

The Impact of China on Latin America and the Caribbean*

by

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Executive Summary

The rapid growth of China and its increased integration with the global economy is having both direct and indirect effects on the Latin American and Caribbean region. This report identifies the main channels through which China's growth is affecting the region and undertakes a preliminary analysis of the impacts that it is having on development. The growth of China represents both opportunities and challenges for the Latin American and Caribbean economies and the report suggests where, in terms of both countries and sectors, these are concentrated. Research on the impacts of China on other developing countries is still at an early stage and there remain a number of key areas where current knowledge is limited and these are identified. Finally the report discusses the challenges facing policy makers both in the region and in China.

Latin American and Caribbean exports to China have exploded since the late 1990s, increasing seven-fold in five years. This growth has been a response to Chinese demand for raw materials running into domestic supply constraints, so that the region's exports are overwhelmingly of primary commodities. A relatively small number of products (soya, iron ore, copper, pulp, fish meal, leather) account for the bulk of these. The extent to which Latin American and Caribbean countries have participated in this regional export boom varies considerably. While China accounted for around 10% of total exports in Chile, Jamaica and Peru, its share was less than 1% in Colombia, Ecuador, Mexico and most of the CAFTA countries.

Imports from China have also grown significantly, although not as rapidly as exports over the past five years. In contrast to exports, imports are almost entirely of manufactured goods, almost half of which are low-tech/labour-intensive products. It is unclear how far imports from China have been at the expense of other exporters and how far they have displaced local producers, but the response of manufacturers in countries such as Brazil and Mexico suggest that they are now feeling the effects of Chinese competition.

In addition to trade in goods, a third direct impact of China on Latin America and the Caribbean is through foreign direct investment flows. Chinese FDI in Latin America is

primarily of the “resource seeking” kind, particularly in oil and minerals. Geographically this investment has gone mainly to Brazil, Chile, Peru and Venezuela. There has also been some Chinese investment in manufacturing in Mexico. Up to now FDI flows have been much less significant than trade in terms of links between China and the region. Latin American FDI in China is even less significant. This has mainly come from Brazil but only a handful of Brazilian companies have so far invested in China.

Two of the main concerns in Latin America and the Caribbean about the growing economic significance of China arise not from bilateral economic relationships but from the perceived threat to the region’s relations with third countries. In the case of trade, some countries see China as a serious competitive threat to their exports, particularly to developed country markets, while in terms of FDI there is concern that investment has been diverted from Latin America to China.

The extent to which China had displaced Latin American exports until relatively recently seems to have been quite limited. However the past may not be a good guide to the future as China’s accession to the WTO in 2001 and the ending of the Agreement on Textiles and Clothing at the beginning of 2005, have created new conditions compared to those that prevailed in the 1990s. Caribbean and Central American countries specialising in labour-intensive manufactures such as clothing and footwear face a particular threat, but it is no longer the case that China only poses a threat in labour-intensive or low-tech products. The share of high technology products in Chinese exports has increased significantly since 1990 indicating that China is now internationally competitive in a wide range of products. More capital-intensive or technology-intensive sectors that face growing competition from China include iron and steel, aluminium, electronic products and auto parts.

The evidence both on countries and sectors affected by Chinese competition suggest that the situation is rather more complex than is sometimes portrayed. It is by no means clear that the threat posed by China is confined to Mexico and Central America or to labour-intensive, low tech industries. This suggests that more work is required to analyse the

way in which the threat from China is changing over time. What are the factors that determine the extent to which industries are threatened by Chinese competition? In which sectors/products does Latin America still have a competitive advantage?

The second area of concern is that the increased attraction of China as a host for foreign investors has reduced FDI flows to Latin America and the Caribbean. The *prima facie* case is based on the rapid growth of FDI to China in the 1990s while investment in Latin America and the Caribbean lagged behind. Compared to the literature on trade, there have been relatively few studies on FDI diversion and those that do suffer from a number of limitations, so that it is not possible to arrive at any firm conclusion.

A further important indirect effect of China's growth has been the recent improvement in the terms of trade for primary products. In aggregate this has been positive for the Latin American and Caribbean economies, although at the level of individual countries, there have been winners and losers, depending on whether the economy competes with China or is complementary to it. It is also important to put these developments in the terms of trade in a longer term context. The recent increase has so far been fairly short-lived and, despite this improvement, the region's terms of trade are still lower than in 1980.

Although quite a lot is now known about both the direct and indirect channels through which China impacts on Latin America and the Caribbean, there is much less evidence on the effect that this has had on the region in terms of growth and especially the impact on poverty.

The short-term impact on growth depends primarily on whether a country is complementary to or competitive with China. Countries which are complementary tend to run bilateral trade surpluses with China while those which compete have bilateral deficits and also tend to be negatively affected by Chinese competition in third markets. In the longer term there are concerns that the growth of China is leading to deindustrialization with potentially deleterious effects on technological development and

long-term growth for the entire region. The emerging pattern of Chinese FDI in the region also tends to reinforce specialization in primary products.

The impact on poverty is the least researched area of China's relations with Latin America and the Caribbean. There are grounds for thinking that the distributional effects of the changes in production and prices brought about by the growth of China have not been positive, but this is an area which requires much more research. Since export growth from Latin America has been dominated by primary products which are not likely to generate direct benefits to the poor, a key question is the extent to which governments in the region are able to appropriate additional natural resource rents and to devote these to pro-poor strategies.

One problem faced in analysing the impact of China is the quality and availability of data. There are substantial discrepancies in trade statistics from different sources as well as reports of significant levels of contraband. In the case of FDI there is a great paucity of data, both on Chinese investment in Latin America and the Caribbean and on flows in the opposite direction.

