

Cross-Country Emerging Markets Analysis

Economic Watch

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Economic Analysis

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China's partnership with Africa and Latin America: going beyond common wisdom

Bilateral relations between Latin America and China, and between Africa and China are growing towards a strategic partnership which should go beyond commodities

- **From international trade to a strategic partnership**
Over the last years economic relationships between China and LATAM have developed around trade of commodities. Through this mechanism LATAM business cycle has benefited from Chinese expansion. Now relations are starting to transform and FDI flows are becoming the new vessels connecting both economies.
- **FDI inflows to LATAM declined in 2009 reflecting liquidity constraints and a global shortage in credit supply**
In spite of global crisis, China's FDI outflows to LATAM increased in 2009.
- **To promote FDI and financial integration between the two regions,**
LATAM countries have signed Free Trade Agreements (FTA) and Agreements for Promotion and Protection of Investments (APPI) in recent years.

In the foreseeable future relations will strengthen and LATAM will become a key partner for Chinese economy. **LATAM development policies must focus on improving competitiveness to take advantage of its geographical location in order to be part of the world value chain. Implementation of major infrastructure projects for trade will be a keystone in this process, a source of growth in the next years and will create business opportunities for Chinese firms specialized in these activities.**

From international trade to a strategic partnership

International trade between China and Africa and China and Latin America has boomed in recent years, becoming a key part of their economic integration process. Trade flows between these two regions have increased more than 50 and 76 times respectively since 1990. The structure of trade between China and the two regions is similar— both Latin America and Africa mainly export commodities, while importing manufactured goods from China.

However, not everything is trade; in fact the economic relationships are rotating towards a new axis. Foreign Direct Investment (FDI) is becoming an important link, albeit in one single direction — from China into Africa and Latin America. Data sometimes underestimates the amount of FDI flow, given the use of major offshore centers by China for FDI entry. Most of China's investment projects in both regions are related to building the infrastructure required to exploit natural resources, such as railroads and seaports.

However, new developments and scope beyond commodities is starting to be considered, and is increasingly moving up the scale. In the case of Latin American countries, Chinese enterprises are starting to invest in medium-high and medium-low manufacturing industries, such as chemical products, motor vehicles, rubber and plastic products and refined petroleum products.

In the case of Africa, there are also some examples, in particular for manufacturing textiles and wearing apparel, where African preferential trade agreements with the USA and EU help Chinese enterprises circumvent import quotas for their products. The future of these relationships will be influenced by long-term State-support to Chinese enterprises, which allows them to execute projects with a risk assessment beyond the limits of short-term market needs. Thus, they can become the sole possible investor or partner when other firms are not willing or can't run certain risks — such as those arising from political instability or continuous changes in the regulatory framework.

In Africa, China has signed many co-operation agreements focused on infrastructure development (roads, railroads, airports, hospitals, etc) with soft loans granted by major Chinese banks on the condition that they hire Chinese suppliers and construction companies. Recently, China has followed the same strategy in some Latin American countries, in particular Venezuela, Bolivia and, more recently, Argentina. In this regard, China is facing criticism for a somewhat too pragmatic approach to direct investment, in-so-far as it may not be supporting the strengthening of domestic institutions, especially in a weaker institutional framework. Taking these regions' historical experience with foreign investors, and the still limited time to evaluate China's approach, the jury is still out.

The future of a strategic partnership

As for the sectors in which China will focus its FDI, Latin America may end up having a very different situation to that of Africa. This is because parts of Latin America, mainly Mexico and to some extent Central America, can offer a comparative advantage for re-exporting — due to their closeness to the still largest market worldwide, North America.

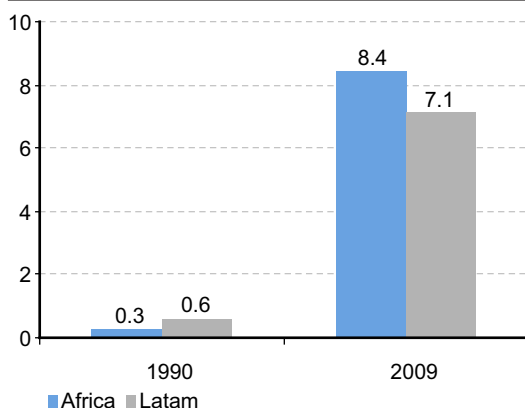
In fact, the future of economic relationships between China and Latin America may very much depend on China managing to insert itself into the existing production chain between Mexico and the US.

Although the idea looks very promising, there are a number of hurdles which still exist before China can profit from such a production chain. One of the largest of these is the still-small infrastructure for trade.

The clearest example is ports, which continue to be more inefficient and expensive than those of Asia. Improvement of transport infrastructure could certainly be the trigger for Latin American economies, especially Mexico, to receive higher FDI. But bilateral relations between Latin America and China, on one hand, and Africa and China, on the other are growing towards a strategic partnership which may go beyond commodities, especially in the case of Latin America.

