Beyond the Boom
Towards a Mature China-LAC Relationship

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Outline

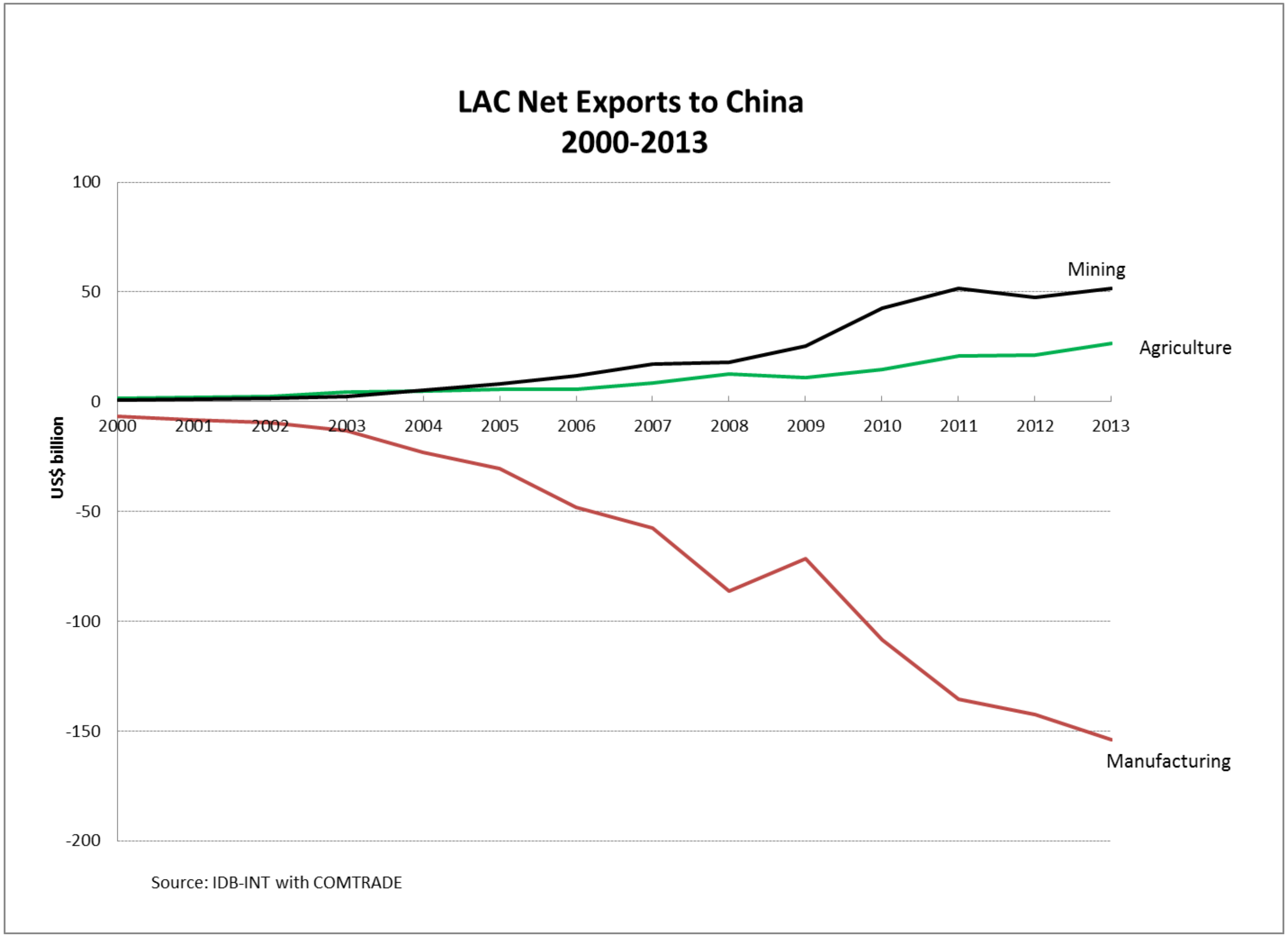
- Looking back at 15 years of boom
  - Trade
  - Investment
- What does the future bring?
  - A new relationship?
- LAC possible response
  - The nightmare
  - The dream
- Conclusions

