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Strictly Business? An Examination of China's Natural-Resource Acquisition Strategy in Latin America

By Juan Andrés Camus, Jane LePham, Roshan Shankar, and Kenny White

Over the past 30 years, China has experienced unprecedented economic growth, yielding an average GDP growth rate of 13.04 percent between 1979 and 2012, according to World Bank data. While China has followed an “export-driven” strategy to sustain its economic growth, the country’s domestic resource constraints have forced it to acquire vast amounts of resources from abroad. To this end, China has strategically engaged and strengthened its commercial ties with resource-rich regions, like Africa and Latin America. This policy brief focuses on China’s relationship with Latin America and, specifically, its natural-resource acquisition strategy in the region.

Resource Acquisition: China’s Economic Strategy

In 2011, China became the second largest importer of resources in the world (\$1.74 trillion) behind the United States (\$2.31 trillion).¹ The country’s rapid industrialization requires a large import of commodities because domestic supply cannot satisfy demand. While China’s rapid growth has generated high levels of export expansion and technological development, this boom in production and exports has also accompanied a shift away from raw-material production.² This structural

¹ UN Commodity Trade Statistics Database

² Exports of raw materials and natural resource-based products fell from 49 percent of total trade in 1985 to just 11 percent in 2008. Manufacturing and value-added products now drive China’s economic growth, with the export of these products growing at more than 10 percent annually.

constraint now forces China to rely on resource-rich countries around the world to sustain its economic growth. The country’s immense need for natural resources, energy-related resources, and agricultural food products forms the cornerstone of its resource acquisition strategy.

China’s acquisition of commodities, however, is more complex than a commercial relationship with a few resource-rich regions. In order to ensure long-term resource security and sustain its economic growth, China has employed an overarching strategy of diversification. This strategy has been well documented,

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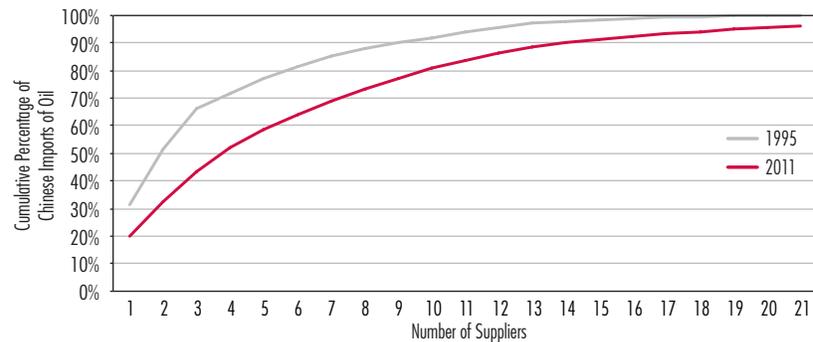
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especially in the fossil fuels arena. China's acquisition of other commodities, such as iron ore and copper, also relies heavily on portfolio diversification. Figure 1 shows how China has diversified the number of major suppliers for its oil imports; over the past 15 years, China has significantly increased the overall number of countries from which it imports oil, particularly small suppliers with high growth potential. We observe identical trends for its imports of other commodities, like iron and copper. Among other major importing countries in Asia, like South Korea and Japan, however, we observe the opposite trend (Figures 2 and 3). Unlike China, these countries' import portfolios have either remained unchanged or become less diversified over the same time period.

China's Interest in Latin America

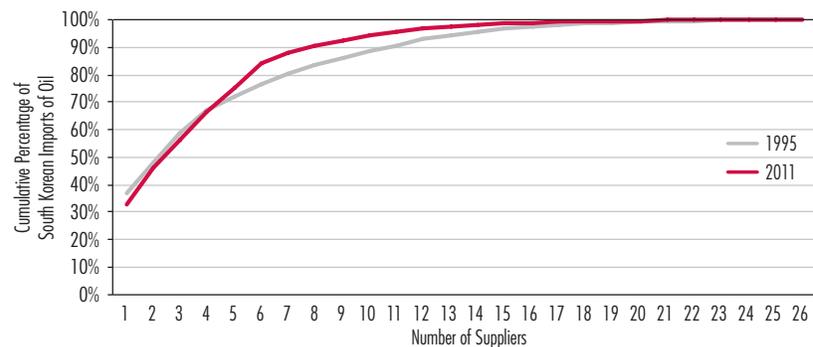
Resource acquisition has become a cornerstone of China's trade and investment in Latin America, especially as it copes with domestic resource constraints that Latin America, one of the most resource-rich

Figure 1
Portfolio Diversification of China's Oil Imports (1995-2011)