A number of areas are identified as requiring further research. Relatively little attention has been given to the growth of imports from China, although these have increased significantly and are now giving rise to concern amongst governments, firms and workers in a number of countries. This is particularly acute in those countries which have a trade deficit with China.

The most important gap in terms of research has been the lack, up to now, of detailed analysis of the outcomes for Latin America and the Caribbean of China's growing economic significance, especially in terms of the impacts on poverty. There is a need for more country studies and studies of specific value chains which can trace through the impact on industrial production, employment, wages and other variables at the national and sectoral levels.

The Impact of China on Latin America and the Caribbean

1. Introduction

China's rapid growth and increased openness over the past quarter century has led to its emergence as a key player in the global economy in the early twenty-first century. GDP has grown at over 9% per annum over the past two decades and China is now the fourth largest economy in the world in terms of GDP at official exchange rates (and the second largest at purchasing power parity rates). Its share of world trade has risen from less than 1% in 1980 to over 6% in 2004, making it the third largest trading economy. On current trends it could become the world's largest exporter by the beginning of the next decade (OECD, 2005).

The increased competitiveness of China and its expanded presence in world markets is having a major impact on both developed and developing countries. While this has been extensively analysed from the point of view of developed countries (Cass et. al., 2003; Prasad, 2004), much less is known about the implications for Latin America. A decade ago trade between China and the region was limited but this has changed dramatically. Between 1999 and 2004 China's imports from Latin America increased seven-fold while its exports to the region more than tripled (see Figure 1 below). Chinese firms are also beginning to invest in the region, which accounted for almost half of Chinese overseas investment in 2004 (Funakushi and Loser, 2005, p.8). These growing economic links have been reflected politically with the visit of Chinese President Hu Jintao to the region in 2004, while a number of Latin American leaders have been to Beijing.

The implications of China's growth for Latin America and the Caribbean are not confined to the direct impact of the growth of bilateral economic relations. There are also important indirect impacts. A major concern for some Latin American countries has been the threat of increased competition from China in third markets, particularly since the latter's accession to the WTO in 2001 and the removal of MFA quotas at the start of 2005. China has been seen not only as a competitor in goods markets for those countries which have specialized in exports of labour-intensive manufactures in which China is highly competitive, but also as a competitor for foreign direct investment (FDI) as a

result of the massive inflows to China since the early 1990s. This has given rise to concern that FDI is being diverted from Latin America to China.

Another important indirect impact is the effect that China's emergence has had on the terms of trade between primary commodities and labour-intensive manufactured goods. The booming demand for agricultural and mineral products (including oil) in China has contributed to rising prices for primary commodities (Kaplinsky, 2005; UNCTAD, 2005, Ch.II.D). On the other hand, the massive growth of Chinese production of labour-intensive manufactures has tended to push down the prices of such goods. Thus China's growth can have implications for Latin American and Caribbean countries even in the absence of bilateral links or competition in third markets.

China's rapid growth has also had a multiplier effect on world demand which has contributed indirectly to the demand for exports from Latin America and the Caribbean. It is also argued that China has contributed to the dynamism of the world, and particularly the US economy, by its policy of buying US Treasury Bills, thus keeping down the rate of interest in the USA. This could also have had a beneficial effect on the Latin America and Caribbean economies. It is more difficult to evaluate the implications of these global impacts on specific Latin American countries so that they will not be discussed in any detail in this paper, although they are important to bear in mind.

It is important to bear in mind that because of the differences in size, China is economically much more significant for Latin America and the Caribbean than the region is for China. This is certainly true as far as individual countries are concerned. Brazil, the largest Latin American exporter to China, ranks fourteenth amongst China's suppliers accounting for 1.5% of total imports, while no other country in the region is in the top twenty import sources. Latin American countries are even less significant as destinations for China's exports with Mexico, the most important, ranked twenty second with less than 1% of China's total exports. Even taking Latin America and the Caribbean as a whole, the region accounts for only 3% of China's exports and supplies 3.8% of its imports. China on the other hand is one of the top five export markets for Argentina,

Brazil, Chile, Cuba and Peru, and is one of the leading five sources of imports in these countries and Colombia, Mexico, Paraguay and Uruguay (CEPAL).

The next two sections of the paper describe the different channels through which China's growth has affected the Latin American and Caribbean economies. The next section focuses on bilateral trade and investment links. This is followed by a discussion of the indirect impacts of China on the region in terms of the competitive threats which it poses, both in terms of Latin America's exports to third countries and as a pole of attraction for FDI, as well as the impacts on the region's terms of trade. Where possible these sections identify the countries and sectors which are most affected by China. Particular attention is given to the two largest Latin American economies, Brazil and Mexico. These are often seen as having contrasting experiences, with Brazil having achieved major exports of primary commodities to China, while Mexico has been negatively affected by Chinese competition in export markets, particularly the US.

The penultimate section of the paper discusses the impacts which the growth of China is having on development in Latin American and the Caribbean with a particular emphasis on the possible implications for poverty reduction in the region. This section also seeks to highlight major gaps in our knowledge concerning the impact of China. The concluding section identifies major policy issues which need to be faced by policy makers both in the Latin American and Caribbean countries and in China itself.