Looking back at 15 years of boom

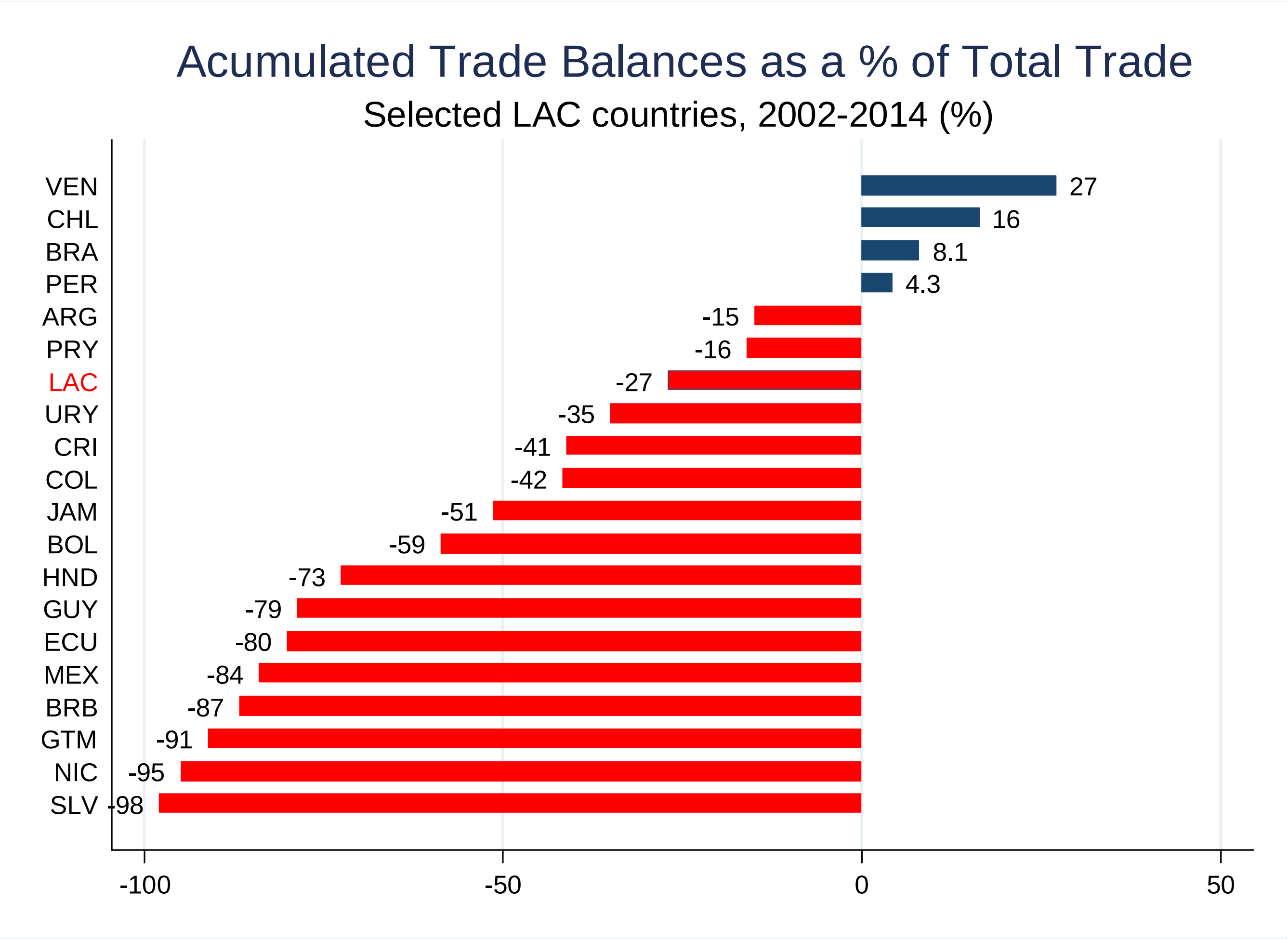
Bilateral trade boomed in the last 15 years…

*1 Sem.
IDB-INT with IMF-DOTS

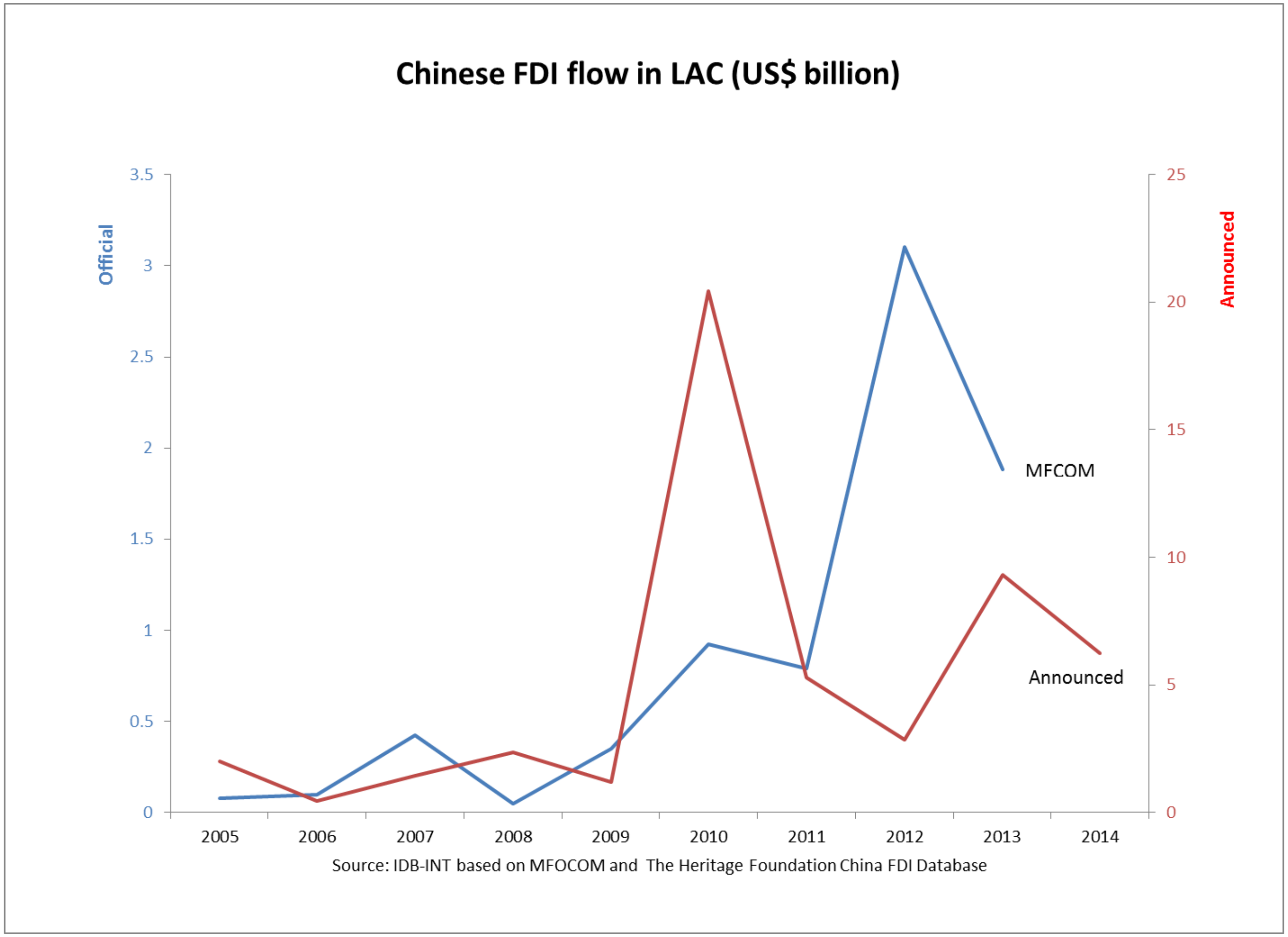
…. on the back of a commodity (export) and a manufacturing (import) boom …



