries have the opportunity to improve the balance between raw-material and manufactured exports to reduce the volatility and exchange-rate problems of this dependence.

The United States can benefit by leading the TPP forward, encouraging Korea to join as soon as possible, and remaining open to the possibility of China's eventual entry. It is crucial to keep in mind that China is the third-largest export market of the United States, and China holds more than a trillion dollars of U.S. Treasury securities. U.S.-Chinese collaborations in LAC investment, infrastructure development, and services hold great promise for all concerned.

Charles Wolf, Jr.:

The Task Force's focus on Asian nations' interactions with Latin American Countries (LAC) is timely and appropriate.

While our report has many additional references to U.S. interactions with LAC, there are few if any references to past, present, or future interactions between the EU countries and LAC. But, of course, these interactions have been and are likely to be abundant—economically, politically, culturally, and linguistically. The report should acknowledge that our omission of references to Europe, and in particular to Spain, Portugal, France and the UK among the EU and euro currency zone, is not intended to slight their importance as trade and investment sources for LAC.

Early in the report it is stated that the current value of accumulated (stock) of U.S FDI is a “substantial multiple” of the \$350 billion book value. Allowing for depreciation as well as for lower-yielding investments within the stock, this assertion should be taken skeptically.

In our report's discussion of the burden of expanding “value-enhancing” FDI, we acknowledge the importance of LAC countries' policies if indeed such value enhancements are to be realized; perhaps even more emphasis should be placed on this point. With this in mind, it should be highlighted that LAC countries are active players in a global market for such value enhancements. The policies—specifically, tax policies, property rights protection policies, regulatory policies—adopted by LAC are obliged to compete with other potential FDI destinations to attract capital sources to invest in LAC.

Our report's brief paragraph on China's prospective investments in LAC seems to overlook the complexities of what is involved in this matter. These complexities involve such issues as whether and how much investment might be made by SOEs and by private Chinese companies; whether and to what extent the AIIB channels investment and bank-lending toward eligible Asian countries rather than LAC; whether and how TPP channels TPP members' trade and investment toward LAC, and so on.

Finally, the discussion of commodity prices should take note of fact that terminating the time period in 2013 is misleading because of the precipitous drop in these prices to a 6-year low in 2014-15.