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China-Latin America Relations in the XXI Century: Partners or Rivals?

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China-Latin America Relations in the XXI Century: Partners or Rivals?

Uziel Nogueira*

Abstract

In the short run, China's rise as a major global trade player is already creating winners and losers in Latin America and the Caribbean, thus its perception of threat or opportunity. On the winning side, the economies of the Southern Common Market (MERCOSUR), Argentina, Bolivia, Brazil, Chile, Paraguay, Peru, Uruguay and Venezuela with strong natural resources exporting sector based on agricultural products, minerals and petroleum. On the losing side, Mexico, Central America and the Caribbean whose exporting economies are highly integrated into North America's industrial production chain. The question is whether Sino-Latin American relations will flourish or turn into rivalry and commercial conflict. Under different assumption- scenarios, relations between the Asian giant and Brazil/MERCOSUR have the best chance to thrive and be less conflictive in the near future.

Introduction. During the presidential campaign of 2002, (then) candidate Luis Inacio "Lula" da Silva made an unprecedented trip to Beijing, the first ever by a presidential candidate. That trip signaled Lula's ambition of creating a strategic relation with a group of emerging economies known as BRICS, Brazil, Russia, India, China and South Africa. Lula's vision was pragmatic, non-ideological

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and sought to position Brazil among the leading countries of the world. He shared similar world affair views as President Hu Jintao and was convinced that cooperation would create prosperity for both nations. One reason is that resource endowment factors make the two economies highly complementary. China is demanding large quantities of Brazilian commodity-based products that suffer market access barriers in advanced countries. Brazil offers a growing market for Chinese products and business opportunity for direct investment in infrastructure, energy and natural resources. The growing trade and economic links between the two countries in the last four years seems to vindicate President Lula's strategic vision on this promising relation.¹

Despite President Lula's administration strategic bet on China, there are doubts among intellectual and business circles on whether Brazil is ready to face Chinese industrial competition. Mexico, at this point, is being closely scrutinized because it has taken the brunt of Chinese competition. Mexican companies are losing market share in the United States, that absorbs ninety percent of their exports, and finding it increasingly hard to compete with Chinese products in their own market.² Current thinking about China's presence in the world economy goes like this: Export what China is demanding i.e., commodities and you surely win. Try to compete with Chinese manufactured goods and you certainly lose. Economic data shed some light on the impact of world competition, including China, in Latin America's manufacturing industry.³

- a. Latin America's manufacturing value-added (MVA) declined from \$316.6 billion dollars in 2000 to \$285.7 billion in 2004, with the contribution to GDP also contracting from 17.2% to 16.6%.
- b. Latin America's manufactured exports in the same period grew by only 5.1% per annum, well below the world average of 8.8%. As a result, its regional share of world manufacturing trade plunged from 4.0% in 2000 to 3.5% in 2004.
- c. In medium- and high-technology exports, the fastest growing and highest value-added end of trade, Latin America's world market share dropped from 3.8% in 2000 to 3.2% in 2004.
- d. The regional share of manufactured exports as a percentage of total exports has declined from 49.2% to 48.2%, which shows an increasing trend towards low value-added commodity trade.

Taking notice of Mexico's travail, President Lula's administration is under political pressure to come up with solutions to deal with Chinese competition. Critics point out that if history serves as a guide, the outlook is not particularly promising for Brazil and Latin America. The question then is whether the bilateral relation will flourish or turn into rivalry-commercial conflict. This paper explores those points in three parts. The first one reviews recent research done by the Inter American Dialogue (IAD) and the Inter-American Development Bank (IDB) on China-Latin America's relation. The second part evaluates socioeconomic weaknesses and strengths of MERCOSUR and Mexico. The third part depicts different assumptions-

scenarios to evaluate China-Latin America's medium term trade relations, followed by a summary and final comments.