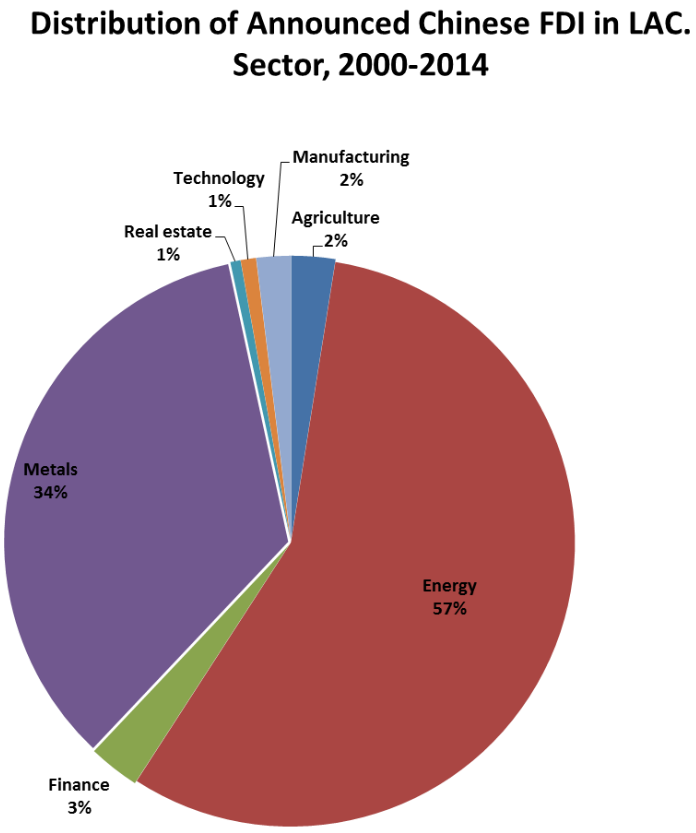
….with very different impacts across the region.

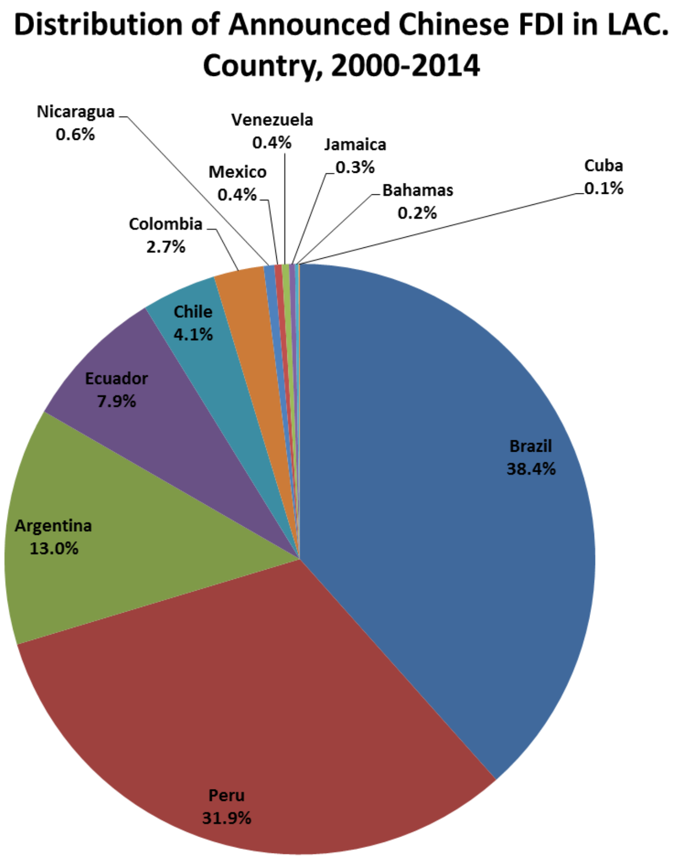


Investment took off much later….



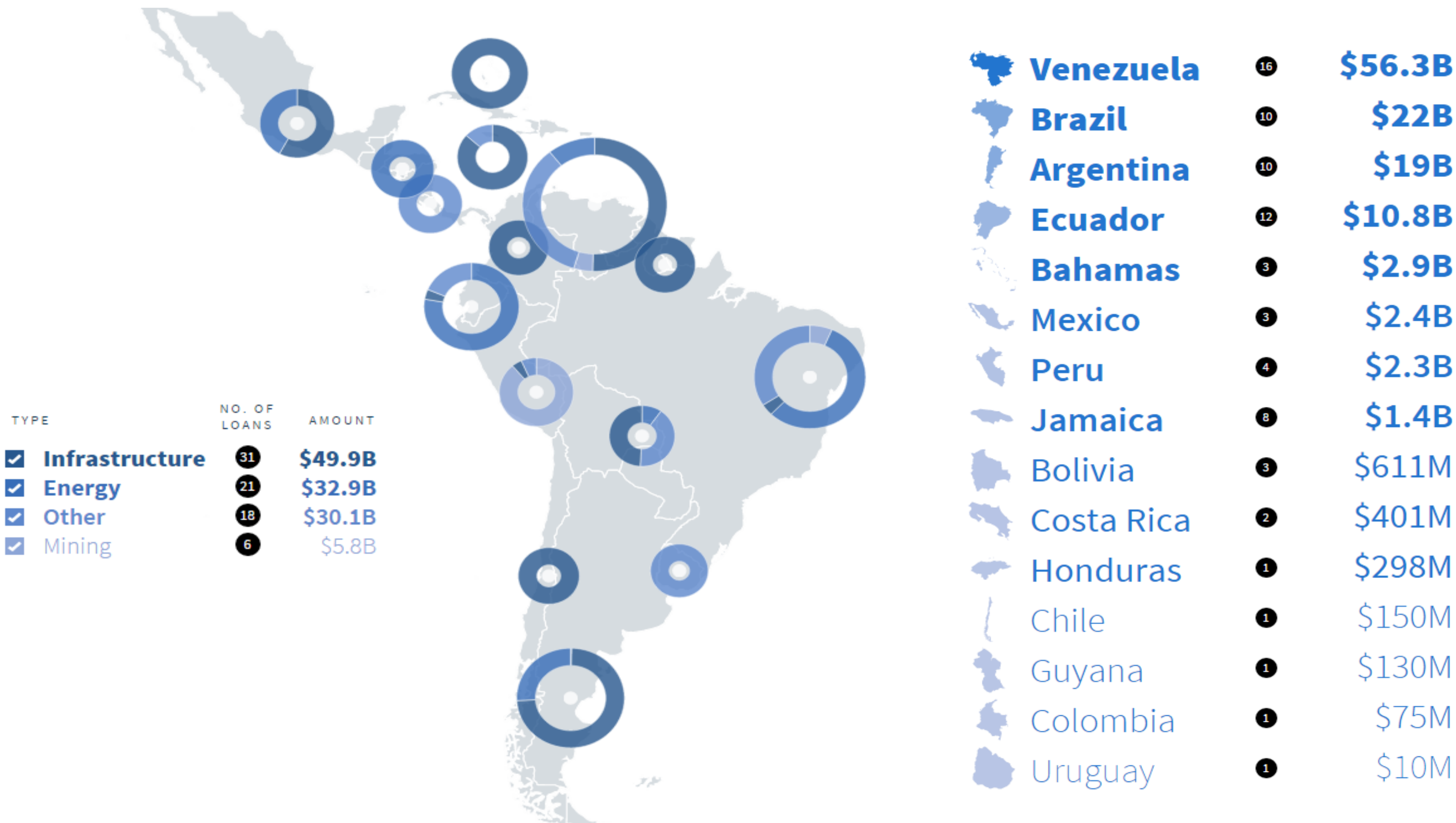
….but has a similar composition to LAC exports.