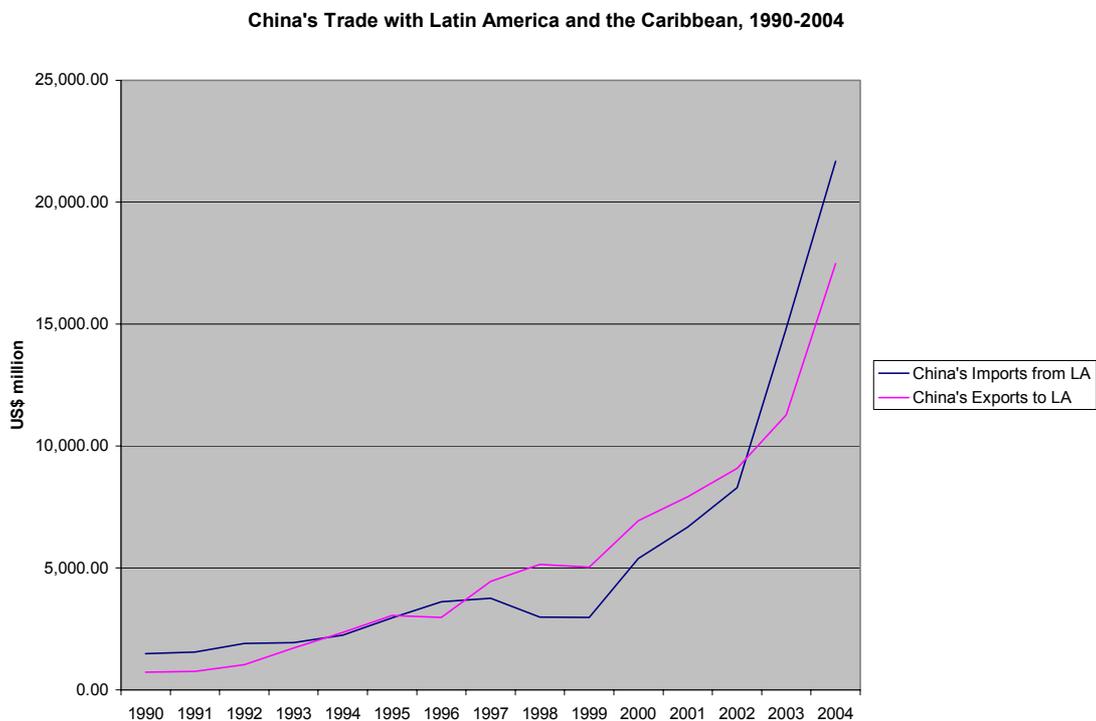
2. Bilateral Economic Relationships between Latin America and the Caribbean and China

a) Exports

As indicated above, Latin American and Caribbean exports to China have grown spectacularly in recent years. While trade with China was expanding during most of the 1990s, the really sharp increase in exports from the region has occurred since 1999 (see Fig.1). Since this pattern holds for all the major Latin American countries exporting to China, it would seem that the explanation must be sought in events in China rather than developments in the various Latin American countries. One possible explanation is that

resource constraints really began to bite in China at the end of the 1990s. This view is supported by the sharp increase in China's net trade deficit in a number of primary commodities which feature prominently in Latin America's exports such as copper, iron ore, nickel and soybeans from the late 1990s (UNCTAD, 2005, Fig.2.8). Furthermore the accession of China to the WTO in 2001 and the ensuing trade liberalization could have given an additional boost to the region's exports.

Figure 1



The extent to which Latin American and Caribbean countries have participated in this regional export boom varies considerably. While China accounted for 5.6% of the region's total exports in 2004, the shares for individual countries ranges from less than 1% of total exports in Colombia, Ecuador, Mexico and most of the CAFTA countries, to around 10% in Chile, Jamaica and Peru (see Table 1).

Table 1: Exports to China of Major Latin American Countries, 1995, 2004

	<i>Value</i> <i>(\$ mn.)</i>		<i>Share of Total</i> <i>Exports</i>		<i>Share of</i> <i>Increase in</i> <i>Exports</i>
	1995	2004	1995	2004	1999-2004
Argentina	284.0	3,167.3	1.4%	8.7%	19.8%
Bolivia	0.1695	28.6264	0.0%	1.6%	6.6%
Brazil	1,203.8	5,440.0	2.6%	5.6%	9.7%
Chile	288.1	3,212.2	1.7%	9.9%	18.7%
Colombia	30.7	137.5	0.3%	0.8%	2.4%
Costa Rica	33.0	163.9	1.2%	2.6%	34.9%*
Cuba	194.1	169.8	12.9%	7.7%	15.5%
Dominican Rep.	0.0	13.7	0.0%	0.3%	10.1%
Ecuador	7.2	49.5	0.2%	0.6%	-0.8%
El Salvador	3.9	3.6	0.4%	0.1%	0.2%
Guatemala	34.0	20.0	1.8%	0.4%	1.8%
Honduras	0.0	8.5	0.0%	0.5%	2.8%*
Jamaica	3.9	187.2	0.2%	10.5%	33.3%
Mexico	37.0	986.3	0.0%	0.5%	1.7%
Nicaragua	1.3	2.6	0.3%	0.2%	0.2%
Panama	4.2	10.9	0.2%	1.2%	4.7%
Paraguay	0.0	44.5	0.0%	2.7%	7.0%
Peru	355.5	1,239.5	6.4%	9.9%	15.9%
Uruguay	124.5	97.3	5.9%	3.0%	3.5%
Venezuela	0.0	560.6	0.0%	1.3%	2.5%

Source: IMF, Direction of Trade Statistics

Note: * share of increase in exports from 2000 to 2004

Exports to China have made a very important contribution to the growth of total exports since 1999 in Costa Rica and Jamaica, where they accounted for a third of the total increase in exports, and a significant contribution in Argentina, Chile and Peru, where they contributed between 15% and 20% of export growth. In Brazil, the leading country in the region in terms of exports to China, these accounted for almost 10% of the total increase in exports (Table 1). However in the other larger countries in the region, the impact of exports to China is marginal.

