Chinese Finance in Latin America

Remarks by

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1. Stephen Kaplan's excellent new book, *Globalizing Patient Capital*, focuses on loans from China's policy banks to Latin American borrowers. He does a great job of explaining how these banks operate, specifically how they are different from western bond markets (with longer maturities; a focus on infrastructure; higher risk tolerance; and micro rather than macro policy conditions). He also analyzes a particular type of impact in Latin America ("fiscal space" or – in non-technical terms – the ability to run deficits).

2. I want to use my (limited) time to complement his analysis by briefly elaborating on three points:

1) Other types of China-Latin America relations that provide a context for thinking about policy bank loans

2) Problems deriving from China's policy bank loans

3) Policy lessons for Latin America

3. Other types of relations

* *Trade*: The most important relationship between China and Latin America involves trade; China is the most important trade partner for half a dozen countries in the region and the second most important for several others. The type of trade is very important – it mainly consists of commodity exports from Latin America to China in return for the import of industrial goods. This pattern leads to many negative consequences for Latin American economies and societies that we don't have time to discuss here.

* *Foreign direct investment*: In quantitative terms, FDI is more important than policy bank loans, especially in the last few years. Chinese FDI reinforces the characteristics of trade relations and tends to involve mergers & acquisitions (M&A) rather than greenfield investments. That is, China wants to buy successful going firms rather than build from scratch, which would be more valuable for Latin America.

* *Politics*?? While China has not tried to exercise the type of political leverage that was so prevalent in the 19th and 20th centuries, first by Europe and then the United States, political relations cannot be forgotten. Certainly, in other regions, China has used political and economic pressure on its partners, and in general it has become more aggressive lately ("wolf warrior diplomacy").

4. With respect to problems with policy bank loans, I want to reinforce some of the things that Kaplan mentions and add some others.

* On the positive side, China's policy banks provide large amounts of capital for investment, which is definitely beneficial, but these loans also create problems.

* Kaplan discusses one set of problems in detail – what he calls commercial (micro) conditions. That is, Latin American (and other) borrowers must purchase equipment from Chinese lenders (what we used to call "tied aid"); also, the Chinese often use commodity guarantees (such as pledging oil for loans) to safeguard their money.

* But there are also other problems. For instance, there are often environmental problems with infrastructure projects that are financed by China. Evidence shows that Chinese projects are even more environmentally unfriendly than projects financed by western countries or multilateral agencies.

* Employment creation from Chinese projects is limited, partly because of the use of Chinese labor; and inputs from local Latin American firms are also limited.

* There is a lack of transparency and the existence of corruption with respect to projects financed by Chinese policy banks. Lack of transparency and corruption can lead to problems of quality – China promotes itself as being cheap and fast in implementing projects, but this can create problems of quality, especially when combined with corrupt relations between local governments and Chinese lenders.

* Like FDI, policy bank loans tend to reinforce the commodity specialization of exports and undermine local industries.

* And they enable deficits (Kaplan's main focus). It can be good to have fiscal space, but that assumes the respective governments use the money wisely; otherwise, deficits only cause problems for everyone, as can be seen most vividly in the case of Venezuela.

5. Let me end with six policy suggestions for Latin America with respect to relations with China:

1) Seek *diversification* of external relations; don't become dependent on China. Do business with China, but simultaneously expand relations with the United States, Europe, and other parts of Asia. Above all, don't get caught in conflicts between China and the United States.

2) *Make demands*, don't just accept offers. Be clear what is specifically desired from China, either from the point of view of an individual country or (preferably) a group of countries that can negotiate together with China. Set the rules for the environment in which China operates.

3) Keep the *broad context* in mind; trade, FDI, loans of various kinds, and possible political pressures are all part of the new and growing relationships with China. All have both positive and negative aspects that need to be understood.

4) Demand *transparency*; China is notorious for not providing data on amounts and conditions on its loans. The academic result is that those studying the loans have had to create their own data bases. The practical result is that lack of transparency can open the door to corruption.

5) *Understand China* and its way of doing business. Kaplan's book is very useful here; as he explains, China operates in quite different ways than its western counterparts.

6) *Invest Chinese money wisely*. Each Latin American borrower should keep in mind its own long-term development goals, as well as potential debt problems, when it accepts loans from China's policy banks.