More impressive than the FDI take-off was the upsurge in “policy” loans

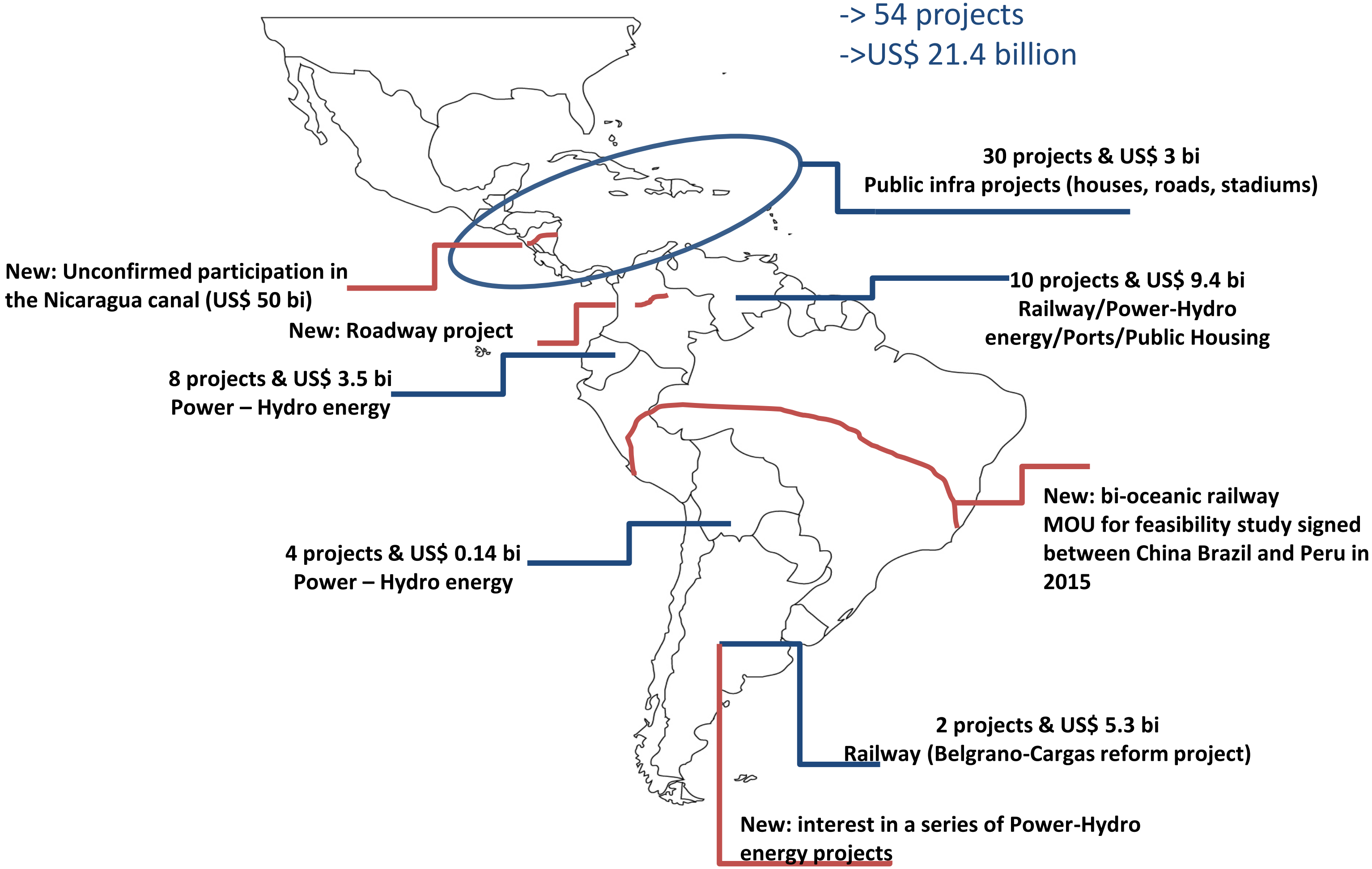
Chinese Announced Loans to LAC – 2005-2014