In terms of the composition of exports to China, the role of the region is clearly as a supplier of primary products and resource based manufactures with a relatively low degree of processing. These account for around three-quarters of total exports (CEPAL, 2005, Grafico V.5; Lall and Weiss, 2005, Table 9). The main products exported from the region are soya, iron ore, copper, pulp, fish meal, leather (CEPAL, 2003, Table VI.2; CEPAL, 2005, Cuadro V.6).

It is also worth noting that for the major Latin American exporters to China, exports are concentrated on a very narrow range of products. Over 75% of China's imports from Argentina and Chile are of soya and copper respectively. Two thirds of imports from Brazil are soya and iron and steel, while a similar proportion of imports from Peru are of copper and fishmeal (CEPAL, 2005, Cuadro V.6). Thus the major Latin American exporters to China have not so far been able to diversify their exports beyond a few primary commodities.

The current pattern of exports to China raises a number of questions. Why have some countries been more successful than others in taking advantage of China's booming market? Does it just reflect differences in comparative advantage or are there missed opportunities which some countries could exploit? According to the International Trade Centre's trade simulation model (SIM-3), Colombia and Mexico's exports to China are well below predicted levels indicating high untapped trade potential, whereas Argentina, Brazil, Chile and Peru all show strong exports to China, above predicted levels.¹

¹ Data available on the ITC website at <http://www.intracen.org/menus/countries.htm>

What other factors apart from comparative advantage have influenced the extent to which different Latin American and Caribbean countries have penetrated the Chinese market? What are the main obstacles facing Latin American exporters to China? Are there particular geographic limitations which discourage the development of trade between certain countries and China? Has China's trade regime, which is still fairly protectionist, particularly with regard to agriculture, impeded exports from some countries? Does the fact that some small Latin American and Caribbean countries still maintain diplomatic relations with Taiwan reduce their trade links with the mainland?

Similar questions can also be asked about the commodity structure of exports from Latin America to China. Is the predominance of primary products and resource based manufactures simply a reflection of the comparative advantage of the region in such products or does China's pattern of trade protection have a significant effect on the structure of its imports from Latin America? In the case of Brazil for example, Abreu (2004) has pointed out that most agricultural exports still face relatively high tariffs (the average tariff for agriculture in 2005 was 17.4 percent), tariff-rate quotas, import licensing, unduly stringent sanitary and phytosanitary requirements and centralized state trading. This is particularly the case for soybean oil, corn, sugar, cotton and beef. The obstacles are said to increase with the degree of processing of the good exported. For instance, it is much easier for Brazil to export soybeans than soybean oil to China, so that the former accounts for 28 percent of exports in 2005 while the latter is only 2% (<http://aliceweb.desenvolvimento.gov.br>).

b) Imports

Imports from China have also grown significantly in recent years although not as rapidly as exports. Figure 1 shows that unlike exports to China, which accelerated markedly from 1999, imports from China have grown steadily since the early 1990s, without any inflection point towards the end of the decade.

Table 2: Imports from China of Major Latin American Countries, 1995, 2004

	<i>Value</i>		<i>Share of Total</i>	
	<i>(\$ mn.)</i>		<i>Imports</i>	
	1995	2004	1995	2004
Argentina	571.5	959.1	3.0%	4.3%
Bolivia	15.2	27.6	1.0%	1.4%
Brazil	1,039.0	3,709.9	1.9%	5.4%
Chile	390.2	1,846.8	2.5%	7.5%
Colombia	38.8	1,067.7	0.3%	6.4%
Costa Rica	17.2	272.5	0.5%	3.3%
Cuba	161.0	354.5	6.0%	8.9%
Dominican Rep.	0.0	225.6	0.0%	2.3%
Ecuador	0.4	722.3	0.0%	9.2%
El Salvador	9.2	113.6	0.4%	1.8%
Guatemala	3.6	627.1	0.1%	6.6%
Honduras	0.0	66.6	0.0%	1.7%
Jamaica	23.7	110.4	0.8%	2.7%
Mexico	520.6	14,373.8	0.7%	6.5%
Nicaragua	20.9	109.7	2.1%	3.8%
Panama	6.7	72.1	0.3%	2.3%
Paraguay	0.0	439.2	0.0%	2.7%
Peru	162.0	325.8	2.0%	3.0%
Uruguay	34.6	230.2	1.2%	6.0%
Venezuela	0.4	0.0	2.0%	3.0%

Source: IMF, Direction of Trade Statistics

China's share in total imports by Latin America and the Caribbean increased from 1.9% in 1999 to around 5.1% in 2003 (CEPAL, 2005, Cuadro, V.5). Table 2 shows the increasing share of imports from China in individual Latin American countries.

Although the share of China varies between countries, the differences are not as marked as in the case of exports.

In terms of the type of goods imported from China, the pattern is the reverse of that noted for Latin American exports to China. More than 90% of imports are manufactured goods and over 85% are non-resource based manufactures (Lall and Weiss, 2005, Table 8). Almost half of all imports from China are low tech/labour-intensive products but the technology level of imports is rising over time (Lall and Weiss, 2005, Table 8).

