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Latin American geopolitics

The dragon in the backyard

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Latin America is tilting towards China, Iran and the global "south"—and away from the United States

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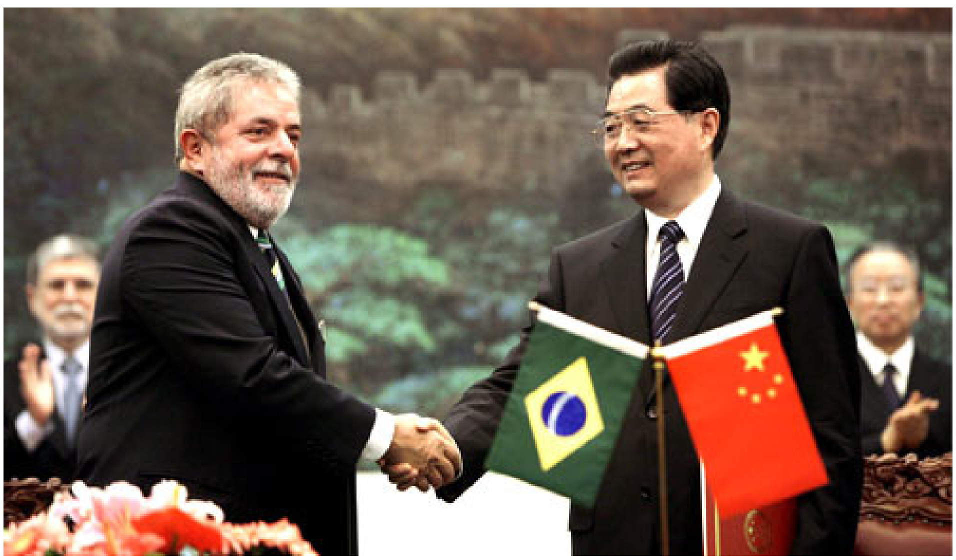
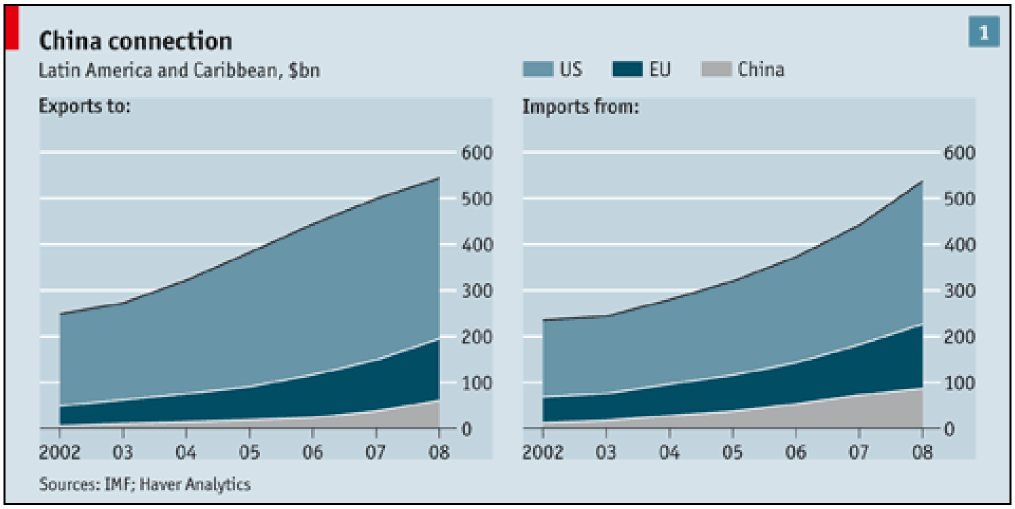


IF ALL goes to plan, by 2012 the first shipments of copper from Toromocho, a mine in the Peruvian Andes, will be sent by train and truck to a new $70m wharf in the port of Callao. From there, they will be shipped across the Pacific to China. The mine is being developed at a cost of $2.2 billion by Chinalco, a Chinese metals giant. Both it and the wharf will be the most visible symbols of the burgeoning trade and investment that are fast turning China into a leading economic partner for Peru and many other Latin American countries.

In the first six months of this year China became Brazil's biggest single export market for the first time (partly because Brazil's manufacturing exports fell sharply in the recession). During two days of talks in Beijing in May between Brazil's president, Luiz Inácio Lula da Silva, and his Chinese counterpart, Hu Jintao (pictured above), an agreement was signed under which the China Development Bank and Sinopec, a Chinese oil company, will lend Brazil's state-controlled oil company, Petrobras, $10 billion in return for up to 200,000 barrels a day (b/d) of crude oil for ten years from the country's new deep-sea fields. Weeks earlier China offered Argentina a currency-swap arrangement involving use of yuan worth $10 billion, and lent cash-strapped Jamaica $138m to enable it to stave off a debt default. Chinese companies have bought stakes in oilfields in Ecuador and Venezuela, and are talking of building a refinery in Costa Rica. This week China National Petroleum Corporation and CNOOC, another oil firm, were reported to have bid at least $17 billion for the 84% stake in YPF, Argentina's biggest oil company, held by Spain's Repsol.