Source: Inter American Dialogue

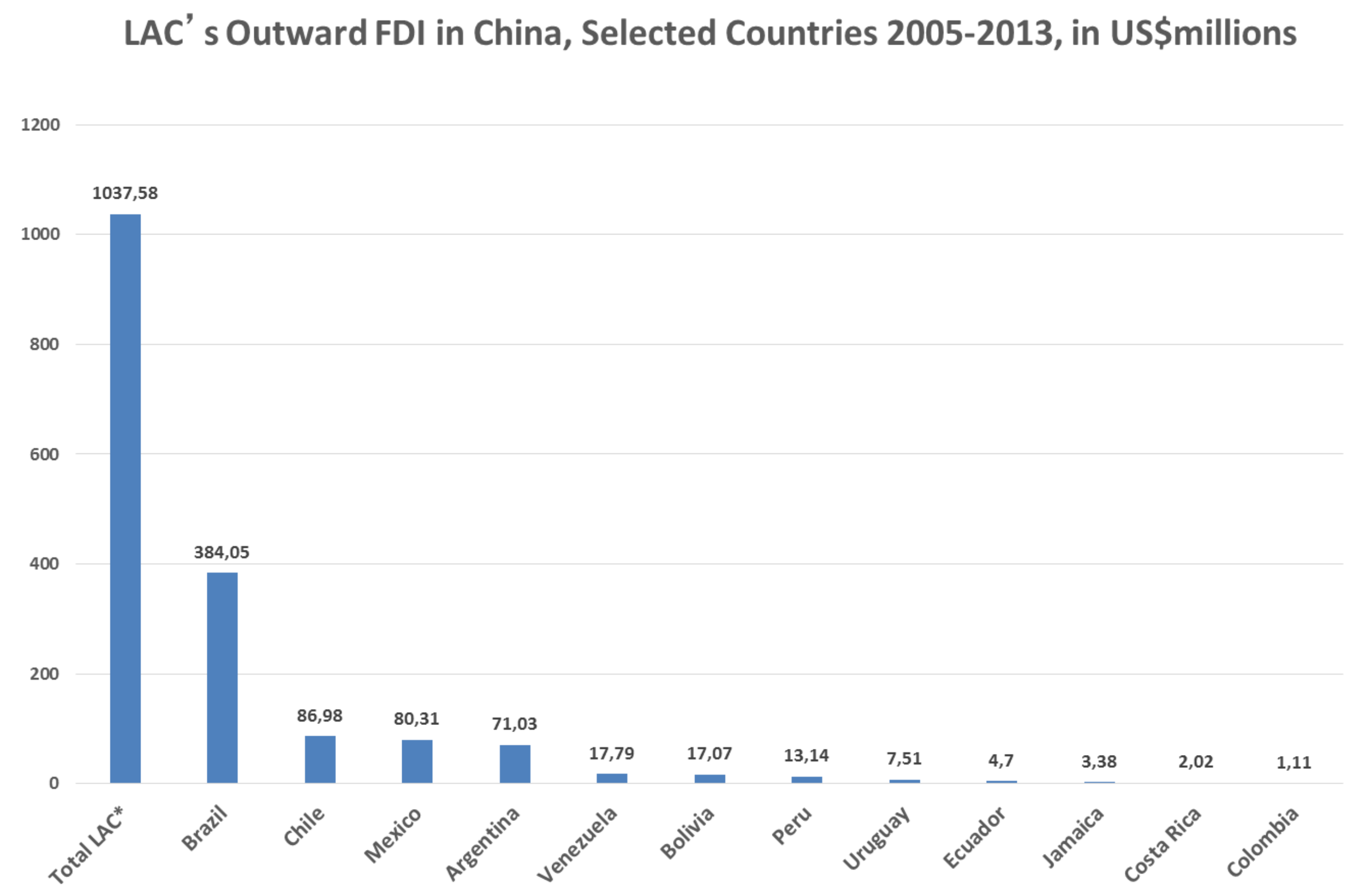
….with infrastructure gaining ground on energy

