

The New Challenge: China in the Western Hemisphere

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Mr. Chairman and Members of the Subcommittee:

I am honored to appear before you today to discuss the challenge of China's growing presence in the Western Hemisphere. In my view, the short and medium term challenge that the United States government faces vis-à-vis the expansion of China's influence in the Western Hemisphere is - and will remain - economic rather than diplomatic or geopolitical.

Even if China had the capacity to project hard power to the Americas, which it does not have nor will it be able to develop in many years (China's tough neighborhood means that the types of hard power it will continue to develop will remain a function of the challenges it faces vis-à-vis Russia, Japan, and India, not to speak of its own internal political troubles), its top priority in the Western Hemisphere is and will remain having a good relationship with the United States. China has much more to lose from alienating the United States than it has to win from strengthening its standing in the Americas. Instead, China has chosen to exercise soft power in the region. Two channels have been used to project this type of power. By far the most important one has been the economic channel in terms of trade and investment promises. The other channel has been diplomatic-cultural and it has been propelled by expanding Chinese embassies, consulates and Confucius cultural centers in the region. Neither of these two channels of influence threatens or jeopardizes the standing of the United States in the region because trade and diplomacy need not be zero-sum games.

In the diplomatic-cultural arena, however much educated Latin Americans admire China's millennial culture and achievements, the region will remain firmly a member of the Atlantic family, sharing its alphabet, its political traditions, and many of its social and cultural mores with Europe and the United States. Additionally, Latin Americans remain distrustful and in fear of over-centralized rule - like China's - given the region's own distant and recent historical experience with unaccountable politics and its corollaries, i.e. human rights' abuses, corruption, economic irrationality, and official impunity. Latin Americans don't want to revisit their political past and therefore China is not a political model that they would like to embrace. On the contrary, what they desperately want is to strengthen their young and still fragile democracies. Therefore, by far the most important policy that the United States can and should promote in Latin

America's diplomatic-cultural arena is strengthening liberal democracy. It's now widely accepted that the United States largely disengaged from the Western Hemisphere after 9/11. Cynics say that in fact nothing could be better for Latin America: better to go unnoticed than to be at the center of United States' policy designs. Of course what this view does not take into account are the high opportunity costs that Latin America incurs when it becomes disengaged from the most powerful country, the largest market, and the most advanced science and technology hub in the world. Of greater concern than the views of political cynics, which in any case remain a small minority, are public opinion surveys that show concern by a majority of Latin Americans regarding the fact that even when the United States engages the region, it does so in negative ways. Thus, the issues that continue to dominate Latin Americans' views of United States engagement in the region are the recurrent verbal spats with President Chávez of Venezuela, continued military aid and training in Colombia, and the continuation of the Cuba embargo.

Most Latin American countries and the United States are members of the world's family of democracies. China is not. Therefore, the United States should promote decidedly the strengthening of liberal democracy in Latin America as a matter of tactics as well as principle. This objective should be promoted not only through the traditional channels such as the Inter-American system or bilateral relations, but also through an explicit program that gives visibility to the United States' government commitment in helping to advance this goal. For all their unattained aims and serious shortcomings, Latin Americans still remember FDR's Good Neighbor Policy and JFK's Alliance for Progress as high tides of constructive engagement. Nostalgia in the region for such type of engagement should be enough for U.S. policymakers to realize that there is appetite for re-engagement, but one that has democracy at the core.

Regarding the growing economic presence of China in Latin America, an argument can be made that this is in fact in the interest of the United States because what this country has to face south of its border is the most unequal region in the world. Whereas this fact should not necessarily represent a problem, inequality has become strongly politicized throughout Latin America since the early 2000s in a way that has produced a backlash. This backlash has been characterized by the rise of democratically elected governments that promise short-term redress and redistribution by undoing the free market policies that the United States and international multilateral institutions

recommended in the 1980s and 1990s (the so-called 'Washington Consensus'). Regardless of how accurate the critique of the 'Washington Consensus' is (i.e. free market reforms in Latin America have had a mixed record, for example helping to bring down the region's previously high inflation rates, but also wiping out jobs in small and medium sized enterprises and concentrating economic activity in few areas), the fact remains that majorities or big minorities of voters throughout Latin America think the outward-oriented model did not deliver on its promises, and therefore must be changed.

Chinese economic engagement in Latin America proves that a commitment to open economies can yield benefits to the latter. Latin America has enjoyed its fastest five-year period growth (2003-2007) since the late 1960s thanks to commodity exports, growing proportions of which have been going to the booming economies of Asia - first and foremost China, but also Japan, South Korea and India. The fast-industrializing Asian giants now consider the supply of raw commodities a matter of national security, and therefore the Western Hemisphere has become their latest region of interest (first came Southeast Asia and then Africa and the Middle East). The so-called 'super cycle commodity boom' that raw materials' exporters have enjoyed since 2003 has translated into several benefits for Latin American economies, which are also in the interest of the United States. First, high windfall gains from commodities' exports have allowed countries to strengthen their fiscal positions by redeeming outstanding external debts, bringing down borrowing costs and creating bond markets in domestic-denominated currencies. These trends are behind the recent investment grade attained by Peru and Brazil. These developments are in the interest of United States banks and businesses, which will find it easier to engage in productive activities in Latin America thanks to stronger, more liquid financial markets in the region. A sound fiscal position and deepening financial markets in Latin America are also in the interest of the United States government because the development of domestic bond markets reduces the likelihood of speculative attacks, macro-devaluations, and the concomitant costs of bail-outs, in some of which the United States has been forced to participate. Second, higher outward-oriented output in Latin America has produced spillovers into the domestic economies, which have translated into higher consumption and savings for the growing lower middle and middle classes. This trend has been facilitated by another China-related factor, namely, the cheap availability of consumer products, many of which used to be the preserve of the upper middle and upper classes in Latin America. The

