



# LATIN AMERICA:

## Key theatre in Sino-U.S. economic rivalry



Both the United States and China have several reasons to be economically involved in Latin America. However, each country brings something unique to the table, and who emerges as the dominant player may have an effect that goes far beyond the region.

BY MARC CHANDLER

**T**he United States may be the world's only superpower, but China is the rising power. With the U.S. being the world's largest debtor, and arguably with over-stretched military commitments, some prognosticators see the seat of empire shifting toward the most populous and rapidly growing country in the world — China.

Of course, it's typical for Americans to look over their shoulder and be insecure about what they see. Remember Sputnik, the missile gap, and how the Soviet Union was going to "bury the West"? In the 80s, Japan was going to eat our lunch, buy our prized real estate, and, through its Treasury purchases, influence U.S. policy. Of course, none of this came to pass, but it was used to rally

GDP is nearly \$8 trillion — or roughly two-thirds of the U.S. figure — and rapidly increasing. China has been growing 9 to 10 percent a year for several years, while U.S. growth has averaged a little more than 3 percent annually.

Chinese demand is considered the key for various industrial commodities such as cement, aluminum, copper, nickel, steel, iron, and oil. China is also a large buyer of agricultural products such as cotton, soy, pork, and fish. It has strong demand for consumer goods as well: cell phones, televisions, washing machines, computers, and microwave ovens. Its large pool of cheap labor is believed by many to be responsible for the loss of some high-paying U.S. manufacturing jobs.

There are also beneficial effects of

Although the U.S. is not about to concede regional hegemony to China in Asia, the more interesting challenge is taking place in South America and the Caribbean. It is there that the alternative strategies of the U.S. and China are the clearest, with far-reaching implications for policy makers and investors alike.

Historically, even as the U.S. pushed for open access for capital and goods throughout the world, it had always claimed South America and the Caribbean as its sphere of influence. Of particular relevance in this regard are not only the Monroe Doctrine (1823), but also the Roosevelt Corollary (1904), and especially the Lodge Corollary (1912).

The Monroe Doctrine sought to prevent Europe from establishing new colonies in the Western Hemisphere. As

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public opinion around nationalistic pride and efforts to boost competitiveness.

Even as the U.S. is engaged in a multifaceted war on terrorism and the casualties in Iraq mount, many politicians, labor leaders, and the popular press recognize the long-term strategic threat posed by China. After all, in a little more than a week's time this summer, Chinese businesses were bidding for Unocal, a large American oil company, and Maytag, a "white goods" manufacturer. Although neither transaction was ultimately consummated, the possibility captured the popular imagination. Earlier, in a high-profile case, a Chinese company bought part of IBM's computer business.

The Chinese economy is the second largest in the world, behind the U.S. Its

China's economic success. The country's recent demand for U.S. treasuries helped lower U.S. interest rates, which in turn strengthened and extended the U.S. economic recovery and made home ownership affordable to a record number of Americans. Its low-cost point of production for many consumer goods has helped keep U.S. inflation contained and allowed U.S. households to purchase a wide range of goods despite the fact that wages have barely kept pace with inflation in recent years.

### Spheres of influence

China has replaced the U.S. as the largest trading partner for several countries in Asia, including Japan, South Korea, and Taiwan. This may not be all that surprising given the geography and the significance of intra-Asian trade.

a fledging nation when the doctrine was first declared, the U.S. wasn't in a position to enforce its claim. However, England and Europe recognized its importance, especially insofar as it may have helped preserve the balance of power in the "Old World."

The Roosevelt Corollary recognized there may be times when police action in South America or the Caribbean is necessary. During such times, the U.S. "however reluctantly" would provide such force in the hemisphere. Teddy Roosevelt had announced his corollary when a default by the Dominican Republic had made intervention by Europe seem imminent. Instead, with what historians have euphemistically called "a little encouragement," Dominican President Carlos F. Morales

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Languasco invited the U.S. to take control of its customs houses and administer the proceeds.

The Lodge Corollary is the least known of the three, but perhaps the most relevant today, when no one is interested in establishing colonies, and when multinational troops (including Chinese), under the auspices of the United Nations, are policing Haiti. In 1912, the U.S. Congress became concerned about negotiations that would have allowed a Japanese company to purchase from an American company a 400,000-acre tract of land in Magdalena Bay in Mexico, close to the U.S. and the new Panama Canal.

The U.S. State Department objected to the sale and managed to block it. U.S. Senator Henry Cabot Lodge submitted a resolution that was overwhelmingly adopted (51-4) that declared the U.S. could not approve the transfer of any harbor or other place in the Western Hemisphere whose occupation might threaten the communications or safety of the U.S. In the next few years, the State Department invoked the Lodge Corollary several times to prevent the sale of land in Mexico to Japan, the rising Asian power of the day.