It is not just China that is taking a much bigger interest in Latin America. So too, in different ways, are India, Russia and Iran. These developments are prompting some to declare the end of the Monroe Doctrine —America's traditional insistence, voiced by President James Monroe in 1823, that any meddling by outsiders in its hemisphere is "dangerous to our peace and safety". Never mind that *Yanqui* dominance has always been disputed by Latin American nationalists as well as by Europe, and never mind that the United States (and Europe) are still far bigger traders and investors in Latin America as a whole than China, let alone India or Russia (see chart 1). What is clear is that there are new and potentially powerful actors in the region.



Their arrival coincides with, and is partly a consequence of, two other developments. The first is the relative decline in the economic and political pre-eminence of the United States after its brief moment of unchallenged power at the end of the cold war. "The centres of power are shifting and the 21st century is about the Pacific," says José Antonio García Belaunde, Peru's foreign minister. More specifically, under George Bush the United States was widely held to have neglected Latin America because of more pressing priorities elsewhere, especially the "war on terror". That neglect has helped others to slip in.

The second factor is that many Latin American countries have become more self-confident and bent on asserting their diplomatic independence. That is either because they have achieved economic stability and more robust democracies, or because they have elected left-wing governments which, for ideological reasons, are seeking new allies. Both factors apply to Brazil, which under President Luiz Inácio Lula da Silva has sought a more powerful role as a regional power of global significance (see article).

The diversification of Latin America's economic ties has raised in some minds a nagging question: does it foreshadow geopolitical changes? In the United States some Republicans worry that China's growing economic weight poses a political threat. Hillary Clinton, the secretary of state, has noted that China and Iran are making "disturbing" gains in the region. But many Latin Americans prefer to see China's expanding ties to their region as an opportunity. The region, with Brazil in the lead, is forging "south-south" alliances with China, India, Russia and South Africa to push for changes in what they all see as an unjust world economic order.

But for Latin America two other questions may be just as important, if not more so. The first is whether the industrialisation of China and India is helping or hindering its own economic development. The second is whether growing economic and political ties with non-democratic countries such as China, Russia and Iran could undermine Latin America's own hard-won commitment to democracy.

From galleons to satellites

Economic ties between Latin America and Asia are not new. From the 1560s until 1815, a fleet of Spanish galleons made an annual epic voyage from the Mexican port of Acapulco to Manila in the Philippines, carrying silver and supplies and returning with Chinese silks and porcelain that were snapped up by the wealthy in colonial Mexico and Peru. In the 1970s Japan emerged as an important trader, investor and aid donor. But the suddenness and scale of the link with China (and to a much lesser extent India) are new.

The first, and still the biggest, impact is indirect. Chinese and Indian demand for raw materials has driven world prices for commodities (of which South American countries are big producers) to unprecedented levels. This played an important role in accelerating the region's rate of economic growth to an average of 5.5% from mid-2003 to mid-2008. Second, China's trade with Latin America has grown at an annual average rate of some 40% since 2003—faster than its overall trade. China has now become a significant market for countries such as Brazil, Chile and Peru.

The rise of China prompted much gloom in Latin America a decade ago. Since average wages in China are a fifth to two-fifths of those in Latin America, it was thought that much of the region's labour-intensive manufacturing industry would be wiped out. That is why Latin American countries have tabled more anti-dumping actions against China at the WTO than has the United States.

A decade on, some of those fears have been justified, but the picture is more positive. Researchers at the World Bank have found clear net gains for the region from the expansion of China. That is largely because of the commodity effect, but also because Latin American exporters have benefited from other countries growing richer by trading with China. The bank also found no evidence that foreign direct investment was being displaced from Latin America to China. Although Latin America has a trade deficit with China, its imports are increasingly of cheap machinery, which helps it to compete in other markets.

The pain has been focused in particular countries and specific industries. Although commodity exporters such as Chile, Peru and Brazil have clearly gained, Mexico and Central American countries have fared less well. For Mexico, one of the region's most industrialised countries, China is a competitor, especially in the American market, in industries ranging from textiles to electronics. Between 2000 and 2005, China's share of American clothing imports doubled, to 26%, while Mexico's fell from 14% to 8%. But some Mexican textile producers have fought back, either by exploiting their greater closeness to the American market or by improving their quality.