Part I. Literature Review

The impact of China in Latin America and the Caribbean has sparked a large number of academic papers, books and newspaper articles in the last five years. Recent research done by the Inter-American Development Bank (www.iadb.org) and the Inter-American Dialogue (www.iad.org) are prominent by their depth, analysis and bibliography. Let's start with IAD, a research organization, specialized in Latin America-Caribbean countries and located in Washington DC. The IAD study takes the interesting approach of looking into Sino-Latin American motivations-incentives for closer economic, commercial, political and military cooperation.⁴ The underlying hypothesis is whether China's growing presence in Latin America should be considered a challenge to the United States.

The 2006 Inter-American Dialogue Report. The study starts by pointing out that Latin America's international relations, in the beginning of the XXI Century, faced two exogenous shocks. First, a growing distance between the region's governments and the administration of George W. Bush over many political and economic issues. Second, the dramatic entrance of China as a significant economic and, in some instances, political partner of Latin America [p.46]. Regarding distance from Washington, frustration in Latin America was caused mainly by poor results of the economic reforms of the 1990's, known as the Washington

Consensus. Also, the United States one-dimensional, simplistic approach to free trade agreements as a solution to solve deep-seated social and economic problems in the region did not help to improve relations either.

Chinese long term strategic thinking is revealed in how Beijing is engaging the Latin American countries since the 1970's. One important aspect of this strategy was to send young diplomats to study Spanish and learn about Latin American culture in 'El Colegio de Mexico'[p.21]. From my own experience, Chinese diplomats posted in Latin America are second to none to any western country. They are well trained, tackle problems with determination, listen with care and incorporate local concerns in their decision making process. Increasingly, knowledge of Latin America's culture and politics allows Chinese diplomats to avoid past mistakes made by western developed countries. Chinese top leadership avoids empty promises and Presidential diplomacy is only used when concrete commercial and economic deals are on the table for discussion.

The report states that Brazil-China relations are truly strategic in nature because they encompass growth of trade, cross country investment and technology cooperation. Also, both countries seek a stronger and more influential place in international affairs and welcome a more restrained role by the United States [p.27]. A section on the China-Venezuelan relation concludes that President Hugo Chavez's efforts to get closer political and economic relations with Beijing, as a counter force to the United States, has few chances to succeed. The reason being that Beijing needs a

benign relation with Washington far more than a strategic partnership with Venezuela [pp 42-44].

Critics may take stock with the conclusion above, arguing that it may hold true only in the short term. However, if President Chavez continues to win elections and holds to power, in a way similar to Fidel Castro in Cuba, the relation might become strategic. Historical evidence shows that long-term economic links between countries lead, inevitably, to deeper cooperation in cultural, political and military affairs.

In summary, the IAD report laid down a comprehensive overview of geo-political, security-defense and economic issues of current Sino-Latin American relations. As in any complex and new phenomenon involving geo-politics, economics and security-defense matters, there are no definitive answers on how the situation will evolve in the near future. For the reader, everything comes down to what one believes based on ideology, knowledge and economic interest. Take, as an example, the intellectual framework in which the Chinese presence in Latin America is being debated by think tanks located in Washington DC.

Current thinking is divided into two groups. The first one, with a radical view, thinks that China represents the most serious challenge to Washington since the end of the Cold War, pointing out Beijing's presence in the Panama Canal, political support of Fidel Castro and growing interest in Venezuela's abundant oil and gas reserves. Venezuela is a special source of concern for three reasons. First, it is a major oil supplier of the United States, representing 15%

of its total imports. Second, the current President, Hugo Chavez, is an outspoken critic and political adversary of Washington. Third, President Chavez's approach of tackling the country's massive level of poverty -- via an authoritarian style of government -- may spread and create a "pink tide" anti-American coalition in the region.

The second group, with a slightly moderate view, argues that growing economic and commercial ties between China and Latin America can play a positive role in helping international insertion and development of the latter. As one expert of this group recently quipped: Perhaps the Chinese have better ideas on how to solve Latin American problems after one hundred years of attempts by the United States. At this point, views expressed by radicals and moderates are debated only in academic and diplomatic circles and do not influence policymaking. The reasons are the US administration's total focus on the Iraq war and, both groups could not articulate a set of workable policies to support their respective positions.