### The challenge

There are myriad factors that have led to a strengthening of Chinese-Latin American relations in recent years. The end of the Cold War eased the polarized ideological environment. The liberalization and modernization of China, started by Deng Xiaoping in the late 70s, contributed to a more outward-looking orientation. At the same time, there was also a notable shift in Latin America away from the semi-independent development model toward more open trade policies. The first state visit from a Chinese president to South America took place in 1990.

In order to pursue its rapid modern-

ization, China requires a favorable international environment and it has adopted a foreign policy conducive to it. Chinese President Hu Jintao calls it the “peaceful development” policy. This entails closer relations with other developing countries, where much of the world’s raw materials, food, and fibers can be found. China also strongly advocated the non-interference in each others’ internal affairs which, given their historical experience, struck a responsive chord in much of South America and the Caribbean.



Increased trade and investment between China and Latin America culminated in two high-level visits by Chinese officials at the end of 2004 and early 2005. Heads of state of at least four South American countries have made trips to China. These trips resulted in numerous agreements and business deals, and a pledge by Chinese President Hu for \$100 billion of investments over the next decade.

Although South America and the Caribbean account for less than 5 per-

cent of China’s trade, for many countries in the region, China is among the largest export markets. For example, China is Brazil’s second largest export destination and its fastest growing market. China is Argentina’s fourth largest market.

The Chilean and Chinese economies are clearly complimentary. Chile accounts for 40 percent of the world’s copper output and China consumes about a fifth of that. The world’s largest copper producer in Chile sends more than 20 percent of its output to China, which is its biggest customer. China is Chile’s second largest trading partner, and the two countries are in the process of negotiating a free-trade agreement.

In 1975, total Chinese-Latin trade was a meager \$200 million. In 1988 it stood at \$2.8 billion — still rather unimpressive. Between 1993 and 2003, though, it grew

six-fold, and between 2000 and 2003 it doubled again to increase to \$28.8 billion.

Between 2000 and 2003, Brazil’s exports to China rose an amazing 500 percent, Argentina’s exports to China surged 360 percent, and Chile’s exports to China rose 240 percent. In 2004, South America’s exports to China rose by one-third. China’s demand is critical as the region’s democratic governments try to work out from under their heavy debt burdens and deliver higher living standards to their people.

### More than trade

To secure adequate supplies of resources, however, China cannot rely simply on trade. It’s also helping South America and the Caribbean boost capacity and improve the region’s infrastructure through direct investment. China’s outward foreign direct investment doubled in 2003 from the previous year, and Latin America received a full third of it. In 2004, Latin America received nearly half of China’s foreign direct investment.

China was the first foreign investor in Chilean copper mines. Chinese companies are operating two oil fields in Venezuela, and are investing in new refineries as well. Chinese companies have also invested in gold mining operations in Venezuela, and iron-ore mines in Peru. In Ecuador, oil fields are attracting Chinese investors.

Chinese capital is helping to expand Argentina’s railways, agribusiness, and oil and gas exploration. China has invested in Brazil’s iron and steel industries. It also plans to lease land in Brazil to produce food and raw materials to be exported back to China. In Mexico, Chinese businesses are setting up manufacturing plants.

China’s oil company, Sinopec, is searching for potential oil fields off the coast of Cuba. There is also a six-year-old agreement between China and Cuba for a joint electronic intelligence facility that is reportedly integrated in China’s global satellite network. News reports suggest it has the capability, for example, to monitor U.S. telephone conversations and Internet data. In addition, China is in a joint venture with Brazil to build and launch satellites and plans on selling the images generated to third parties.

Hutchinson Whampoa, a Hong Kong-

## To be clear, the U.S. strategy is not based simply on monetary interests. Traditionally, U.S. policy makers have argued that economic freedom and political freedom go hand in hand.

based conglomerate with reported ties to the Chinese military, helps operate the Panama Canal. China also built the world's largest container port in Freeport, Bahamas.

China's interest in Latin America extends beyond the realm of economics. It is engaged in cultural, scientific, and technological exchanges with at least 16 countries in South America and the Caribbean. China has recognized many Latin American countries as "tourist destinations." This status allows tour groups to travel without restrictions, which encourages further bilateral interaction. According to the World Bank, some 27 million Chinese traveled abroad in 2003, and it forecasts a five-fold increase by 2020.

### The U.S. strategy

Contrary to the claim of "malign negligence" toward Latin America by both conservatives and liberals, the U.S. has a clear and fairly consistent strategy. It is one of hemispheric economic integration. Even though the Free-Trade Agreement of the Americas has been diluted and delayed, the U.S. continues to pursue bilateral free-trade agreements.