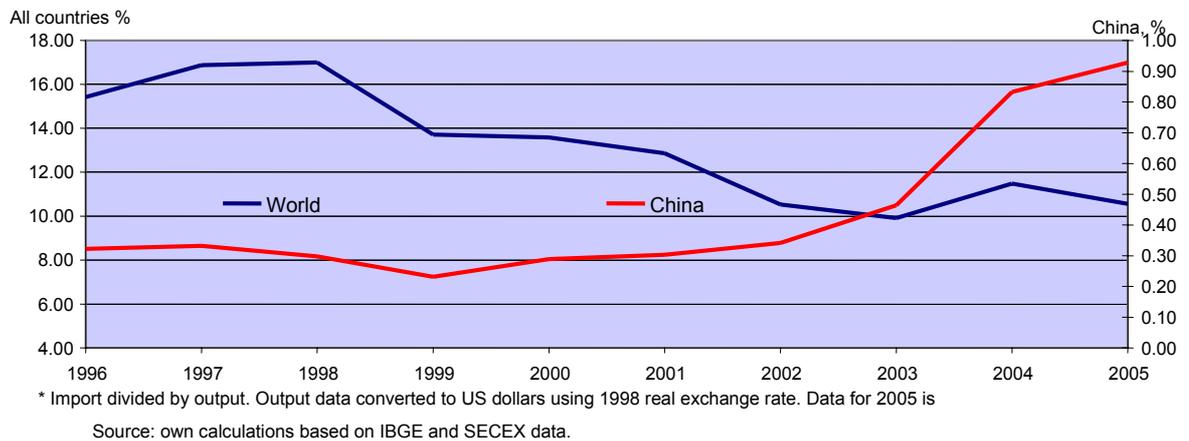
The composition of manufactured imports from China differs between countries. Imports of low tech products account for only around 20% of total imports from China in Argentina, Brazil and Mexico in 2002 compared to 45% for the region as a whole (Lall and Weiss, 2005, Table 8 and Appendix Table A.6). Unskilled labour-intensive manufactures are about 20% of total imports from China in Brazil and Mexico, but much more significant (around 40%-50%) in Bolivia, Nicaragua and Peru (Jenkins and Edwards, 2004, Table A.5).

An important factor in determining the likely impact of increased imports from China on the Latin American and Caribbean economies is whether they displace local producers or simply replace imports from other countries. In the latter case, there is a presumed benefit to the importing economy from the increased supply of cheap Chinese manufactures. If imports compete directly with local producers however, account needs to be taken of the welfare losses arising from their displacement.

There are no detailed studies of this issue for Latin America and the Caribbean. Anecdotal evidence suggests that in the early stages of the growth of Chinese exports to the region, the impact was felt mainly by other exporting countries, but that more recently domestic producers have started to be affected. This appears to have been the case in Brazil where industrialists only began to realize the size of the challenge from China in 2005. The reasons for this can be seen with the help of import penetration indices shown in Figure 2. Whereas overall import penetration fell substantially after the 1999

devaluation, Chinese exporters managed to increase their presence in Brazil's market for manufactured goods by a factor of 3. Since they started from a very low base, their share is still modest, close to 1 percent of total domestic output, although this masks considerable variation across industries. The substitution effect *vis-à-vis* other exporters and the low base help to explain why Brazilian manufacturers took so long to wake up to the Chinese challenge. The recovery of overall imports in 2004 and 2005, driven, *inter alia*, by a big jump in Chinese imports (their share of total Brazilian imports climbed from 4.4 percent in 2003 to 7.2 percent in 2005), seems to have been the wake-up call.

Figure 2 - Brazil's Import Penetration* in Manufacturing goods.
World and China. 1996-2005



One limitation of any analysis of the impacts of imports from China on the Latin American and Caribbean economies is the high level of smuggling in many countries, so that not all imports from China are reflected in the official trade statistics. The Mexican textile industry trade association, for example, estimates that illegal imports account for 60% of the local garment market and this has led to massive shut downs of firms (CANAINTEX, 2005).

c) Foreign Direct Investment

The role of bilateral FDI flows is not nearly as significant as that of trade in relations between China and Latin America. Although it has been reported that almost half of Chinese overseas investment in 2004 went to Latin America, this included investment in

Caribbean tax havens such as the British Virgin Islands and the Cayman Islands (Funakushi and Loser, 2005, p.8). In any case China accounts for only about 0.5% of global FDI outflows.

Chinese FDI in Latin America is primarily of the “resource seeking” kind, particularly in oil and minerals. Geographically this investment has gone mainly to Brazil, Chile, Peru and Venezuela (Funakushi and Loser, 2005: CEPAL, 2005, Cuadro V.5). There has also been some Chinese investment in manufacturing in Mexico.

The modest impact of Chinese investment in Latin America is confirmed by data on individual Latin American countries. According to Brazil’s Central Bank, Chinese investment in the country in 2001-2004 totalled US\$58 million (mainly in consumer electronics and telecommunication), a rather modest figure given that Brazil’s total inward FDI in this period amounted to US\$ 78 billion. A number of high profile investment announcements last year hinted at stronger impacts on inward FDI. For instance, Shanghai Baosteel, announced investment of roughly US\$ 2 billion in the steel sector in a joint venture with CVRD (Brazil’s leading mining company). Yet, most of these investments were later cancelled or postponed. Chinese investment in Mexico was equally limited. In the period 1999-2005 Chinese FDI in Mexico accounted for \$41 million or 1.2% of FDI from Asian countries of which 52.7% was in manufacturing and 24.4% in services. 339 firms with Chinese capital were registered in Mexico, accounting for 1.1% of foreign firms in 2005 (SE 2005).

Latin American FDI in China is even less significant. This has mainly come from Brazil but only a handful of Brazilian companies have decided to invest in China. The pioneer was Embraco (compressors), which set up a joint venture with a Chinese company in 1995, and was followed by firms such as Embraer (aircraft), Weg (electrical motors), Sabo (autoparts) and Marcopolo (buses). The stock of investment of all these firms combined was not more than US\$15 million in 2003 (the latest figure available), out of Brazil’s US\$ 43.4 billion stock of outward FDI (Abreu, 2004; Fleury and Fleury, 2006). A recent announcement by InBev, a Belgian-Brazilian brewer, of a US\$ 750 million acquisition of a Chinese state company (New York Times, December 5) may signal

greater investment of Brazilian companies in China, but then InBev can hardly be seen as a typical Brazilian firm.