The 2006 Inter-American Development Bank Report. The IDB was the first multilateral financial institution to undertake major research to assess the strategic implications of China's economic performance on growth and development in Latin America.⁵ Despite a variety of topics being touched, the main focus is centered on trade and investment. The book is divided into five chapters, including a vast and rich bibliography review, background papers and references.

The main conclusions of this research can be summarized as follows. Historically, China's emergence as an economic powerhouse is not entirely new. Reemergence is a more appropriate description, since China had the world's largest economy for most the past thousand years. Until the 15th century China was not only the world's richest country but also a technological leader. Current high rates of growth will be accompanied by radical changes in the makeup of Chinese export competitiveness and import demand. Countries enjoying a boom in commodity demand from China, or facing stiff competition in basic textiles and apparel, may find a different playing field ten years hence. China will be buying 'lighter' imports and selling much more specialized and sophisticated textiles and apparel. Anticipating China's position in the international value chain is as important strategically as managing the benefits and competitive challenges of today.

For Latin America, China's emergence as a major player in the world markets involves at least three important dimensions: 1. A potential market of 1.3 billion consumers but also a low-cost producer of goods and services; 2. China's becoming an important economic-commercial partner; 3. China turning into a strong competitor for Latin America's manufactured goods. The main challenge for policy makers is how to reconcile findings from these separate three dimensions and forge an effective response to the Chinese phenomenon [pp. 195-198]

The Bank's research is the best analytical reference on the challenges and opportunities presented by China's emergence. In this respect, it touches the crux of the

matter i.e., whether Latin America is prepared, or not, to cope with Chinese competition. The rapporteur takes a rather optimistic view on the so-called competitive (positive) assets of Latin America to face global-Chinese competition. They are resource endowment-geography, democracy, vibrant private sector and economic integration. Conversely, inequality, poor educational system, highly skewed income distribution and weak public institutions are mentioned as negative assets [pp.209-226].

The Bank's report can be enhanced further if additional research is done on the (difficult) task of weighting and judging Latin America's positive and negative assets. For instance, do positive assets offset the negative ones or vice-versa? Is there a set of effective socioeconomic policies to enhance the positive assets and offset the negative ones? Policy makers require this type of analysis in order to prepare a coherent strategy to deal with the questions at hand. For many, a merging of MERCOSUR-NAFTA is probably the only chance to create a level playing field to face global competition, particularly from China and India.

A background paper prepared for the main IDB report takes a less optimistic view on whether Latin America can compete with Chinese manufactured goods.⁶ According to Mesquita, even without the presence of China, the future of manufacturing in Latin America is usually seen with pessimism on the grounds of geography and endowments. The sector's tribulations of the last two decades seem to corroborate this point of view. Yet, geography and endowments do not tell the whole story. The import substitution legacy, macroeconomic volatility and the

overreaction to the excesses of government intervention also played a major role in the sector's misfortunes [p.27]. To deal with the shortcomings, a set of policy recommendations are made: a. strengthen macroeconomic fundamentals; b. lessen credit-constraints of domestic producers competing with highly leveraged Chinese firms; c. boost domestic technological capabilities i.e., human capital, science and technological infrastructure [pp.27-28].

Mesquita's excellent analytical work can be enhanced further with research on whether macro and micro-economic policies in Latin America are correctly in place and are sustainable in order to support policy recommendations. In the case of Brazil, as discussed next, macroeconomic policy is not compatible with and, far from being an ideal one to promote industrial development and increase productivity in manufacturing production.

Part II. MERCOSUR and Mexico⁷

At the end of 1980's, after the successive energy crises of 1974-1982, it became clear that the industrial import-substitution strategy to overcome underdevelopment had failed in Latin America and the Caribbean. Mexico, Brazil and Argentina, the most advanced industrial economies in the region, took different integration paths as a way to correct the failures of the past. In the case of Brazil, Argentina, Paraguay and Uruguay the decision was to form a custom union, mirrored in the European model, which culminated in the creation of the Southern Common Market

under the Asuncion Treaty of 1991. Chile, Bolivia and Peru became associated members i.e., linked to the bloc via a trade agreement. Venezuela became the fifth full member of the custom union on 4th July 2006.⁸ Its definitive acceptance, however, depends on approval by the respective Congresses.