Nearly all Brazil's shoemaking and toymaking has been wiped out, or has moved to China. "It's impossible to compete against China in these sectors," says Roberto Giannetti da Fonseca of São Paulo's Federation of Industries. He cites Brazil's high labour taxes and interest rates as self-inflicted handicaps. Nevertheless, South America's new links to China have helped it to ride out the world recession relatively unscathed. Marcelo Carvalho of Morgan Stanley, an investment bank, points out that Chinese demand for commodities seems to have contributed significantly to faster economic growth, a stronger currency, and lower inflation and interest rates in Brazil.

While trade has boomed, Chinese investment in Latin America has hitherto amounted to less than meets the eye. That is in contrast to India, whose trade with the region remains modest, but whose companies have begun to make significant investments in software, pharmaceuticals, business software and natural resources. It did not help that in 2004 China's Mr Hu, on the first of two visits to the region, was misquoted as announcing planned investments totalling $100 billion over ten years. (In fact, he said he hoped two-way trade would reach that figure by 2010, and that foreign investment would double, both of which are likely.)

Pumping Venezuela's oil

Chinese investment has so far been overwhelmingly concentrated in mining and oil. (An early and still unusual exception is a joint venture with Brazil, dating from the 1980s, to produce communications satellites, in which China provides 70% of the finance and the technology.) Toromocho is just one of three big investments in copper projects in Peru. Chinese companies have become the biggest foreign investors in Ecuador's oil industry.

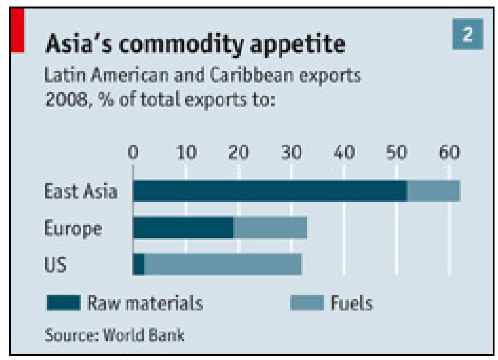
But it is China's stake in Hugo Chávez's Venezuela that is potentially most contentious. The China Development Bank has lent two-thirds of the capital for a $12 billion joint fund which Chinese companies could tap for investment projects in Venezuela. Most of these are likely to be in oil: CNPC, a Chinese company, is operating several smallish oilfields and is investing in the Orinoco tar sands.

The United States has long been the main foreign market for Venezuelan oil. Venezuela provides about 10% of American oil imports, and Petróleos de Venezuela (PDVSA), the state oil monopoly, owns Citgo, an American oil distributor which has several refineries specially adapted to process the country's heavy and sulphurous crude. This mutual dependence has long been a discomfort to Mr Chávez, and he has repeatedly said that he wants to divert Venezuelan oil to China (though transport costs would be much higher). So far Venezuelan oil exports to China have risen from a negligible level to 398,000 b/d. But PDVSA has announced that it wants to increase the flow to 500,000 b/d by December. That could be done only by reducing shipments to the United States.

In Africa, China's much larger investments in oil and mining have brought accusations from some quarters that it has created neo-colonial enclaves. But in Latin America, a more developed region, China is just one of many foreign investors. After a shaky start, Chinese companies seem to have become more sensitive to local concerns. Take Peru. The first Chinese investment was by Shougang, which bought an iron-ore mine in 1992. It brought in 350 Chinese staff, and acquired a bad reputation because of constant troubles with the Peruvian workforce. In contrast, points out Luis Chang, a former Peruvian ambassador in Beijing and a consultant to Chinese firms, Toromocho has just three Chinese managers and the CEO is a Canadian.

Mr Chang is one of some 3m Peruvians who claim Chinese descent, the largest such community in Latin America. (Around 100,000 Chinese coolies were brought to Peru as labourers between 1849 and 1875, and integrated well.) Peru has become only the second Latin American country after Chile to sign a free-trade agreement with China. Mr García Belaunde hopes this will encourage further Chinese investment, especially in sorely needed transport infrastructure, such as at Callao and other ports.

But the pattern of trade and investment so far reinforces the fear among some Latin Americans that China is causing the region to respecialise in commodities, as it did in the 19th century, to the detriment of industry. While China's exports to the region span a wide range of manufactured goods, its imports are highly concentrated in a few commodities (see chart 2). Soyabeans and iron ore account for two-thirds of Brazil's exports to China, and crude oil for a further 10%. (By contrast, Brazil's exports to the United States are mainly manufactures.) This specialisation is not necessarily damaging in itself. But as many branches of Chinese manufacturing overtake their Latin American counterparts, Latin American governments may start to place more stress on improving the competitiveness of the region's firms, partly through industrial policy.