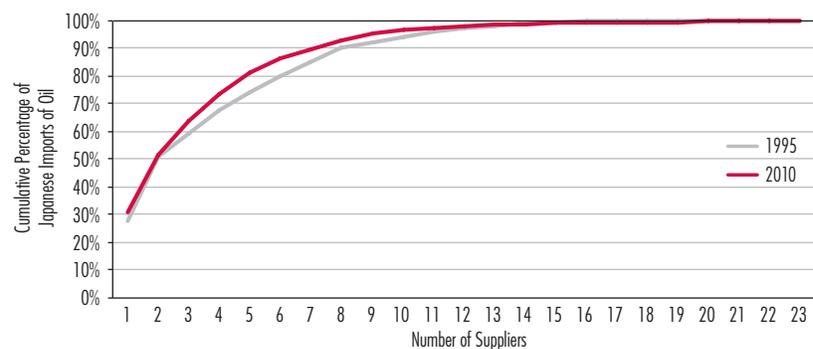
Source: UN Commodity Trade Statistics Database

Figure 2
Portfolio Diversification of South Korea's Oil Imports (1995-2011)



Source: UN Commodity Trade Statistics Database

Figure 3
Portfolio Diversification of Japan's Oil Imports (1995-2010)³



Source: UN Commodity Trade Statistics Database

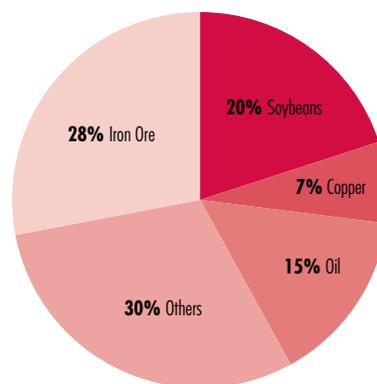
³ This figure excludes 2011 data for Japan. Following the Fukushima Daiichi nuclear meltdown in 2011, Japan began to rely much more heavily on fossil fuel imports, which may have affected the country's ability to diversify its oil portfolio.

regions in the world, can help mitigate. The growing importance of Latin America to China is evident in their trade patterns. From 1995 to 2011, annual trade between China and Latin American countries grew 29.6 percent annually—from \$4 billion to \$253 billion. In other words, trade has more than doubled every three years. As a result, China has emerged as Latin America's third largest trading partner; only the United States and the European Union, whose bilateral trade with Latin America in 2011 totaled \$716 billion and \$280 billion, respectively, were larger trading partners.⁴

Much of China's interest in Latin America, particularly in South America, is economically motivated, with China eager for access to primary resources in order to meet the demands of its booming economy. Trade between China and Latin America thus remains highly concentrated in resource-rich countries. Oil, copper, iron, and soybeans comprise the leading exports from Latin America to China, representing 70 percent

of the total exports to China in 2011, and come from five main countries—Brazil, Peru, Chile, Venezuela, and Argentina (Figure 4). Given the sheer scope of trade in these four commodities, identifying China's strategy to acquire these resources is essential to understanding its future engagement in Latin America.

Figure 4
Distribution of Exports from Latin America to China (2011)



Source: UN Commodity Trade Statistics Database

FTAs, Loans, and FDI: China's Engagement Strategy in Latin America

China has used three economic instruments to engage Latin America and gain access to critical resources: free trade agreements (FTAs), development loans, and foreign direct

investment (FDI). These three instruments have allowed China to orchestrate a multifaceted approach that it adapts to global commodity markets and to the internal dynamics of commodity exporters. Table 1 summarizes China's use of each instrument in Latin America.

Free-Trade Agreements

China has used FTAs to reduce trade barriers and to open market access, thereby allowing its state-owned companies to extract resources. China's copper-focused FTA with Chile, for example, coincided with a promise by Codelco, the Chilean state-owned mining company, to sell 55,750 tons of copper ore to China annually.⁵ Peru also signed an FTA with China that opened its vast untapped copper reserves to Chinese investment.

While China's FTA negotiations with Chile and Peru focused on satisfying its resource demands and reducing policies that seemed most detrimental to market access, its eagerness to

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⁴ UN Commodity Trade Statistics Database

⁵ Bárcena, Alicia, Antonio Prado, Mario Gimoli and Ricardo Pérez. "Foreign Direct Investment in Latin America and the Caribbean, 2011." ECLAC, United Nations Briefing Paper.