-> 54 projects
->US$ 21.4 billion



Source: IDB-INT

LAC investment in China has yet to acquire a critical mass

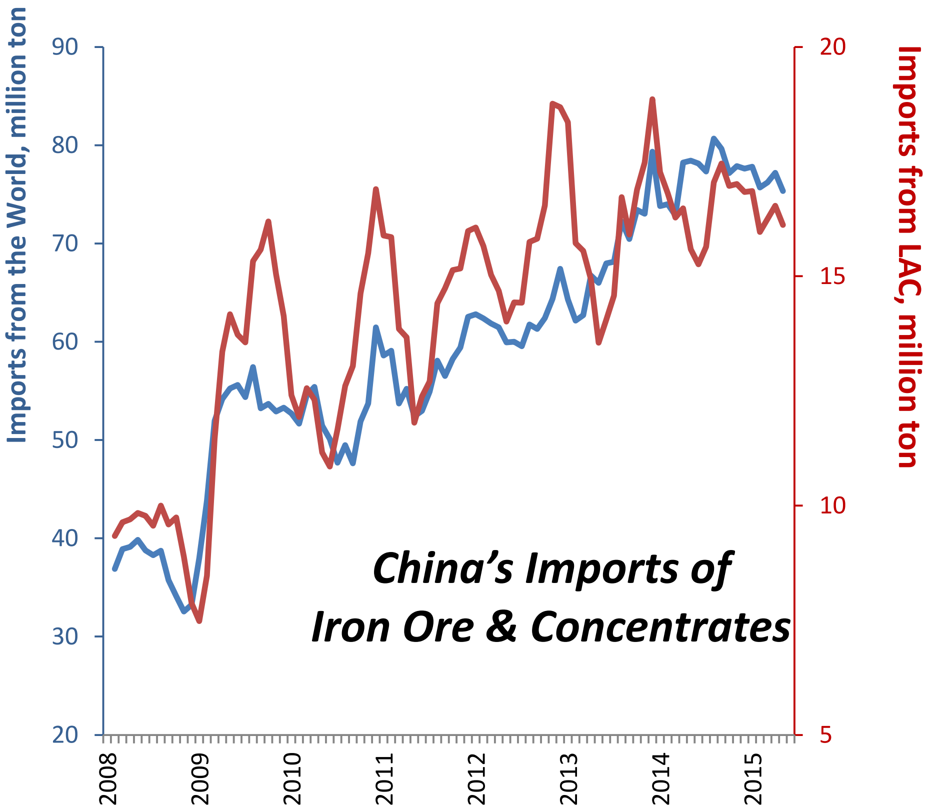


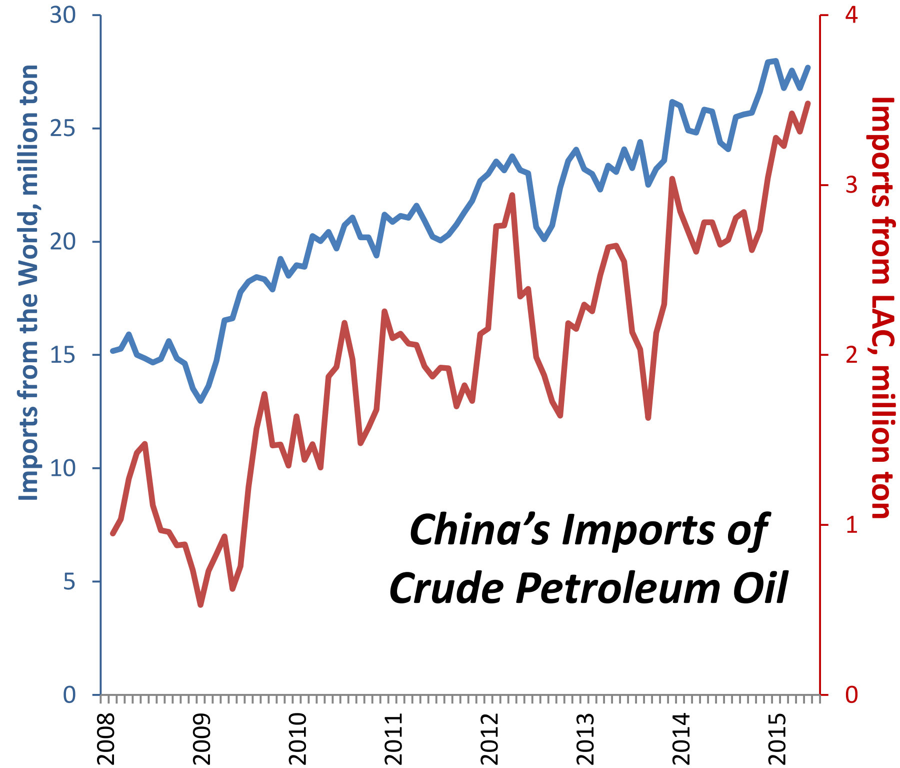
Source: MOFCOM and UNCTAD World Investment Report, 2014
*Not including tax havens

From boom to stagnation: what does the future bring?

A new pattern of trade or just a strong cyclical adjustment?

- A cyclical adjustment seems to explains most of the story.
- Growth in Asia will continue to demand vast natural resources, driven by the size of their markets and changes in food consumption patterns and increasing urbanization. E.g. The volume of China's commodities import continue to rise.

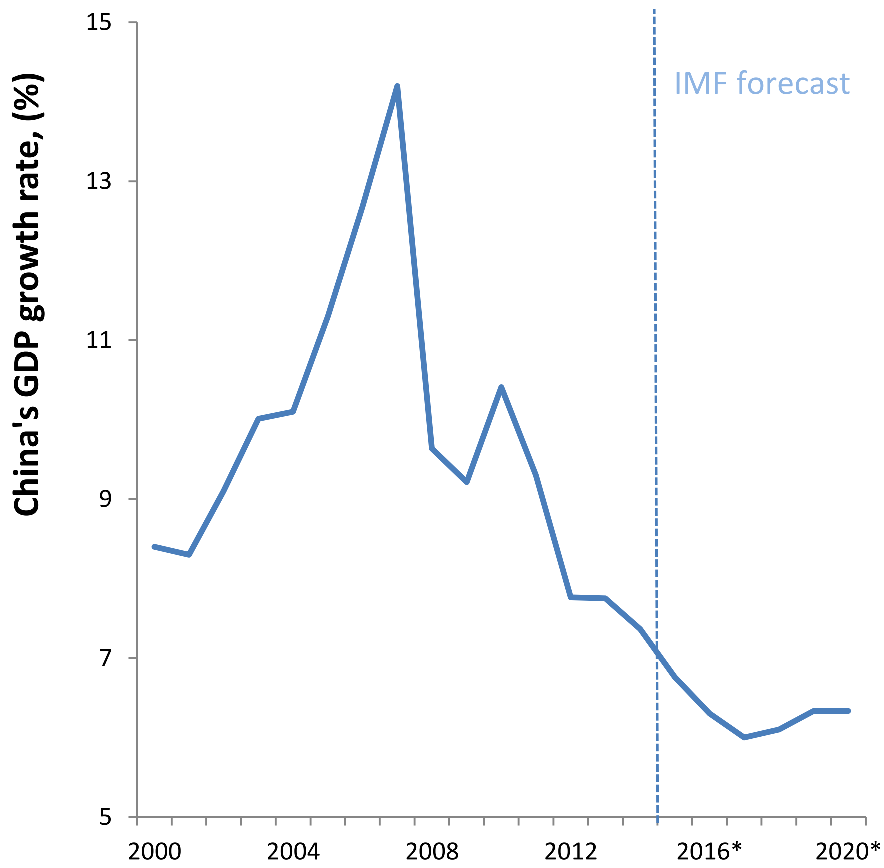




Yet, the epic days seem to be over

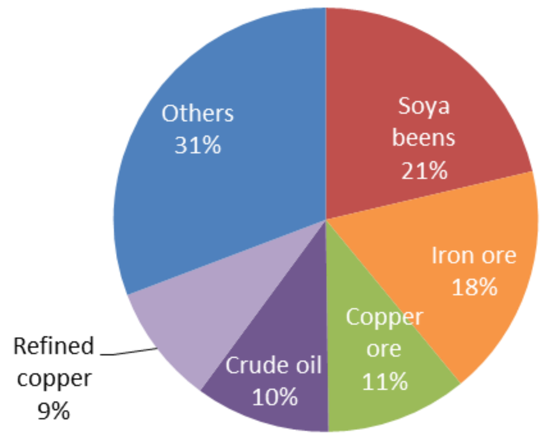
- The story also has <u>an important structural component</u> that suggests that it is unlikely that we will see again the double-digit rates of commodity export growth of the last 15 years

