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Chinese Money, Institutional Weaknesses, and Populism: A Recipe for Disaster?

The expansion of Chinese commercial activities in Latin America and the Caribbean raises questions.

R. Evan Ellis*, Latin America research professor with the U.S. Army War College Strategic Studies Institute. | 9 November 2018



Salvadoran Foreign Minister Carlos Castaneda (L) and Chinese Foreign Minister Wang Yi take part in a signing ceremony to establish diplomatic relations, in Beijing on August 21, 2018. (Photo: Wang Zhao, AFP)

On September 7, 2018, the U.S. ambassadors to El Salvador and the Dominican Republic, and the U.S. charge d'affaires to Panama met in Washington D.C. to discuss the recent decision by those three countries to switch their diplomatic relations from the Republic of China (Taiwan) to the People's Republic of China (PRC). Following the meeting, the U.S. State Department issued a strong statement: that it would consider suspending the visas of officials in such countries where there was evidence they had engaged in corruption or other criminal acts, including commercial contracts and other deals with their new PRC-based partners.

The expansion of Chinese commercial activities in Latin America and the Caribbean, including over \$150 billion in loans to the region, and \$114 billion in equity investment, has thrust the behavior of PRC-based companies in the region into the spotlight. The challenges of corruption and other questionable activities in public contracts in the region long pre-date recent Chinese engagement. Nonetheless, the irregularities involving projects with PRC-based entities are striking, particularly in Venezuela and Bolivia, and previously Ecuador and Argentina, as well as within governments with limited resources, such as those of Central America and the Caribbean.

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Examples include uncompleted railroads and factories and massive purchases of Chinese appliances in Venezuela, loans-for-oil contracts with lucrative intermediation fees in Ecuador and Venezuela, and the empty "City of Knowledge" built by Chinese contractors in Ecuador. Others include unaddressed flaws in the country's massive (supposedly completed) Coca-Cola Sinclair hydroelectric facility, a broad array of questionable contracts in Bolivia, an unproductive paper mill, a zinc smelting facility in Potosi, delay-plagued road and bridge projects awarded to the Chinese firms Vicstar and Sinohydro, and the construction of a rail line from Montero to Bulo Bulu (in which both Chinese contractors had to be fired).

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Beyond the populist socialist regimes, examples of irregularities include the granting of lucrative real estate by the Jamaican government to China Harbor Engineering company for construction of a highway, and most recently, a series of questionable projects in Panama, including failure of Chinese business groups to stop construction on a port despite a court order, uninvestigated labor law violations involving the same port, the awarding of a construction contract for the fourth bridge over the Panama Canal under questionable circumstances, and the use of public monies to pay for a cruise ship terminal and possibly a \$5.5 billion cross-country train, although neither were identified in the national development plan.

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As the Lava Jato scandal in Brazil has shown, no country in the hemisphere is immune to public corruption. Nor are Chinese companies the only entities which may be engaging in corrupt practices. The preference of Chinese companies for government-to-government deals and the building of personal relationships are not always corrupt. There are, however, strong tendencies for the pursuit of interests by PRC-based companies in both populist socialist and small states of the region to fuel public corruption and deals that benefit the Chinese, and the personal interests of the local elites involved, while harming the interests of the country and the health of its democratic institutions.

With respect to leftist populist regimes, the turn away from the West has placed additional importance on Chinese loans and investment as alternative revenue streams, while the character and political orientation of their populist leaders has made them receptive to negotiating government-to-government deals with their Chinese counterparts, rather than using conventional sources of financing and procedural mechanisms. At the same time, the consolidation of power by those populist governments increases the risk of abuse by transforming institutions and undermining or eliminating previously existing (if flawed) mechanisms for oversight, as well as checks and balances on power through democratic opposition.

The weakening or disappearance of such institutions, which also provided technical advice, further undermined the ability of populist regimes to negotiate effectively with the Chinese to secure a good deal for their countries. The associated erosion of transparency and oversight also expanded options for Chinese organizations to court populist elites through particularistic favors in exchange for arrangements that benefitted the Chinese more than the populist government.

As with populist regimes, other countries in the region such as those in the Caribbean and Central America are also highly vulnerable to the Chinese style of wooing elites with particularistic benefits, albeit for different reasons. On one hand, the small size of their populations and economies magnifies the temptation of even modest-sized Chinese loans or investment, often offered with relatively limited delays and few political or fiscal conditions, but substantial conditions involving the use of Chinese contractors, workers, materials and equipment.



Honduran engineer Fabricio Lobo points at the construction site of the Patuca III hydroelectric plant, 180 km east of Tegucigalpa, on March 20, 2018. The project is being built by Chinese state-owned company Sinohydro with an expected cost of \$347 million, and at least 150 Chinese citizens work there among engineers and other personnel. (Photo: Orlando Sierra/AFP)

The small size of the local market and often high levels of public indebtedness of Central American and Caribbean nations makes the offer of Chinese money yet more attractive for local governments starved for easy alternatives. Making matters worse, the small bureaucracies of those nations are often grossly out-resourced by their Chinese counterparts, open to making exceptions in public procurement practices and vulnerable to corruption.

With so many advantages, the Chinese are not only effective in winning projects, but also in protecting their own interests in dealing with regimes of limited capability and projects of questionable economic logic. In addition to the common Chinese practice of securing sovereign guarantees for such projects through government-to-government deals, the Chinese employ an array of bureaucratic protective measures, from securing loans through commodities contracts in the case of "oil-for-loans" deals in Venezuela and Ecuador, or sophisticated default clauses, such as that used to secure control over the Baha Mar hotel project from local partner Sarkis Izmirlan in a Hong Kong court when performance deficiencies by the Chinese builder drove the project into bankruptcy. In doing business with socialist-populist nations, the Chinese "win-win" approach means that the Chinese win even the most questionable projects to then establish the bureaucratic conditions to "win again" if it fails.

The risk posed by the interaction between the Chinese style of engagement and the vulnerabilities of their Latin American counterparts in the short term is magnified by the renewed struggle between PRC and Taiwan. Insofar as PRC's establishment of diplomatic relations with countries in the region involves a flood of new loan-based infrastructure projects and other forms of cooperation, it is particularly worrisome that the nine states in the region that still recognize Taiwan are relatively small, with imperfect institutions and particularly vulnerable to the corrupting effects of such engagement.

The United States cannot and should not attempt to block the countries of the region from the benefits of open, legitimate engagement with PRC and its companies. Rather, insofar as the conditions in Latin America directly impact the United States through ties of commerce, investment, geography, and family, it's particularly incumbent on the United States to be a good neighbor, helping the region to strengthen its institutions so that it can secure the greatest advantage for its own development out of economic engagement with China and other extra-hemispheric actors.

*The views expressed herein are strictly the author's.

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