availability of consumer goods plus the rise of credit markets for poorer sectors in the region is not a silver bullet that will remedy the complex challenge of underdevelopment in Latin America. However, it is an important trend that can act as a cushion against the wholesale attack against free markets that has come to dominate politics in many of the region's countries. China's appetite for raw materials has been partly responsible for the rise of this trend and Latin American economies have benefited from it.

This is not to say that Chinese economic engagement with Latin America has not produced drawbacks. As in most trade relationships there have been winners and losers. The best way to appreciate which Latin American countries have benefited and which have not is by comparing their economic structures with both the United States and China (figure below), and then relating them to countries' exports destinations and the products included in their exports' baskets.

Source: Data elaborated from World Trade Organization (WTO), Statistics database, Trade profiles,
<http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=AR,BR,CL,CN,MX,PE,US>

Countries that mostly export mining commodities like Chile and Peru are the most complementary with China given this country's overwhelming manufacturing export base and its rapid urbanization. Similarly, Brazil and Argentina's strong agricultural export base also makes these sectors complementary given China's rapid demand growth for foodstuffs. The high growth of copper, iron, zinc, tin and other minerals, and of soybeans and other foodstuffs' exports from these Latin American countries to China in the last five years corroborates that their economies are complementary in these sectors. There is a caveat however because whereas Chile and Peru have very small manufacturing export bases, Brazil and to a lesser extent Argentina have bigger ones that compete directly with China in sectors such as textiles/apparel, furniture, toys, and footwear. Moreover, the real threat to these sectors is not necessarily their dwindling foreign markets because at the end of the day Brazil and Argentina's real prowess as exporters still lies in raw commodities (except for Brazil's heavy manufacturing base which includes the auto industry and aeronautics). The real threat has been for Brazilian and Argentinean manufacturers whose natural markets have been traditionally domestic, and whose products have been displaced by cheaper Chinese imports.

Of all the big Latin American economies, Mexico's has been the hardest hit by the Chinese manufacturing juggernaut. It is not only that Mexico's export structure resembles China's more than any other Latin American country, but also that both countries compete with a similar export basket of goods for the same market, namely, the United States. In addition, Mexican manufacturers have been losing market share not only in the United States, but also, like their Brazilian and Argentinean peers, domestically. Central American countries with growing manufacturing sectors, mainly concentrated in textiles and apparel like the Dominican Republic, El Salvador, and Honduras, have also been squeezed. Regarding the United States itself and despite its similarity with China's exports' structure, they do not compete because their export baskets and destinations are fundamentally different. United States manufacture exports are concentrated at the top-end of the value chain whereas China's remain at low and intermediate levels.

Given the strategic and long term interests that the United States has in its most proximate vicinity, including Mexico, Central America and the Caribbean, and given

that losers in the China-Latin America economic relationship concentrate in this area, the American government should promote higher growth, job creation, and compensatory schemes in this region. The institutional frameworks of NAFTA and CAFTA would be ideal vehicles to reach agreements that promote such aims. We cannot forget that mass illegal immigration to the United States, a large majority of which comes from Mexico, Central America and the Caribbean, is a function first and foremost of a lack of economic opportunities in these countries. The less capable these economies are in competing with rising giants such as China and India, the more pressure there will be on the ground to migrate to the United States (and if this is not possible then to organize, protest and follow the lure of populist politicians, who promise short term redress and radical redistribution).

Lastly, regarding the issue of energy resources in the Western Hemisphere and potential competition between China and the United States to secure such resources, the conventional wisdom has it that a China-Venezuela partnership would be to the detriment of American energy security. This proposition is false on two counts, economically and politically. Economically, it makes no sense (nor will it make anytime as long as oil remains a fungible commodity) for Venezuela to ship heavy crude to China. The bulk of heavy refining capacity remains in the Gulf of Mexico coast of the United States. Even if China started investing in heavy refining infrastructure, the likelihood that this line of investment could become dominant is very low because most of China's oil import bill is made up of light crude shipped from the Middle East and Africa. Why invest in a venture that requires massive installation costs plus higher transport costs when the current alternative is the most cost effective? Politically, China will continue to tread very carefully in Latin America for fear of alienating the United States. This does not mean that the Chinese will forgo investment and commercial opportunities in places that have caused some concern in some American circles such as Venezuelan and Ecuadorean oil, the Panama Canal, or the Manta base in Ecuador. The same political logic will continue to apply to these and to other similar ventures. Chinese firms will bid for projects in the region but they will do so in the same fashion as Japanese, South Korean, Spanish or Canadian firms do, that is, as strict commercial ventures only. Moreover, given China's awareness about the potential to alienate the United States if it pushes into Latin America as aggressively as it has in, say, Africa, Chinese bids and real commercial commitments (as opposed to those simply expressed)

in Latin America will remain smaller and more low profile than those of other Asian or European countries.