Mexico's leadership decided to deepen the country's historical economic ties with the United States via the North American Free Trade Agreement (NAFTA), signed in December of 1994. The novelty of this agreement was that, for the first time ever, a developing country accepted integration with a highly advanced economy without any financial support except for managed trade and promises of direct investment. Before NAFTA, the idea of integration was the European Union model. Criticism of NAFTA should be tempered by reality and realpolitik. It would be politically impossible for business corporations and the US Executive branch to sell the European integration model to Congress. It requires macroeconomic coordination, joint trade negotiations and financial support to other member countries. More importantly, labor mobility is a key factor at the advanced stage of a common market, something unthinkable in the US political system.

Competitiveness: How Latin America is positioned in the global economy? The main objective of economic integration in Latin America and the Caribbean is to be competitive in the global economy. According to Professor Michael E. Porter of Harvard Business School: "The world economy is not a zero-sum game. Many nations can improve their prosperity if they can improve productivity. The central

challenge in economic development, then, is how to create the conditions for rapid and sustained productivity growth.”⁹ Since independence from Portugal and Spain in the XIX century, there were several attempts at political and economic integration in Latin America and the Caribbean. After 15 years of the existence of MERCOSUR and 12 years of Mexico’s integration in the North America Free Trade Area (NAFTA), how are the main economies of Mexico, Brazil and Argentina globally positioned?

In order to answer the question above, three sets of indicators, 2006 Global Competitiveness Index (GCI), the Corruption Perception Index (CPI) 2005 and WTO exporting ranking 2006 are used in Table I. Countries are grouped according to geographic location and/or trading-integration blocs, i.e., NAFTA, EU, Asia and MERCOSUR. The global competitiveness index (GCI) provides qualitative data on how countries are positioned in the global economy as far as attracting investments, doing business and overall quality of life for their citizens. The corruption perception index works as a proxy to evaluate economic performance.¹⁰ Essential public work such as roads, bridges, schools, hospitals (despite cost overruns) is always finished in advanced countries. Corrupt officials and politicians are punished, most of the time. Public work in a developing country is kept unfinished and, when finished, presents cost overruns that sometimes bankrupt public finances. Corrupt public officials and politicians are seldom found guilty and/or punished.

The use of export ranking index deals with the question of trade-wealth creation and income distribution. The set of

indicators would be complete if education had been included. Knowledge is a key proxy to measure economic competitiveness and quality of life. Latin America is consistently below world standards in primary, secondary and university education levels. The ranking of university quality teaching illustrates this point. Among the top two hundred best universities in the world, there are only two located in the region i.e., Universidad Autónoma de Mexico (UNAM), ranking 193 and Universidade de São Paulo (USP), ranking 195.¹¹

Table I

	GCI ^{/1}	CPI ^{/2}	Exports Ranking ^{/3}
NAFTA			
Canada	16	8.4	9
México	58	3.5	15
United States	6	7.6	2
EUROPE			
Austria	17	8.7	22
Belgium	20	7.4	10
Denmark	4	9.5	32
Finland	2	9.6	35
France	18	7.5	5
Germany	8	8.2	1
Greece	47	4.3	n/a
Iceland	14	9.7	n/a
Ireland	21	7.4	26
Italy	42	5.0	8
Netherlands	9	8.6	6
Norway	12	8.9	28
Portugal	34	6.5	47
Spain	28	7.0	17
Sweden	3	9.2	21
Switzerland	1	9.1	20
United Kingdom	10	8.6	7
ASIAN BLOC			
Australia	19	8.8	27
China	54	3.2	3
Hong Kong	11	8.3	11
India	43	2.9	29
Japan	7	7.3	4
South Korea	24	5.0	12
Malaysia	26	5.1	19
New Zealand	23	9.6	
Singapore	5	9.4	14
Taiwan	13	5.9	
Thailand	35	3.8	25
MERCOSUR			
Argentina	69	2.8	46
Bolivia	92	2.5	n/a
Brazil	66	3.7	23
Chile	27	7.3	45
Paraguay	106	2.1	n/a
Uruguay	73	5.9	n/a
Venezuela	88	2.3	38

Notes: ^{/1} Global Competitiveness Index - 2006 Rank - Source: World Economic Forum (2006), Global Competitiveness Report 2006-2007.

