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CHINA

Latin America and China: Choosing self-interest

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In their global economic engagement, the countries of Latin America and the Caribbean have a natural interest in putting their own economic development and the good of their people ahead of alliances and questions of ideology.

Latin America's engagement with China has become a key subject of focus, both in the region, and in Washington. China's large markets, considerable capital for loans and investment, and the possibility of teaming up with Chinese partners for projects, holds the

allure of significant opportunity for politicians and businessmen in the region.

Although U.S. leaders have cautioned Latin America and the Caribbean about the risks of doing business with China, such words are frequently dismissed as mere artifacts of the emerging Sino-U.S. competition.

There is nothing wrong with engaging China, per se, just as there is nothing inherently problematic in seeking different exchange opportunities in the ever more interconnected global economy. Yet in choosing how to engage, and with whom, businesses and political leaders in the region must make decisions based on a clear-headed assessment of the risks, as well as the potential rewards.

This means considering an informed examination of China's capabilities, objectives and engagement style over the long-term, together with a realistic picture of the capabilities and limitations of their Latin American counterpart institutions. Only by doing so will the region arrive at policy decisions and safeguards most likely to produce project success, long-term value added for its own workers and economies, and enduring benefit for the broadest cross-section of its societies.

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In business and national policy, as in personal life, not every deal that appears to promise quick or easy benefits is worth taking. While virtually all ventures come with risks and challenges, engagements with China arguably present a set of disadvantages worth considering.

Over the long term, China tends to lock its partners into relationships with limited value added or decreased opportunities for the partner's citizens, in some cases generating harmful environmental effects and other negative consequences, and creates a dangerous compact between the Chinese and cooperative local elites which foreclose options by the rest of society to shine light on problems with contracts and improve their terms, or to effectively articulate dissent from the decisions by those elites to engage with China.

Such negative outcomes do not occur because Chinese institutions are nefarious, but rather, because PRC-based companies—which are wholly-owned subsidiaries of the Chinese Communist Party—aggressively pursue its perceived self-interest, centered around a long-term campaign to reorient global income flows, wealth, and institutions so that the value added in its "win-win" relationships goes increasingly over time to its own companies and people.

The PRC is highly adept in pursuing such goals through the coordinated activities of its bureaucracy, firms, and financial institutions, leveraging significant PRC instruments of control over its commercial sector, its freedom to think long-term and strategically without the disruptions of (often tumultuous) democratic political processes, and with assistance from its security services and other organs of the state in obtaining key technologies.

At the same time, the strategy of Chinese companies to engage in predatory behavior in pursuit of contacts and markets is also assisted by the relative absence of the state's active enforcement of legal prohibitions against corrupt practices, as occurs with their Western counterparts, enabling a perfect state-enterprise partnership.

On the Latin American side, governments are disadvantaged in securing their long-term interests by institutional imperfections—including corruption and political discord— impairing the ability to plan for, select, negotiate, and enforce the projects that bring the greatest value to the country.

China uses the lure of easy financing to magnify its negotiating advantage by persuading regimes to set aside competitive procurement procedures in favor of "government-to-government" deals, or at least the more flexible rules of public-private partnerships, with the Chinese associate putting in part of the money.

Particularly when dealing with smaller countries such as those in the Caribbean, China comes to the table with all of the bargaining advantages: its banks offer the financing critical to the proposed project—generally in exchange for the use of Chinese companies, components, and/or workers in its execution.

Such non-transparent engagements maximize opportunities for the Chinese to secure asymmetric deals by offering personal benefits to those negotiating (eg. lucrative side contracts for companies owned by the friends and families of those agreeing to the deal) in exchange for overall terms favorable to Chinese companies. An example of such negotiations are Chinese construction projects in Ecuador, and the

parallel oil contracts to pay for them, which are now subject to numerous criminal investigations by Ecuadoran authorities.

Chinese firms may also use non-transparent agreements to extort or otherwise take advantage of their local partners, as happened with the Baha Mar resort in the Bahamas, in which alleged malfeasance by China Construction Americas ultimately cost local partner Sarkis Izmirlian the entirety of his $845 million stake and forced him out of the project.