3. Indirect Impacts of China's Growth on Latin America and the Caribbean

Two of the main concerns in Latin America and the Caribbean about the growing economic significance of China arise not from bilateral economic relationships but from the perceived threat to the region's relations with third countries. In the case of trade, some countries see China as a serious competitive threat to their exports, particularly to developed country markets, while in terms of FDI there is concern that investment has been diverted from Latin America to China. This section will examine each of these threats in turn. It will also consider the possible impact of China on the terms of trade of the Latin American and Caribbean economies.

a) The threat to Latin American and Caribbean exports

In considering this issue, it is necessary to distinguish between the impact that China has had in the past on exports from the region and that which it is likely to have in the foreseeable future. The first of these is addressed by looking at past changes in world market shares for China and the Latin American and Caribbean economies to see the extent to which declining shares for the region are related to an increase in China's market share (Lall and Weiss, 2005; Mesquita Morreira, 2004). The second approach compares the current product structure of China's exports with those of the Latin American and Caribbean economies on the basis that countries whose exports are most similar to China's are likely to face the greatest competitive threat in the future. Previous studies have found that the region (apart from Mexico) is less threatened by Chinese exports to third markets than are the Asian economies or the transition economies of Eastern Europe (Blazquez-Lidoy et. al., 2004; IDB, 2004, Ch.5).

There have been few attempts to quantify the extent to which exports from the region have been affected by Chinese competition in the past. One attempt to do so by Mesquita Moreira (2004) finds a relatively small effect for the period 1990-2002. In aggregate it

was estimated that losses to China represented only 0.7% of the region's exports in 2002, although it was also shown that these losses tended to increase over time.

There are several reasons why the present threat from Chinese exports may be more serious than has sometimes been suggested. First the past may not be a good guide to the future as China's accession to the WTO in 2001 and the ending of the Agreement on Textiles and Clothing at the beginning of 2005, have created new conditions in terms of the competitive threat from China, compared to those that prevailed in the 1990s.

In considering future competition the main indicators used to measure the competitive threat can be misleading. The Export Similarity Index and other similar measures which have been used in such studies can substantially underestimate the degree of competition faced by a small country with a high degree of specialisation in a limited number of products, when compared with a much larger and more diversified economy such as China.² Thus the low figure for many Latin American and Caribbean countries may simply reflect their small size relative to China.

There are also problems with the data used in some instances. In the case of some Central American countries (e.g. Honduras, Nicaragua) exports from Export Processing Zones are not included in the trade statistics and since these are predominantly of clothing, which competes with Chinese exports, the threat from China is underestimated.

There are also significant differences between Latin American and Caribbean countries in terms of the extent to which they face Chinese competition in third markets. Mexico is generally regarded as the country most affected by Chinese competition in third markets. China has now overtaken Mexico as the second largest source of US imports. There are also grounds for believing that the Central American countries are likely to be negatively

² The intuition behind this statement is that the ESI measures the degree of overlap between the product structure of the exports of two countries. However where the two countries are of very dissimilar size, the overlap may cover a large proportion of the smaller country's exports but only a small proportion of the large country's. Since the index is calculated for the two countries together, it substantially underestimates the degree to which the small country faces competition from the large country's exports.

affected because they have specialised in exports of labour-intensive manufactures. Thus a contrast is often drawn between Meso-America and the South American countries which have very different export structures and do not therefore face a significant competitive threat from China (Funakushi and Loser, 2005).

It should also be noted that it is no longer the case that China only poses a threat in labour-intensive or low-tech products. The share of high technology products in Chinese exports has increased significantly since 1990 (CEPAL, 2005, Gráfico V.2) suggesting that China is now internationally competitive in a wide range of products. Latin American and Caribbean export sectors which are threatened by China include not only the well known cases of relatively labour-intensive industries such as clothing, textiles, leather and footwear and furniture, but also capital-intensive ones such as iron and steel and aluminium (Lall and Weiss, 2005, Appendix Table 5; Stevens and Keenan, 2005)

Mexico, for example, faces competition in the US market from China, not only in textiles and garments but also in electronics and auto parts. Although Mexico still seems to have a higher technological level in terms of its exports to the US, China is rapidly catching up. Studies of the garment sector in Mexico have found that competition in the US market from China since its entry to the WTO and the elimination of the MFA in 2005 has had a negative impact on output (CANAINTEX 2005; CNIV 2005; Cornejo 2005; Dussel Peters 2005/a/c; Rueda Peiro et. al 2004). In electronics, Dussel Peters (2005/a) finds a similar pattern whereby Mexico has lost production lines and FDI as a result of competition with Asia and particularly with China.

In Brazil, a constant market share analysis³ indicates that low-tech industries suffered the highest losses of export markets to Chinese competition (7.2 percent of 2004 exports), followed by the high-tech (2.1 percent), medium-tech (1.4 percent) and resource-based

³ For the methodology see Batista J. C. (2005). In this framework, a market share loss for Brazil (in any product or market) is understood as a reflection of the fact that its exports have grown less than world exports because they were (i) less dynamic than those of China and/or (ii) less dynamic than those of the rest of the world.

industries (1 percent). Table 5.2 provides a breakdown of these categories and footwear clearly stands out with unmistakably high losses⁴ - the type of dislocation that seems more consistent with the two countries' competitive advantages. The losses, though, in sectors such as pig iron, fruit juices and in most of the high-tech sectors are a clear reminder that China's comparative and competitive advantages go well beyond cheap labor.