^{/2} Corruption Perceptions Index 2005: relates to perceptions of the degree of corruption as seen by business people and country analyst and ranges between 10 (highly clean) and 0 (highly corrupt) - Source: Transparency International (2005).

^{/3} 50 Leading exporters and importers in world merchandise trade, 2005 - Source: WTO (2006).

What does Table I tell us? Mexico is well ranked in trade due to strong links with the United States but competitiveness is low and perception of corruption is high. Income generated by exports of goods and services worth \$215 billion in 2005, including 1.8 million of barrels of oil a day [Banco de Mexico's statistics] is highly concentrated in the hands of a few. Since NAFTA came into effect in December 1994, the number of Mexicans seeking to enter the United States illegally increased substantially. Nearly half of the country's 106 million people live in poverty. However, it has more billionaires [10 as of 2005] than Switzerland according to Forbes magazine's list of the world's richest people. A recent in-depth World Bank report concludes that concentration of wealth is the main constraint for economic growth.¹² The state of Nuevo Leon, capital Monterrey and Chiapas, capital Tuxtla Gutierrez illustrates the relation between wealth, trade creation, regional inequality and concentration of income.

Monterrey, along the US border, has the highest per capita income in the country and a sophisticated manufacture industry highly integrated to North America's production chain. The state enjoys a high rate of literacy and its political-business elites are comfortable with US culture. Tuxtla Gutierrez, bordering Guatemala, has the lowest per capita income in the country and a subsistence-type of agriculture as the main activity. It holds a very large illiterate population and the highest poverty level in the country. Domestic political dynamics explains such regional contrast. As elsewhere in Latin America, the political system creates regional inequality and a highly skewed

income distribution, enhanced further by trade creation wealth generated in the last decade. Brazil's socio-economic picture is a mirror image of those of Mexico. The states of São Paulo, capital São Paulo and Maranhão, capital São Luis are the counterparts of Nuevo Leon and Chiapas.

Chile holds the best competitiveness ranking for a Latin American economy with a good export performance and low perception of corruption. Chile's success story is due to economic reforms undertaken in the 1970's and 1980's. These reforms included reduction of import tariffs, attraction of foreign direct investment, prudent fiscal and monetary policies to control inflation while maintaining a favorable exchange rate to promote exports. The country's economic reforms were only possible after leaving the "Comunidad Andina de Naciones" in 1976, a custom union type of integration incompatible with Chile's decision of unilateral import tariff reduction.

Despite Chile's success in promoting natural resources based exports, it is still unable to develop an effective strategy to create knowledge-based products. Switzerland's ranking (1) in competitiveness illustrates this point. This European country success is due to good institutions and competent macroeconomic management, areas in which Chile stands in the same league as Switzerland. Also, Swiss world-class educational system has focused on technology and innovation that leads to a successful strategy for boosting competitiveness. In this requisite, Chile has a long way to go in relation to advanced countries.

MERCOSUR as a platform to compete in the dynamic sectors of world economy has failed so far. Brazil and Argentina have very low marks on competitiveness, perception of corruption is high and trade position is mediocre for countries with great export potential. Brazil's ranking as the 11th economy in terms of size is irrelevant given its (low) ranking in competitiveness and high perception of corruption. China and India present levels of competitiveness not much better than Brazil. However, if Brazil, Argentina and Mexico are having problems competing with Chinese and Indian manufactured goods today, what will happen in a few years when both Asian economies will certainly be better positioned?