Chinese approach to business and investment

The Chinese approach sets their partners up for failure in multiple ways. As opposed toWestern financial institutions, Chinese institutions don’t require a solid business strategy to fund projects, focusing instead on mechanisms to guarantee that the Chinese receive payment thus facilitating the construction of questionable projects in host countries, with side benefits to the signatories.

At the same time, there is no guarantee that projects will produce enough benefits to pay back the initial loan, saddling the signing government or business partner with the repayment of the debt, as happened with the Chinese-built Hanbantota port in Sri Lanka.

The Chinese preference for using their own workers, and seeking ways to possibly circumvent local labor and environmental regulations, foments pushback by local labor, contractors and communities, further delaying projects and often contributing to social conflict.

The list of Chinese construction, petroleum and mining projects in Latin America and the Caribbean delayed or derailed by labor and community protests is long. It includes repeated incidents at the Maracona, Las Bambas, Rio Blanco and other Chinese-operated mines in Peru, the Chinese-operated Sierra Grande mine in Argentina, the Jindal mine in Bolivia, the Mirador mine in Ecuador, Ecuadoran oil wells in Tarapoa and Orellana, Chinese-built hydroelectric projects such as Patuca III in Honduras and Chone in Ecuador, and roads such as the Ivirgarzama to Ichilo highway in Bolivia, to name a few.

Beyond investment projects, in commerce, Chinese companies—with the support of the PRC government—generally seek to import goods from the region at the lowest possible value, such as the purchase of Argentine soybeans to "produce" pigs in China rather than importing Argentine pork.

In extractive industries, the Chinese compound their focus on purchasing low-value added raw materials by acquiring petroleum and mining concessions in the region, controlling extraction and its revenues, and further locking the region into a pattern of primary product exports to the PRC. Chinese infrastructure projects in the region—often paid for by Latin American taxpayers through loans from Chinese banks to the region's governments—exacerbates this pattern to the region's disadvantage.

As with colonial relationships of a previous era, China's Belt and Road Initiative (BRI), supported by targeted Chinese operation of extractive operations, ports, and key infrastructure in the region, facilitates this process; with each country shipping its low-value commodities to China and purchasing its high-value added products and services,

rather than strengthening the region's connectivity to itself, or helping to construct supporting "social" infrastructure (eg. hospitals and schools) that would truly help the region expand its own value added.

Even while structuring trade and financial flows with the region in a neocolonial, mercantilist fashion, the PRC government works to move its companies up the value-added chain, with an increasingly diverse array of ever more technologically sophisticated products and services, including by protecting and supporting strategic industries–as evidenced in "Made in China 2025"—and theft and exploitation of key technologies.

Consequently, Chinese products and services have increasingly displaced the region's own manufacturing base, both in domestic markets, and in their traditional export markets such as the United States. Through the combination of these Chinese maneuvers in imports and exports, Latin American manufacturing countries such as Brazil show signs of "deindustrialization," with domestically owned industry and service sectors giving way to lower value commodity exports to China, correspondingly reducing opportunities for local workers.

For those who see control by Chinese companies as a mere cosmetic change from the long dominant position of Western multinationals in the region, it is useful to note that there is a great difference in domination of the local market by Western multinational firms, versus Chinese firms.

Chinese companies are notoriously inadequate, for example, in providing opportunities for locals in senior management. There are

similarly great contrasts in treatment of workers and subcontractors, voluntary adherence to local labor, environmental and other standards, contributions of Chinese companies to local communities, and opportunities for local businesses to sell goods and services to them on a level playing field.

China's diplomatic and sharp power tools

Diplomatic recognition of the PRC is another vehicle opening the door to rapid transformations that asymmetrically benefit China, and a few well connected local elites, often at the expense of small producers and the most vulnerable in society.

Recognition of the PRC typically brings a flurry of non-public Memorandum of Understanding (MOUs) that open up the local market to Chinese companies, including loan-based construction projects, concessions in the telecommunications, electricity generation and transmission, logistics, and other sectors. The negotiation of a free trade agreement, and a special economic zone, as was attempted without success in Costa Rica in 2014 and El Salvador in 2018, would compound the privileged access for Chinese companies with special tax treatment and exemption from certain regulatory requirements.