Table 5.2. BRAZIL's World Market Losses to China by Technology Intensity (1990-2004)			
Five Sectors With Major Losses in Each Category (SITC Rev 2)			
(Losses as % of each category and Losses in millions of USD\$)			
Nomenclature		%	Millions of USD\$
High-Tech			
751	Office machines	24.1	24.9
752	Automatic data processing machines	19.1	19.8
778	Electrical machinery and apparatus,	14.5	15.0
764	Telecommunications equipment and pa	11.5	11.9
759	Parts of and accessories suitable f	9.8	10.1
Medium-Tech			
671	Pig iron,spiegeleisen,sponge iron,i	23.6	79.6
672	Ingots and other primary forms,of i	19.5	65.9
762	Radio-broadcast receivers	12.1	40.7
775	Household type,elect.& non-electric	4.2	14.2
741	Heating & cooling equipment and par	3.7	12.5
Low-Tech			
851	Footwear	64.6	506.7
658	Made-up articles,wholly/chiefly of	4.2	32.9
651	Textile yarn	3.1	24.2
673	Iron and steel bars,rods,angles,sha	2.7	21.5
696	Cutlery	2.3	18.3
Resource-Based			
058	Fruit,preserved,and fruit preparati	43.8	117.8
684	Aluminium	13.1	35.2
687	Tin	6.5	17.4
014	Meat & edib.offals,prep./pres.,fish	5.2	13.9
625	Rubber tyres,tyre cases,etc.for whe	5.0	13.5

Source: Comtrade with author's own calculation.

The evidence both on countries and sectors affected by Chinese competition suggest that the situation is rather more complex than is sometimes portrayed. It is by no means clear that the threat posed by China is confined to Mexico and Central America or to labour-intensive, low tech industries. This suggests that more work is required to analyse the

⁴ For a case study of the response of Brazilian footwear producers to Chinese competition in the US market in the 1990s, see Schmitz (1998).

way in which the threat from China is changing over time. What are the factors that determine the extent to which industries are threatened by Chinese competition? In which sectors/products does Latin America still have a competitive advantage?

Box 1: Chinese Competition in Textiles and Garments

Undoubtedly the sector which has given rise to most concern over the impact of Chinese competition has been textiles and garments, particularly with the final phasing out of MFA quotas at the beginning of 2005. Even prior to this, China's share of US imports of garments had been increasing since 2001 as some quotas were removed. This has accelerated sharply in 2005 leading to an agreement to restrict the rate of growth of Chinese exports.

The countries most threatened by these developments are the Dominican Republic, El Salvador, Honduras, Nicaragua and Guatemala. Textiles and garments make up a substantial share of their exports, over half for the first three and more than a third for the last two (Condo, 2004). They also rely heavily on the US market which account for over 90% of their textiles and garments exports (IDB, 2004, Fig.7.5). Around half a million workers are employed in the industry in Central America and the Dominican Republic (Condo, 2004). Mexico too is likely to be affected, although textiles and garments account for a much lower proportion of its total exports.

These countries are particularly vulnerable because their export growth has depended on preferential access to the US market. As the margin of preference is eroded, China's competitive advantage in the US increases (Cordova et.al., 2005). Compared with China, total costs of clothing manufacture are almost double in Mexico and a third higher in Nicaragua, the poorest Central American country with the lowest wage levels (IDB, 2004, Table 7.2). This reflects not only lower wages in China but also its success in developing most segments of the textile-garment value chain in contrast to a very partial development of the China in Central America and Mexico (see Dussel Peters, 2004).

Recent evidence suggests that these countries have indeed been hit hard. Mexico's share of US apparel imports fell from 14% in 2001 to 9% in 2004. Imports from the Dominican Republic fell in the most sensitive categories in 2004, while in El Salvador around 6,000 textile and clothing workers were laid off in 2004 following a decline in orders from the US (ILO, 2005, pp.32-3). It is reported that 18 plants closed in Guatemala, Honduras, Costa Rica and the Dominican Republic during the first two months of 2005 with a loss of 10,000 jobs (Thompson, 2005). Hopes have been pinned on the new DR-CAFTA agreement with the US but critics argue that the benefits which this offers will not be sufficient to offset the competitive advantage of China in the US market (Condo, 2004).

A number of points are worth considering here. Lall and Weiss (2005, pp.180-182) find a correlation between the loss of market share by Latin America relative to China and the growth of world exports of the product concerned. This is particularly worrying since it suggests that the threat from China is greatest in the most dynamic products. What are the possibilities for Latin American exporters maintaining a competitive advantage? One might expect that in the case of exports to the US, Latin America (or at least Meso-America) would have an advantage in sectors with high transport costs. There is some evidence to support this since on average Latin American exports are much heavier relative to value than exports from China i.e. Latin America has specialised in heavy, low value products (IDB, 2004, p.65). Another important question is the extent to which preferential trade agreements (NAFTA, DR-CAFTA) give some Latin American countries a competitive edge over China in the US market?⁵

b) The threat of FDI diversion to China

The second area of concern is that the increased attraction of China as a host for foreign investors has reduced FDI flows to Latin America and the Caribbean. Compared to the literature on trade, there have been relatively few studies on this. The *prima facie* case is based on the rapid growth of FDI to China in the 1990s while investment in Latin America and the Caribbean lagged behind. This does not necessarily indicate any causal relationship.