Latin America's main lesson is that trade-based integration of an emerging economy with an advanced one is not a short cut and/or a solution for underdevelopment. Trade wealth creation, not accompanied by compensatory public policies, exacerbate an income gap between regions and social groups. This situation leads, inevitably, to political turmoil and social unrest. Democracy, as practiced in Latin America and the Caribbean, has failed to provide an effective solution for income distribution. From a historical perspective, it has created few winners and millions of losers.

Finally, there is a connection between competitiveness, corruption, trade and security-defense. Countries highly competitive, with strong trade position and low levels of corruption have modern public defense forces, extremely costly nowadays. Also they provide better internal security for their citizens against violence and crime. Conversely, countries with poor levels of competitiveness, weak trade

position and high levels of corruption have outdated defense forces and cannot provide adequate domestic protection for their citizens against violence and crime. This is true for MERCOSUR and Mexico, except for Chile that provides adequate internal security and is rapidly modernizing its armed forces.

MERCOSUR: Strengths and Vulnerabilities. The strengths and weaknesses can be grouped into three areas: Institutional framework, perception of the elite and strategy of insertion into (dynamic) areas of global trade. There is a divorce between the theoretical project of constructing a custom union, aimed at becoming a common market, and the day-by-day reality. A free trade area, requisite for a full custom union, has not been established yet. The integration bloc lacks rigor and discipline to apply norms and regulations agreed upon. Three fourths of approved community norms and regulations were never adopted by each country, since there is no penalty and/or incentive to do so. Despite the existence of a conflict resolution mechanism [Protocolo de Olivos] to settle commercial disputes, another instrument [Mecanismo de Ajuste Competitivo-MAC] was signed between Brazil and Argentina in 2006. This mechanism resembles a safeguard type of instrument, prohibited in a custom union.

Important segments of the political, business, academic and diplomatic corps lack strong belief in the integration process. They argue that economic integration among poor countries is bound to fail since there is not a single example of a success story until now. Another weakness is lack of competitiveness of Brazilian and Argentinean

manufactured goods in the global markets. This leads to bilateral conflicts of difficult resolution. As manufactured goods lose competitiveness in extra-regional markets, exporters start to compete for a (relatively) small market offered by the integration bloc. The conflicts between Argentina and Brazil mirror those of the European Union in agriculture products, revealing in both cases low levels of competitiveness.

Brazil -- the largest economy of MERCOSUR -- illustrates the (unsolved) problem of how to implement a comprehensive strategy to increase competitiveness of manufactured goods. For more than a decade, the country has been experiencing low rates of growth, that can be described in macroeconomic terms as follows: High public debt [60%/GDP] combined with high real interest rates + overvalued currency + heavy taxation [39%/GDP] = Average GDP growth of 2.5% year. Besides a mediocre growth rate, the unfavorable macroeconomic framework induces a high marginal propensity to import and a low propensity to export products with high value added. In turn, this increases the share of low value added commodities in the balance of payments. In addition, a tight public budget position, caused by payment of public debt, prevents allotting much-needed funds to upgrade the decaying and antiquated infrastructure. Therefore, macroeconomic policy can and must be changed in Lula's second term in office. The question is how long it will take to turn the economy around.

The shortcomings of the macroeconomic policies cited above, combined with an antiquated and decaying infrastructure, are causing trouble to producers and exporters to compete

domestically and internationally. The country is rapidly losing market share in products such as shoes, textiles, clothing, transport vehicles, machine tools, chemical products and steel that were highly competitive in the past. The problem is compounded by low literacy rates and poor training of the workforce that prevent development of knowledge-based industry. Consequently, leveraged companies are starting to move production outside the country, in a rapid process of internationalization. Steel, mining, food processing, pulp-paper and construction are leading the way. The presence of Brazilian multinational companies is already being felt in South America and elsewhere. In 2006, for the first time ever, Brazil's foreign direct investment surpassed those coming into the country. The acquisition of INCO, a Canadian mining company, worth \$18 billion by Vale do Rio Doce exceeded the total foreign direct investment in Brazil during 2006. This economic phenomenon deserves academic research because of its implication for domestic social policies.