Business and politics

Chinese officials insist that their closer relations with Latin America are driven by two things: a shared diplomatic interest in a multipolar world, and mutually beneficial economic and business ties. "We're not seeking special influence. We have reiterated [to the United States] that our relations with Latin America aren't a threat to anyone," says Qiu Xiaoqi, China's ambassador in Brasília. It is also of interest to China that half of the 24 mainly small countries around the world that still recognise Taiwan rather than China are in Latin America and the Caribbean.

Despite a flurry of presidential and ministerial visits in both directions, and mounting mutual curiosity, China and Latin America are hardly close. There are no direct flights between the two. Few Chinese are knowledgeable about the region (Mr Qiu speaks no Portuguese, though he is one of the relatively few Chinese diplomats who speak Spanish). But sooner or later China's economic involvement in Latin America seems certain to have geopolitical ramifications, requiring it to make choices. That is because of political developments within Latin America, and in particular the rise of more or less anti-American governments in some countries.

Venezuela under Mr Chávez has sought closer ties not just with China but also with Russia and Iran. During the cold war the Soviet Union bankrolled Cuba for almost three decades, and supported left-wing movements and governments throughout the region. Last year Dmitry Medvedev became the first Russian president since those days to visit Latin America. Russia also sent a small naval flotilla to the Caribbean for joint exercises with Venezuela and Cuba. This was a tit-for-tat gesture after the United States sent ships to support Georgia after its brief war with Russia last summer.

Russia's abiding interest in Latin America is focused on arms sales. Between 2005 and 2008 Mr Chávez bought Russian weapons worth $4.4 billion, including 24 Sukhoi fighters. As the oil price sank last year, shrinking Mr

Chávez's kitty, Russia offered a $1 billion credit line for further arms purchases. This month Mr Chávez said he would seek "battalions of tanks" from Russia on his next visit to Moscow, in response to an agreement letting America use military bases in neighbouring Colombia. But his most worrying purchase was of 100,000 Kalashnikov automatic rifles and a production line to build more. Colombian officials fear that some of these rifles will end up with the FARC guerrillas.

Mr Chávez has also gone out of his way to court his Iranian counterpart, Mahmoud Ahmadinejad. In 2007, in Tehran, he joined the Iranians in declaring an "axis of unity" against the United States. There has been talk of nuclear co-operation. Venezuela and Cuba, along with Syria, were the only countries to support Iran's nuclear programme in a vote in 2006 within the United Nations' International Atomic Energy Agency. Mr Ahmadinejad has made two visits to Latin America, taking in Nicaragua, Ecuador and Bolivia, as well as Venezuela on both occasions. His government has opened embassies in Chile, Colombia, Ecuador, Nicaragua and Uruguay. Under an investment programme sponsored by the two governments, Iranian firms are making tractors and cars in Venezuela, and building housing for the poor.

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Chávez and Ahmadinejad, bosom pals

Iran this month offered Bolivia a loan of $280m, in addition to spending $200m on building two cement factories and three milk facilities. Mr Ahmadinejad also promised Nicaragua $1 billion in aid, and Iran has announced plans to invest in Ecuador's oil industry. But as with many of Mr Chávez's announced investments, little cash seems to have been disbursed.

Iran's cultivation of radical Latin American governments appears aimed partly at securing diplomatic allies in international bodies, while irritating the United States. Some analysts see a more sinister dimension, pointing to the presence in Venezuela of sympathisers with Hizbullah, the Lebanon-based Shia militia. An Argentine judge, with government backing, has issued arrest warrants for seven Iranian officials and a member of Hizbullah in connection with the bombing of the Israeli embassy in Buenos Aires in 1992 and of a Jewish community centre two years later that killed a total of 114 people and injured more than 500. But there is no firm evidence of a continuing and active Iranian-inspired terrorist presence in the region.

For China, the international entanglements of Mr Chávez and his friends are a complication rather than an attraction. "China is not very interested in radicalisms," says Pan Wei, a political scientist at Peking University's School of International Studies who recently spent a sabbatical term at Lima's Catholic University; "China is not going to stir up political troubles in this area, nor have a military presence." He points out that China forged warm relations with Chile during the dictatorship of General Augusto Pinochet.

China makes much of its pragmatic, non-judgmental approach to foreign affairs. But that might just set it on a collision course, in which it has to choose between its strategically vital relationship with the United States and Venezuelan oil. Expect it to do everything possible to avoid being faced with such a choice.

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