In the early stages of new diplomatic relationships, Chinese institutions typically invite a handful of well-connected elites in traditional export industries such as coffee and fruit to the PRC for VIP treatment and the granting of symbolic export contracts or phytosanitary certifications to create the impression that recognition produces rapid benefits for exporters and jobs.

In virtually all cases, however, the growth of exports to the PRC is limited, especially once political attention moves away from the change, leaving only an expanded network of Chinese companies and products in the country, compromised elites, and broken promises.

Beyond trade and investment dynamics, China's state-promoted advances in telecommunications and surveillance systems sectors put at risk the region's ability to make the most effective choices about its own development. China's theft of intellectual property is well documented. While companies such as Huawei assert that they would never violate the privacy of client data, Chinese law, including the 2017 National Security Law, requires such companies to put their assets in the service of the state, if called upon to do so.

The proliferation of Chinese telecommunication equipment and infrastructure across Latin America thus creates almost infinite opportunities for China to advance its strategic economic and political objectives in the region: obtaining competitor technologies, government information regarding public tenders, and even sensitive personal information on Latin American business and government elites that may be used to induce them to behave in a way favorable to the PRC.

China's export of telecommunications and surveillance systems further risks Latin America's democracy. ZTE's implementation of the "fatherland identity card" in Venezuela helps the Nicolás Maduro dictatorship track and monitor its citizens, linking behavior acceptable to the regime to desperately needed benefits like food rations under the *Comité Local de Abastecimiento y Producción* (CLAP) program.

In short, Chinese telecommunications and surveillance technologies moves the region toward a dystopian future in which the PRC can not only more effectively secure technology, commercial projects, and political advantage there, but help compliant authoritarians like Maduro in Venezuela stay in power to China's benefit.

Recommendations to advance healthy Sino-LAC relations

To best take advantage of the opportunities afforded by commerce with the PRC while managing the risks, countries in Latin America and the Caribbean must engage with enlightened self-interest, in a framework of transparency, institutional strength, solid planning and analysis, and commitment to universal procedures and enforcement of laws. The region must strategically plan its investments, so as to best leverage its competitive advantages and public resources to move up the value chain, rather than signing up to play a subservient role in the strategic plans of others, as is the case with China's "Belt and Road Initiative."

With the help of trusted partners such as the United States, the region must combat corruption in its public institutions, and strengthen its administrative capabilities including infrastructure planning, contract and proposal evaluation, so that it can choose the projects that will ensure sustainable growth and high-quality jobs at home, as China seeks to do for itself. Projects that offer politicians quick access to funds with little oversight, by contrast, usually move their countries in exactly the wrong direction.

Governments in the region must avoid the temptation to use easy Chinese financing to liberate themselves from inconvenient requirements of oversight and good governance by Western

institutions. As seen in Venezuela under Hugo Chávez and Ecuador under Rafael Correa, going down this path ultimately undercuts the regime's bargaining position and institutional capability to negotiate a better deal, while generating a downward spiral of corrupt projects with ephemeral benefits for the elites who sign them, at the expense of the people and the country.

Despite their understanding of the risks, it is almost inevitable that governments of all political orientations in the region will nonetheless engage with the PRC. For this reason, it is particularly important for them to strengthen their oversight capabilities, to ensure that Chinese institutions, or other contractors paid with public funds, adhere to the agreed upon terms regarding the use of labor, and compliance with environmental and other regulations.

Finally, the region's governments should limit the entry of Chinese institutions into certain sectors—such as telecommunications and surveillance—that are so sensitive that such presence could put at risk the ability of its politicians and administrators to make effective and independent decisions. Allowing Chinese companies to manage the most sensitive commercial and political data, or the personal data of its business and political leaders, simply invites exploitation, while making it difficult for other partners such as the U.S. to continue to work with and share their own sensitive information.

In the face of the advancement of China in the region, the appropriate response for the United States is not to block that engagement, nor try to "outbid" it. Rather, the U.S. should continue to facilitate opportunities for sustainable private sector engagement through programs such as the Development Finance Corporation, while

articulating the associated benefits of partnering with the U.S., including the associated benefits of transparency, good governance, and the rule of law.

The U.S. must work toward demonstrating its interest in the region's wellbeing is sincere and enduring, for its geographic proximity means that what happens there profoundly affects the U.S. through flows of goods, people, and bonds of family.

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