Internationalization strengthens companies; make them more profitable but leads to job losses domestically. The possible hollowing out of the industrial base is a serious socio-economic problem because of the high degree of urbanization [90%] of the country. Already, Brazilian major cities are populated by an increasing army of thousands of poor-uneducated young men and women that, with easy access to guns, are creating a lethal social problem of crime and violence. If industrial de-basing is permitted to happen, the consequences will be serious since urban violence and crime will become more out of control. To find a solution for this complex conundrum should be the top priority for

President Lula in his second term in office and his successor in 2010.

Finally, despite conflicts and differences, MERCOSUR has been expanding with inclusion of Venezuela that became full member on the symbolic date of 4th July 2006. Commercial-economic links with other South American countries have been strengthened due to the internationalization process of Brazilian companies. The bloc's continuity can be explained by internal and external factors. The weak institutional framework described previously, paradoxically, is a strength since its 'flexibility' helps to withstand constant political and economic crises within the bloc. If MERCOSUR had adopted a rigid system of rules and regulations, similar to the European Union-NAFTA, the bloc would have collapsed a long time ago.

The impasse on WTO-Doha, Free Trade Area of the Americas (FTAA) and EU talks also works to strengthen the bloc because regional integration remains the only game in town to be played. China's demand for commodities helps the bloc since it guarantees a large and steady flow of hard currency. One school of thought argues that the world's economic paradigm has been changed by the spectacular growth of the Chinese and Indian economies for the foreseeable future. If that proves to be the case, MERCOSUR -strong on natural resources based exports - will continue to benefit from this shift in paradigm.

Part III. Outlook for MERCOSUR-China Relations.

The future is always elusive but what can we expect from China-Latin America's relations in the near future? As the title of this paper proposes, will the relation be of partnership or rivalry-conflict? To attempt to answer those questions, the endgame of WTO-Doha trading talks is used to do an exercise of scenario-construction. The best-case scenario is a successful ending of Doha-FTAA talks combined with sustainable growth of the world economy. The worst-case scenario is 'status quo' i.e., impasse and/or collapse of Doha-FTAA talks combined with a slow down of the world economy.

Scenario I. Positive Outcome Doha-FTAA Talks

Brazil-MERCOSUR= Extremely Positive

México, Central America-Caribbean = Neutral or Negative

Scenario II. Negative Outcome Doha-FTAA Talks

Brazil-MERCOSUR = Negative

México, Central América-Caribbean = Negative

Scenario I. A successful ending of Doha-FTAA talks implies better market access to the agro-business. Brazil-MERCOSUR, agriculture and bio-energy powerhouse is a clear winner. The result is neutral or negative for Mexico, Central America and the Caribbean since they are net agricultural importers. Brazil-MERCOSUR trading position is strengthened since improved access to high-income markets can be translated into a permanent improvement in the balance of

payments position. This, in turn, gives extra time to update infrastructure and improve productivity of manufactured goods. Mexico, Central America-Caribbean continue to suffer full court pressure from Chinese imports and worsening trade position with the Asian economy can be expected. The only solution for Mexico is to continue attracting large amounts of foreign direct investment, upgrade antiquate infrastructure, significantly improve education-training of the workforce and promote an effective income-distribution policy.

Scenario II. The status quo of impasse and/or collapse of Doha-FTAA talks is very dangerous for Latin America because the balance of payments becomes vulnerable to abrupt changes in external conditions. Trade conflicts can escalate in sensitive areas of steel-related production of consumer goods and automotive manufacturing. This scenario can turn even worse if the world economy slows down, stagnates or goes into recession.¹³ This worst case is an acid test for economic-commercial relations with China because diplomacy and cooperation will be first casualty all over the world. In this case, for Mexico, highly dependent and integrated into the North American market, the results would be catastrophic. Brazil-MERCOSUR perhaps could fare better since it has a relatively large domestic market to fall back on and a diversified trade-exporting base.