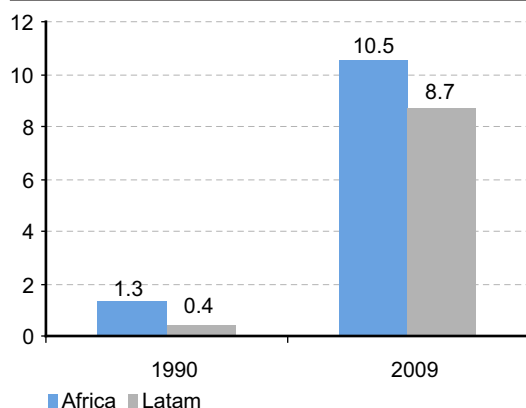
As regards commodities, the growing role of these two regions in their relations with China needs to be taken into account by other players, notably Australia. Diversification towards other sectors in trade and FDI, as well as the growing role in commodity exports both from Latin America and Africa, should constitute a win-win situation which will support the success of these partnerships in the long run. China will also play a more important role in South-South relationships, trade and capital flows, with a higher impact on geopolitics — gaining political relevance as a world leader.

Chart 1

**Exports from Africa and LATAM to China
(as percentage of their total exports)**


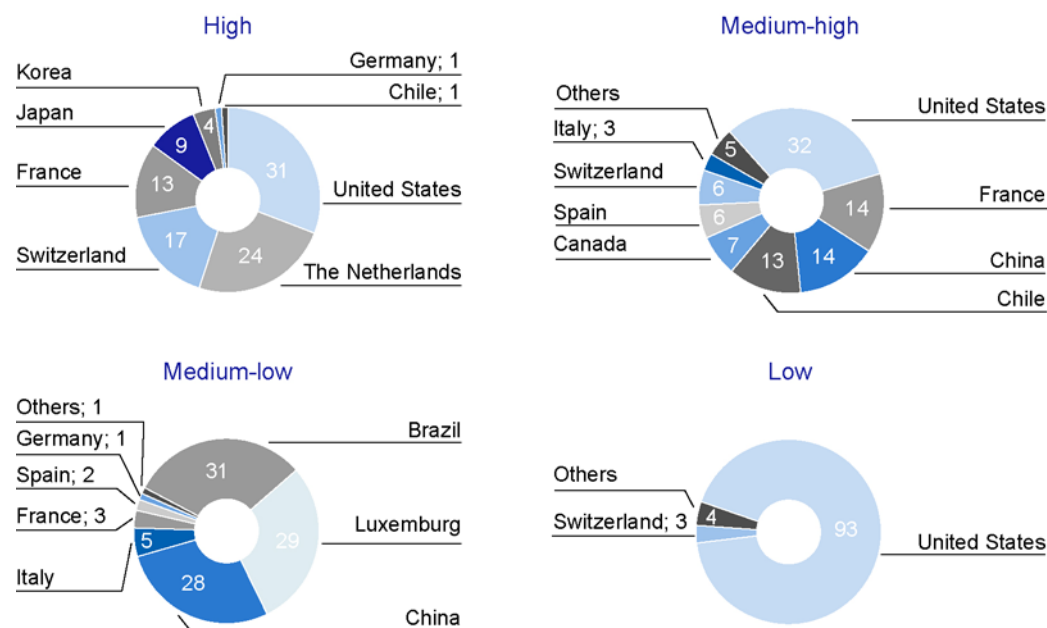
Source: COMTRADE and BBVA Research

Chart 2

**Exports from China to Africa and LATAM
(as percentage of its total exports)**


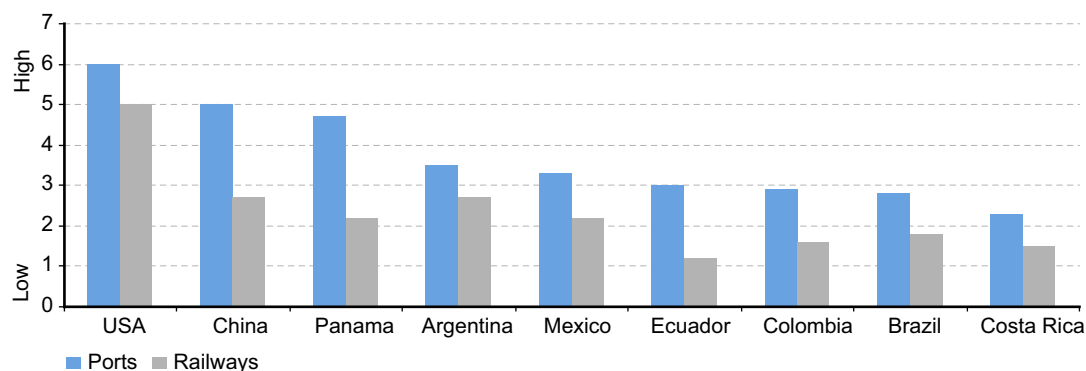
Source: COMTRADE and BBVA Research

Chart 3

LATAM FDI projects (Percentage share)


Source: ECLAC

Chart 4

Infrastructure reassessment (index)

Source: World Bank

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