- China is already experiencing the inexorable <u>diminishing returns</u> as the stock of capital grows and productivity gains are exhausted;
- Lower growth + growing share of services in GDP = <u>less dynamic demand for commodities</u>
- However, the new cycle will start from a <u>much larger trade base</u>



The "new normal" asks for a more pro-active trade policy

- This scenario puts even more urgency on the need to diversify the region's exports to Asia, still highly concentrated on a few commodities



- Yes, commodities are likely to remain LAC's main business in Asia, but to maintain a strong export performance the region will have to diversify its portfolio of goods.
- Diversification, in turn, depends on a more active trade policy, addressing trade costs, which are still significantly high. The days of epic and effortless gains are over.

Tariffs and non-tariff barriers are still high, particularly for LAC's processed agricultural goods

Table 1 -China's Import Tariffs. 2013				
Average Applied MFN Tariff (%)	Total	Agriculture	Manufacturing	Mining
Simple average (6-dig)	9.9	13.4	9.3	3.2
Average weighted by				
Chinese imports	4.6	10.3	5.4	1
Argentina's exports to WLD	14.4	17.3	13.1	1.7
Brazil's exports to WLD	10.1	17	9.2	0.8
Colombia's exports to WLD	4.1	12.3	9.5	1.4
Mexico's exports to WLD	9.6	16.1	10.9	0.7
World's exports to WLD	8	16.1	8.5	2.4
Note: See technical appendix for classification.				
Source: tariffs from WTO, trade UN COMTRADE, 2013.				

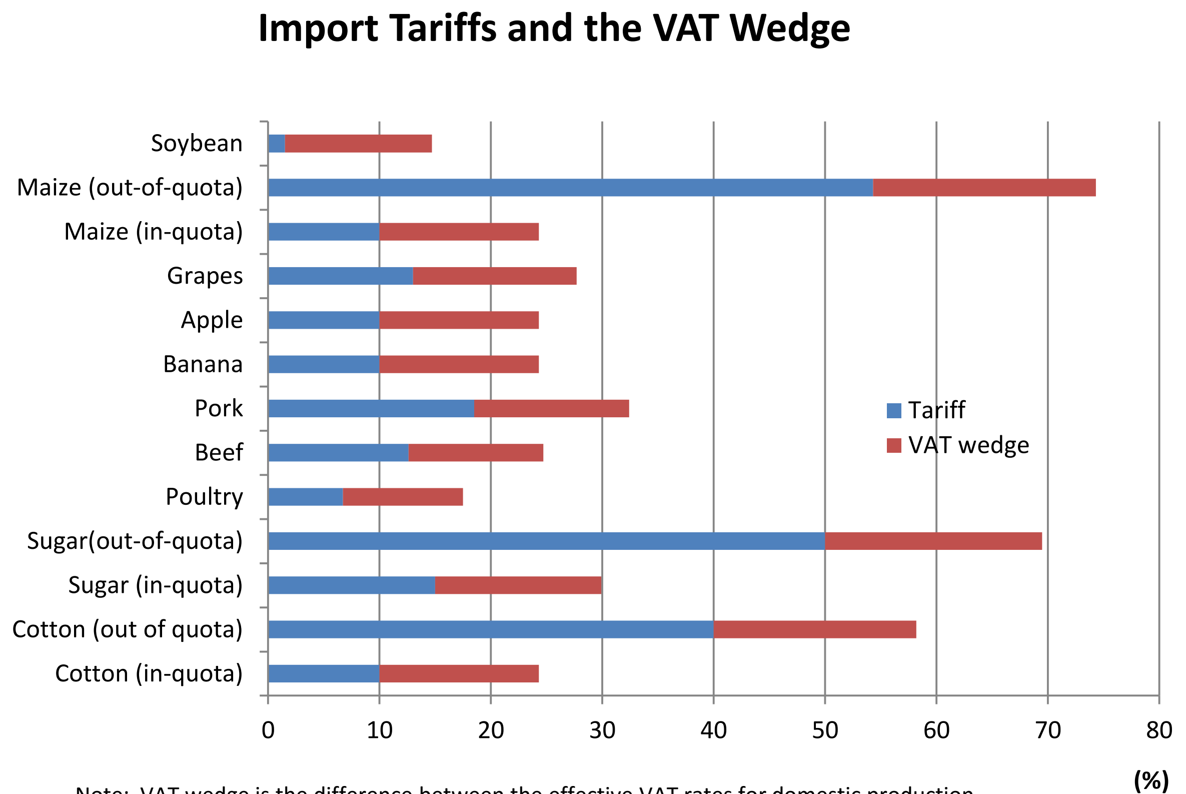
Note: tariffs are weighted averages of the latest available information 2010 – 2014.