The outcome of the FTAA talks, included in the two scenarios above, is a question for a post-Bush administration. It can opt out from two policy positions to deal with Latin America:

- (I) Keeping the status quo of benign neglect [High probability]. China's presence in the region continues unabated. Only a serious conflict Beijing-Brasilia (highly unlikely) could check the Asian influence in South America. Beijing can prevent escalation of trade disputes through fine-tuning of economic diplomacy. In case bilateral trade balance turns highly negative for Brasilia, it can be compensated via speeding up direct investment in Brazilian natural resources-based industry and infrastructure.

- (II) Engages Brazil-MERCOSUR with an integration agenda that cannot be refused [Very low probability]. A merging of MERCOSUR-NAFTA creates a hybrid integration process with components of free trade and the European model. This implies making (politically) difficult concessions on immigration and financial assistance to Latin America. This (highly unlikely) scenario is the only chance to counter China's growing presence in South America. A tight, highly integrated Western Hemisphere would become a strategic rival rather than a partner of China.

Summary-conclusions: The Answer is not in China or in the Stars

To sum up, this paper concludes that China's emergence has already been felt in the Western Hemisphere, creating winners and losers in the short run. Using boxing as a metaphor, the first round is over. In one corner, the bruised economies of the United States-Mexico. Next to US/Mexico, the still unscathed economy of Brazil-MERCOSUR. In the opposite corner, the Chinese economy observing with a mixture of joy-apprehension the next round. What will happen next is difficult to forecast. A simple exercise shows that under different assumptions, the relation can vary from partnership to rivalry. However, under different assumptions-scenarios, economic and trade cooperation between China-Brazil/MERCOSUR has the best chance to be sustained and prosper. Global political, economic, cultural and technological factors are highly favorable to such outcome.

However, at the end of the day -- as the current saying goes - it is up to each country to make difficult choices for grabbing up opportunities offered by globalization. The formula for success is quite well known but difficult to put together and be implemented. It requires a well-prepared political elite, sensible economic policies, highly educated-trained workforce and a political system that provides opportunity for the majority and not for a privileged minority. China seems to be in the right path of that formula. Latin America has a long way to go in finding the right combination of that winning prescription.

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⁸ The Institute for Integration of Latin America and the Caribbean (INTAL) provides the best collection of annual reports on MERCOSUR. Link http://www.iadb.org/intal/detalle_subtipo.asp?tid=6&idioma=esp&stid=5&c_id=234

⁹ World Economic Forum (<http://www.weforum.org/>), Global Competitiveness Report 2006-2007.

¹⁰ See WORLD BANK: Towards a fairer world: Why is corruption still blocking the way? Goals, Themes and Outcomes. By Pierre Landell-Mills. Washington DC 2006. <http://www.12iacc.org/archivos/12IACC-GoalsThemesAndOutcomes.pdf>. A recent (2006) World Bank's Independent Evaluation Report concludes that although the Bank's anti-corruption efforts have been successful in bringing legal and regulatory reform to many countries, the organization has frequently failed to follow up with the necessary enforcement. Rather than aiming for sweeping reforms, the report suggests that the Bank should focus on public

spending. While corruption is acknowledged as a significant problem, little is known about the most effective means of fighting it.

¹¹ For details and methodology used for ranking the 200 best universities in the world, see link <http://ri.epfl.ch/webdav/site/ri/shared/Ranking.pdf>

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¹³ See OXFORD ANALYTICA in-depth analysis: EAST ASIA: CAN THE REGION SURVIVE A US SLOWDOWN? - November 28, 2006. The report says that East Asian economies are still highly dependent of the US market, particularly China with the highest dependence index. It goes saying that other emerging economies in the region have in effect substituted dependence on the US market for indirect dependence, via China. This rising export-orientation towards China reflects a regional division of labor in which the Chinese economy operates as a central assembler and export of finished manufacture to global markets. The report concludes that while East Asia continues to enjoy rates of economic growth that are far superior to those in other regions, the structure and durability of the growth model has yet to be tested by any severe slowdown in US demand that is not compensated for by demand increases elsewhere.



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