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Table 1
Economic Instruments and Commodities Matrix

Country	Commodity	Investment Instruments			Notable Chinese SOEs ^a	Description
		FTA	Loans	FDI		
Argentina	Oil		•	•	China Petrochemical Corporation, CNPC, CNOOC	Generic development loans for capital infrastructure projects; acquisition of Argentina-based oil operations.
	Soybeans			•	Beidahuang Group	Investment for irrigation infrastructure, in exchange for exports.
Brazil	Oil		• ^b	•	Sinopec, Sinochem, COFCO Group, CNOOC	Generic development loans for capital infrastructure projects and transportation; oil-backed loans for credit crisis; acquisition and JVs for existing operations.
	Iron			•	Wuhan Iron and Steel Group	Financing for JVs.
	Soybeans			•	Chongqing Grain Group, Ltd.	Investment for construction of industrial base.
Chile	Copper	•		•	China Minmetals	Use of FTA to systematically increase Chinese stock of copper in exchange for tariff concessions; JVs with domestic firms.
Peru	Copper	•	•	•	Shougang Hierro Peru	Use of FTA to systematically increase Chinese stock of copper in exchange for tariff concessions; generic infrastructure loan for mining equipment; JVs with domestic firms; general infrastructure investment.
	Iron			•	Capital Steel	Infrastructure investment; acquisition of existing operations.
Venezuela	Oil		^b	•	Sinopec, CNPC, CNOOC	Oil-backed loans for poor credit history and political instability; state-sanctioned strategic partnership; JVs with domestic firms.

^a Not intended to be a comprehensive list of Chinese SOEs in Latin America.

^b Denotes the specific use of oil-backed loans.

secure steady access to copper compelled it to accept two lopsided agreements in which China agreed to unequal tariff reductions.⁶ China's use of FTAs in Latin America demonstrates a unique pattern: China is not only using FTAs in pursuit of commodities, but it is also willing to make compromises in order to secure deals with long-term dividends.

Loans

Development loans also play an important role in China's strategy. Between 2005 and 2010, Chinese banks loaned an estimated total of \$75 billion to Latin America, extending \$37 billion in loan commitments in 2010 alone.⁷ China's loan commitments in 2010 were more than the total loan commitments made to Latin America by the World Bank, Inter-American Development Bank, and the U.S. Export-Import Bank combined for that year.

⁶ Chile gained duty-free access for 92 percent of its exports while China only gained duty-free access for 50 percent of its goods going to Chile. Peruvian negotiators reduced tariffs on 99 percent of Peru's exports to China, 83.5 percent of which entered the Chinese market duty free at the outset of the agreement. In return, 68 percent of China's exports to Peru were granted immediate duty-free access.

⁷ China's loan commitments to Latin America have increased exponentially since 2005, reaching a high of \$37 billion in 2010. Reliable estimates of China's loan commitments in 2011 are unavailable at this time, as Chinese banks rarely publish figures detailing their loan activities.

In order to facilitate resource acquisition, China uses two types of loans: infrastructure loans and energy-backed loans. Infrastructure loans fund projects that either directly or indirectly facilitate resource extraction. For example, the Beidahuang Group, an agricultural investment firm, loaned \$1.5 billion to retrofit a harbor near the newly developed Chinese soybean farm in Argentina's Rio Negro province. Chinese banks, meanwhile, use energy-backed loans to aid the country's quest for a diversified energy supply. In these loans, a line of credit is extended to a domestic oil company and interest payments are paid back directly in oil shipments to China. Energy-backed loans, which comprise two-thirds of all Chinese loan commitments in Latin America, have been used primarily in Venezuela and Brazil.

Foreign Direct Investment

Foreign direct investment (FDI), mergers and acquisitions (M&A), and joint ventures (JVs) form the third set of investment-based instruments that Chinese firms use to acquire natural resources. Chinese firms consider FDI and M&A particularly attractive because they allow

these firms to gain an equity stake in future production, which vicariously grants China a claim over Latin American resources. In addition to fostering resource acquisition, each of these instruments (FDI, M&A, and JVs) allows firms to gain local knowledge and influence because they are actively involved in ground operations.

Direct investment into Latin America from Chinese firms alone totaled \$15 billion in 2010, which was more than double the aggregate amount invested between 1990 and 2009. During this period, Chinese firms were most active in acquiring resources from the mining and oil industries. Since 2009, for example, aggregate investment in oil production has totaled \$13 billion; and although the mining industry has received only \$3.5 billion over the same time period, Chinese firms have allocated \$15 billion for future investment, particularly in Peru. Planned aggregate investment in Peru's underdeveloped mining sector totals \$8.6 billion.⁸

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⁸ Bárcena, Alicia, Antonio Prado, Mario Gimoli and Ricardo Pérez. "Foreign Direct Investment in Latin America and the Caribbean, 2011." ECLAC, United Nations Briefing Paper.