A free-trade agreement with six Central American countries (Guatemala, El Salvador, Costa Rica, Honduras, Nicaragua, and the Dominican Republic) was signed into law by U.S. President George Bush this summer. The Central American Free Trade Agreement (CAFTA), as it is called, is probably more symbolic than substantive. The region is smaller than the state of Oklahoma, and U.S. exports there are less than its exports to France. Under the Caribbean-Basin Initiative of the mid-80s, more than three-quarters of CAFTA countries' exports to the U.S. were already entering duty-free on a temporary basis. The new

treaty makes these concessions permanent.

This may help secure the assembly-for-export sector that has been created in textiles and electronics in the region and employs an estimated 400,000 people. Proponents of CAFTA also argue that making such arrangements permanent will encourage fresh investment and allow businesses to source raw materials and other inputs outside the U.S., allowing for CAFTA countries to be more integrated in multinationals' global industry strategies.

In addition to CAFTA, the U.S. has entered free-trade agreements with Canada, Mexico, and Chile and is negotiating free-trade agreements with Peru, Colombia, Ecuador, and Panama (which has an economy based on the U.S. dollar).

Given the record U.S. trade deficit, loss of manufacturing jobs, and the political cycle, it is perhaps understandable that free-trade agreements are increasingly an uphill battle in the U.S. The direct gains to the U.S. economy appear quite modest. A University of Michigan study, for example, concluded that CAFTA might boost the U.S. GDP by 0.2 percent a year, hardly more than a rounding error. The same study found that the free-trade agreement could boost the output of CAFTA countries by almost 4.5 percent a year and create as many as 300,000 jobs in textiles, apparel, and footwear industries.


Political expediency in the U.S. frequently requires some dilution of the ambitious goals of the trade negotiators and CAFTA was no exception. In a concession to U.S. textile producers and their political representatives, the agreement says CAFTA countries can export trousers to the U.S. duty-free, if the pockets and lining come from U.S. mills. Nicaragua also must agree to purchase

more U.S. fabric. Also, U.S. sugar growers are protected from a dramatic increase in sugar imports from the region.

In order to assure passage of free-trade agreements, U.S. administrations have often entered into side agreements with reluctant members of the legislative branch. While these are often troubling to purists, they rarely come to fruition and instead appear to be simply part of the larger political process in the United

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States. A study by Public Citizen, an advocacy group that opposed CAFTA, found that U.S. administrations reneged on 80 percent of the 90 deals made over the past 12 years to secure votes for trade legislation.

To be clear, the U.S. strategy is not based simply on crude monetary interests. Traditionally, U.S. policy makers have argued that economic freedom and political freedom go hand in hand. Most recently, the Bush Administration asserted that CAFTA was needed to solidify the democratic gains in the region, which has often experienced civil wars.

Although they may not be the most effective means, U.S. policies that isolate Castro's Cuba and contain Chavez in Venezuela are arguably consistent with promoting free markets, modernization, and regional stability. After all, the U.S. containment policy toward the Soviet Union did not undermine its efforts to promote global free trade and world development. Nor does the U.S.'s costly war on drugs contradict its strategic course, even if it is not an integral part of it.

### Turning presence into influence

One of the most important aspects of the free-trade agreements, including the multilateral agreements under the auspices of the World Trade Organization, is that they establish procedures to resolve disputes. It is like a basketball game. Breaking the rules — committing a foul or traveling with the ball — does not end the game.

Rather, the violation of the rules is incorporated within the game, and this contributes to the game's perpetuation. Indeed, the conflict resolution process contained in the trade agreements contributes to the stability of the arrangement, legitimizes the free-trade system, and promotes the rule of law.

Recently, U.S. and European agricultural subsidies have been challenged. Led by Brazil and China, U.S. subsidies to its cotton producers were successfully challenged at the WTO. Separately, Uruguay is claiming U.S. aid to rice farmers is illegal under the WTO.

China's participation in some of the challenges under the backing of the WTO has not gone unnoticed or unappreciated in Latin America. Along with the other network of relations, it has begun yielding political benefits. Several countries in South America,

including Argentina, Brazil, Chile, and Peru, formally recognize China as a "market economy." China very much covets this status, which under the WTO makes it more difficult for countries to protect local industry against cheap imports.

Although several countries in the region continue to have diplomatic ties with Taiwan, some, such as the Dominican Republic and Grenada, have dropped their recognition of Taiwan in favor of China in exchange for sizeable aid packages. On another diplomatic front, China has won Brazil's support to join the Asian Development Bank. Although no *quid pro quo* is implied, China does support Brazil's bid for a permanent seat on the U.N. Security Council.