Asean: Cambodia, Indonesia, Lao, Malaysia, Philippines, Singapore, Thailand, Vietnam

East Asia: China, Hong Kong, Macao, Japan, Korea, Taiwan

South Asia: Bangladesh, India, Pakistan

and non-tariff barriers are still high, particularly for LAC's processed agricultural goods

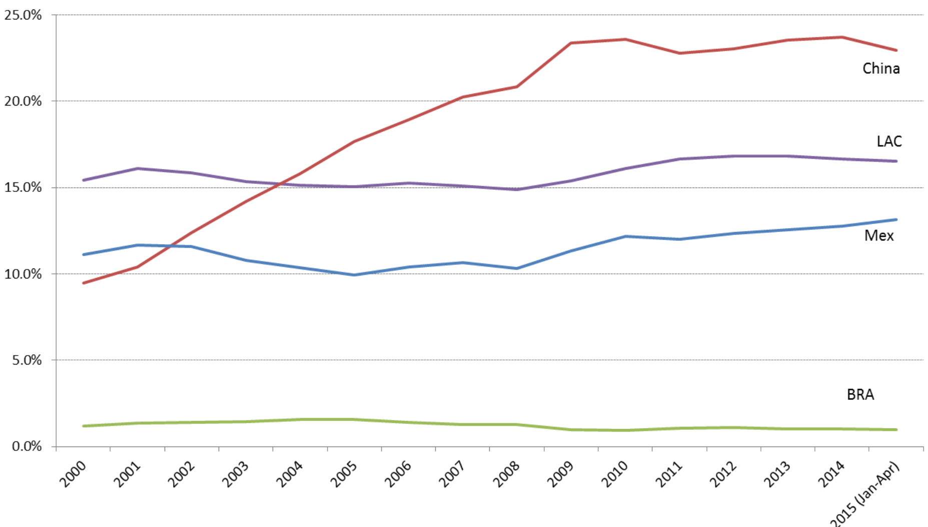


Note: VAT wedge is the difference between the effective VAT rates for domestic production and imports

Source: IDB-INT with Trains data for tariffs and interviews and USDA 2007 for the VAT wedge.

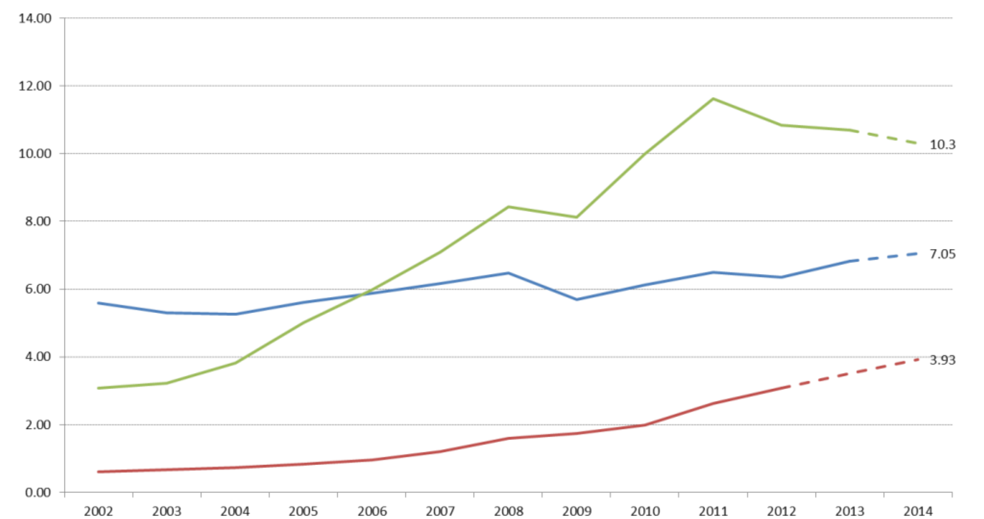
…and competition in manufacturing is likely to remain strong

Share of U.S. Manufacturing Imports. 2000-2015



Source: IDB-INT with USITC data

Hourly compensation costs in manufacturing, U.S. dollars, 2002-2014



Source: IDB-INT with US-BLS , CEIC data, BIE, PIMES

Possible LAC responses: nightmare scenario

Trade

- **Governments**: a) fail to negotiate trade barriers (tariffs, tariff escalation, NTBs and subsidies in agriculture), and government support and TRIMs for industry.

  b) Resort to protectionism and subsidies to stave off a perceived threat of deindustrialization, delays inevitable adjustment and cut incentives to increase productivity
- **Private sector**: instead of fighting market access and increase productivity, lobbies the government for protection and subsidies and remains content with natural resource rents;
- **China**: Push for total , “soil to shop”, control of supply chain in agriculture and mining undercuts the potential for diversification and erodes rents (transfer pricing);

Possible LAC responses: nightmare scenario

Capital flows

- **SOE** investment in natural resources continues to heavily dominate **China's FDI** in the region, contributing little to diversify the local economy and raising governance, sovereignty and environmental concerns.
- **LAC's FDI in** China remains negligible, with firms failing to take advantage of tariff jumping, proximity to clients and to reap the benefits of variation in factor prices.
- China's takes advantage of growing macroeconomic imbalances to steps up the signing of **opaque loan-for-resources or loan-for-infrastructure deals**, and in the process countries see their rents erode, debt sustainability compromised and their local companies shut out of Chinese financed projects.
- **Financial dependence**, disguised under the rhetoric of "South-South cooperation", leads LAC governments to fail to advance their own interest in bilateral and multilateral trade negotiations

Possible LAC responses: best scenario

- Fortunately, none of the nightmare need come to pass, if LAC governments and the private sector **make a different set of choices.**
- **Backed by strong macro and fiscal positions**, governments take a more pragmatic and forceful trade policy stance, challenging China trade and industrial policy practices. The motto is **trade not aid.**
- China's **FDI** is led by the private sector and diversifies into **manufacturing and services** and operates under a strong **set environmental and competition safeguards**. Motivation is not tariff jumping but **transport cost and access to the local and U.S. market.**
- **China finance** continues to flow into the region to finance infrastructure, but under more transparent and market-led conditions. It moves away from badly managed economies.

Conclusions

- ✓Bilateral had boomed in the last years, driven by an exchange of commodities for manufacturing goods, with heterogeneous impact across the region.
- ✓Capital flows only came late in the cycle, and by in large reinforced the pattern of bilateral trade.
- ✓The commodity cycle and the slowdown in the Chinese economy brought trade to halt, but the fundamentals suggest this is just a cyclical adjustment and growth is likely to resume sooner rather than later, but a slower pace.
- ✓Moving ahead, LAC governments and firms have clear choice: reinforce some of the worrying trends of the *status quo* into a nightmare scenario..
- ✓…Or take a more pro-active stance to turn the bilateral relationship into a powerful force for sustainable growth.