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Characterizing China's Strategy in Latin America

Overall, China's strategy is highly adaptive and coordinated across instruments. FTAs, loans, and FDI have allowed China to acquire resources in a variety of different circumstances. FTAs in Peru, for example, have enabled Chinese firms to take advantage of the country's underdeveloped copper reserves and position themselves for future growth. In particular, the Chinese government was able to negotiate an FTA with Peru because the country was small and did not have a large manufacturing sector. Now, as a result of the FTA, China is positioned to import large amounts of copper without paying tariffs. In Venezuela, Chinese banks have provided the country with badly needed credit and, in turn, given Chinese national oil companies (NOCs) the opportunity to secure future oil supplies. Because of the close diplomatic relationship between China and Venezuela, the China National Petroleum Company (CNPC) now has control over five percent of oil production in Venezuela. In Brazil, Chinese oil

firms have also taken advantage of cheap credit from the China Development Bank (CDB) and purchased equity stakes in JV operations with multinational oil companies. These investments will improve the technical acumen of Chinese NOCs and grant them access to one of the largest untapped oil fields in Latin America.

China's Strategy in Global Perspective

A comparative analysis shows that China's use of FTAs, loans, and FDI in its pursuit of natural resources differs significantly from the strategies employed by the rest of the world, especially Western countries and institutions. For example, China has employed a commodity and market-access based agenda when negotiating FTAs, while the United States has focused more generally on economic liberalization. With loans, Chinese banks have diverged from lending patterns exhibited by the World Bank (an institution *de facto* controlled by the United States), focusing much more heavily on infrastructure lending without loan conditions. Chinese banks have also made

an unprecedented amount of oil-backed loans to Latin American countries. Although Chinese firms appear to operate similarly to other multinational corporations, the country as a whole has focused heavily on investing in natural-resource extraction. Overall, we conclude that China's tactics toward acquiring natural resources in Latin America are not standard when compared to the region's other trading partners. Moreover, we find that, in many ways, these methods are a departure from the status quo and are unique to China.

We observe several patterns in China's tactics that extend across its three investment instruments. First, China's resource-acquisition strategy in Latin America exhibits many of the characteristics of a South-South relationship, with unique characteristics.⁹ Second, China is willing to make compromises and tradeoffs in its pursuit of commodity markets over the long term. And finally, China has parted with a purely free-market driven strategy and, instead, relied on more mercantilist approach.

⁹ South-South relations are defined as exchanges between developing nations (e.g., China and Venezuela). North-South relations are exchanges between a developed nation and a developing nation (e.g., the U.S. and Mexico).

Conclusion

Over the past 10 years, economic ties between Latin America and China have deepened tremendously, as China has turned to the region to address its domestic resource constraints. China has relied on three economic instruments to acquire natural resources in Latin America: FTAs, loans, and FDI.

Overall, China's long-term strategy and engagement indicates that the rising superpower will be a force in Latin America for years to come. Given the region's close proximity and economic importance to the United States, U.S. business leaders and policymakers must accept China's presence in Latin America and better understand its motivations.

About The Authors



Juan Andrés Camus is originally from Chile and currently is pursuing a joint MBA/MPP degree at Stanford University. He received his B.A. in Business Administration and Economics from Universidad Católica de Chile in 2006, where he also served as the President of the Student Association. Prior to Stanford, Juan served as the Chief of Social Affairs for Un Techo para mi País, an NGO fighting extreme poverty in 19 Latin American countries; the development manager of Patagonia Sur, a for-profit conservation initiative in the Chilean Patagonia; and a member of the emergency team formed by the government of Chile after the 2010 Chilean earthquake.



Jane LePham is currently completing her Master of Arts degree in Public Policy, with a concentration in financial policy analysis. She also received a B.A. in Public Policy from Stanford University. Jane has held a variety of research and internship positions, including work at the Stanford Graduate School of Business, the Stanford University Department of Political Science, the Federal Reserve Board, and the U.S. Securities and Exchange Commission. This past summer, Jane worked as an investment-banking analyst for the Public Finance group at Barclays Capital, where she will return upon graduation.



Roshan Shankar is completing a joint M.S./MPP degree in Management Science & Engineering and Public Policy, where his interests lie in policy analysis and the implementation of government programs. He currently serves as the Social Sciences representative and the Secretary of the Graduate Student Council of Stanford University. Roshan has completed internships at the MIT Poverty Action Lab, The Economist Intelligence Unit, and IBM India. He holds a Bachelor of Engineering degree in computer science from the Netaji Subhas Institute of Technology in Delhi, India. After graduation, he would like to work in government and possibly run for elected office in India.



Kenny White is a Master of Public Policy student concentrating in international policy. He received his B.A. in Economics from Stanford University in 2011. Kenny currently serves as a teaching assistant for the Introductory Economics Center at Stanford and recently held a Stanford in Government (SIG) fellowship with the Ministry of Finance and Economic Development in Mauritius, where he worked with the finance secretary to examine factors that underlie growth and strong economic performance in Sub-Saharan African countries. Post-graduation, Kenny hopes to find his way abroad to pursue career opportunities in international development.

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