Roger Noriega, the former Assistant Secretary of State for Western Hemisphere Affairs, testified before Congress last April that "(The U.S.) will be attentive to any indication that economic collaboration will feed political relationships that could run counter to our key objections for the region."

Around the same time, the head of the U.S. Southern Command, General Bantz Craddock, dismissed the idea of a Chinese threat, but did acknowledge China's growing economic influence and recognized that that influence could have strategic implications.

### Competing developmental models

It is in South America and the Caribbean that the U.S. and China's models of development offer the clearest contrast. China's approach will tend to perpetuate the region's traditional weak economic model that relies on commodity production and arguably exacerbates the scourge of corruption in the region.

The statist legacy in South America and the Caribbean tends to provide incentives for "rent-seeking" behavior (i.e., attempting to extract money from

others by manipulating the economic environment), which is often associated with graft. A recent report by Brazil's Attorney General's office found that graft rather than drug trafficking was the source of almost three-quarters of the "dirty money" laundered in Brazil. It noted that only a third of the resources disbursed by the government actually reached their intended destination.

In a similar vein, a 2002 report in the official Chinese newspaper, the *People's Daily*, claimed that money laundering was equivalent to 2 percent of the country's GDP in 2001 and 11 percent of its reserves.

Transparency International, an anti-corruption watchdog, issues a "Corruption Perception Index." In its 2004 ratings (on a 0-10 scale with higher numbers associated with less corruption) China's 3.4 score put it near or ahead of many South American countries, including Brazil (3.9) and Argentina (2.5).

Outside of commodities and natural resources, for which China represents a positive demand shock, the long-run beneficial impact on the region's development may be quite limited. Low-cost, labor-intensive manufacturing is getting squeezed in various industries from textiles and footwear to toys, electronics, and furniture. Countries that have limited endowments of commodities, such as Honduras and the Dominican Republic, are particularly vulnerable.

Mexico's clothing, footwear, and glass industries face stiff competition from



China. The cost of production is thought to be less than half of Mexico's. An estimated 300 export assembly plants in Mexico have reportedly closed shop only to be re-established in China. And, although Brazil enjoys a substantial trade surplus with China, Chinese manufacturing exports to Brazil are growing faster than Brazil's commodity exports to China.

In contrast, the U.S. developmental model is based on greater and broader integration into the global economy. Given that many of the developing countries in Asia, including China and India, have significantly lower production costs than South America and many Caribbean nations, integration into the global economy should provide powerful incentives for Latin America to diversify the economies away from purely raw materials and labor-intensive production and toward greater value-added manufacturing.

From the perspective of the political elites in Latin America, the U.S. model often has greater implications for the internal affairs of their countries than the Chinese model. However, as many policy makers and economists recognize, without reform of domestic institutions, including governments, sustained development and modernization is difficult to achieve.

In many ways, the U.S. developmental model is more disruptive than China's. Development means change, and it requires a shift in incentives from favoring rent-seeking behavior to rewarding entrepreneurs. It means industrial restructuring, a weakening of the entrenched agricultural interests, and significant civil service reform. But it also means greater transparency, rule of law, and the expansion and strengthening of civil society.

In its emphasis on consumption, the U.S. model may also lead to less of a disparity between the rich and poor in South America and the Caribbean, which suffer from the greatest inequality in the world. The Chinese model favors those that currently control the countries' resources and therefore would strengthen the grip of the existing rent-seeking economic elites.

### What can be done?

As the challenges to U.S. agricultural

subsidies illustrate, the U.S. is subject to the same system and rule of law it helps propagate and seeks to enforce on others. The U.S. model is capable of reform in a way that China's may not be. It is doubtful the Chinese model of development would have resulted in the establishment of democratic regimes throughout South America and the Caribbean.

However, the U.S. model has come under much criticism throughout Latin America. Wishing to offset traditional U.S. influence, Latin American governments may be tempted to use China's commercial interests to create space and degrees of freedom. In addition, as was the case during the Cold War, playing great powers off each other is a time-tested strategy of lesser powers.

Although China's demand and investments have been a boon for many countries in the region, where current levels of GDP per capita were achieved one or two generations ago, it's not that unadulterated. Latin America doesn't have a coherent

strategy that would boost manufacturing and diversify exports, and China's approach to the region doesn't encourage movement in that direction either.

The size and proximity of the U.S. market and traditional cultural ties, including familial relations and the absence of a significant language barrier, realistically constrains Latin America's range of practical options. A Chinese alternative for the region may prove a bit of a fantasy at best.

South American and Caribbean nations might be best served by not so much searching for an elusive "Third Way," but by combining both the Chinese and U.S. approaches. They should take the money and infrastructure assistance that China is offering and use it to help fund serious reform, including economic modernization and diversification. ☺

*For information on the author see p. 10.*

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