In discussing foreign investment it is usual to distinguish between different types of FDI according to their motivation – natural resource seeking; market seeking; efficiency seeking. Diversion is most likely to occur in the last of these where FDI can reinforce changes in trade patterns as firms relocate to lower cost countries. It is less likely where investment is primarily resource seeking since these depend on the existence of natural

⁵ There are obvious advantages from duty free access to the US market although these are constrained by the rules of origin of the preferential trade agreements. Supporters of DR-CAFTA also point to the link with labour rights issues in the agreement, although these have been criticized by others as inadequate (see Bolle, 2005 for the different arguments). It is debatable whether these measures will give a significant competitive advantage to Central American manufacturers in the US market.

resources and are much less footloose. Market seeking investments occupy an intermediate position where investors may consider the relative attractiveness of different markets in terms of their size and growth. Although a significant part of FDI to China can be regarded as efficiency seeking, this is less significant in Latin America and the Caribbean where natural resource and market seeking FDI have dominated (CEPAL, 2004, Table I.6)

Despite the rapid growth of FDI since the early 1990s, China only accounts for about 6% of world FDI inflows. In aggregate therefore, even if there were some diversion to China, the effects on the availability of foreign capital for other regions such as Latin America and the Caribbean is likely to be limited. However if capital markets are imperfect there may be significant effects on flows in individual sectors and for particular countries (IDB, 2004, Ch.6).

Some stylized facts suggest that diversion to China is not likely to have been very significant. First, in terms of sources of FDI, investment in Latin America and the Caribbean comes mainly from the US and the European Union, while FDI in China is mainly from East Asia. Similarly the sectoral distribution of FDI is also different. US FDI in China is mainly in manufacturing while other sectors dominate in Latin America (IDB, 2004, Ch.6). Although this makes diversion unlikely for the region as a whole, the situation does vary between countries. As with trade, Mexico appears to be the country most threatened by Chinese competition.

Three econometric studies have attempted to test the FDI diversion thesis more systematically with contrasting results. Chantasawat et. al. (2004) find that FDI in China has no effect on the level of FDI in Latin America but is significant in the share of Latin American countries in total FDI in developing countries (but is not the main determinant). Eichengreen and Tong (2005), using a gravity model, found no evidence of FDI diversion from Latin America to China in 1988-2002. Herrero and Santabárbara (2004) distinguish two time periods (1984-2001) when like Chantasawat et. al. they

find no significant FDI diversion to China and (1995-2001) when they do find a significant negative effect on FDI in Mexico (and to a lesser extent Colombia).

These studies suffer from a number of limitations. The time period of the analysis may be important and even if it were the case that in the past there had been no significant diversion of FDI to China, this is no guarantee that it would not occur in the future. Herrero and Santabárbara (2004)'s findings concerning the effects on different Latin American countries also indicate that aggregate data on the region as a whole may hide significant impacts on individual countries. There may also be sector specific effects which are not captured in the very aggregated type of studies that have been carried out so far. Thus for example it has been found that in electronics Mexico has lost FDI as a result of competition from Asia particularly China (Dussel Peters 2005/a). This suggests a need for further work on this issue, particularly on the impacts on individual countries and sectors where diversion is most likely to occur.

c) China's impact on the terms of trade and the Latin American and Caribbean economies

So far the paper has considered the impact of China as a bilateral trade and investment partner of Latin America and as a competitor in export markets and for FDI. However because China is such a large economy, its emergence has impacts on world prices which also affect the Latin America and Caribbean economies indirectly through changes in their terms of trade.

One of the most commented upon aspects has been the impact of China on primary commodity markets. In recent years China has accounted for a significant share of world demand for a number of the major commodities exported from Latin America. In 2003 it accounted for a third of world imports of soybeans, almost 30% for iron ore and over 15% for copper (UNCTAD, 2005, Fig. 2.7). China's contribution to the growth in global demand between 2000 and 2003 was 76% for aluminium, 95% for steel, 99% for nickel and 100% for copper (Kaplinsky, 2005). China also accounted for over 30% of the increase in global oil demand between 2003 and 2004 (UNCTAD, 2005, p.74).

As a result the prices of many primary commodities exported from Latin America have increased significantly since 2002 (Gottschalk and Prates, 2005, Chart 5; UNCTAD, 2005, Table 2.8), leading UNCTAD to conclude that:

“The recent upward movement in commodity prices has been driven by very strong demand and emerging supply constraints. Rising imports by China, and, for some commodities also by India, have been the main sources of additional demand” (UNCTAD, 2005, p.73).

The other aspect of China’s impact on world prices is the effect on the goods which it exports, particularly those labour-intensive manufactures which have become “commodified”. World manufacturing export prices have been falling since the late 1990s and this has been particularly marked for those goods which China exports (Kaplinsky, 2005). Those countries which are importers of such goods clearly benefit from an improvement in their terms of trade, whereas exporters will suffer. Identifying these effects is more difficult than in the case of primary commodities since manufactures tend to be less homogeneous. It is also less clear how changes in world prices will affect domestic prices where both protectionist policies and the degree of pass-through drive a wedge between world and local prices.

The combined effects of increased prices of primary commodities and falling prices for imports of many manufactures has led to an improvement in the terms of trade of most of the major Latin American and Caribbean economies in recent years. Argentina, Brazil, Chile, Peru and Venezuela have all enjoyed increased terms of trade since 2002 (UNCTAD, 2005, Figure 3.4). The only large economies in the region where the terms of trade did not improve were Mexico and Colombia (UNCTAD, 2005, Figure 3.3).⁶ When the sources of changes in the terms of trade are identified, the reasons for these intra-country differences become clear. Chile and Peru have benefited from increased prices for ores and metals, Venezuela from oil price increases, and Argentina from

⁶ Some of the smaller Central American and Caribbean economies such as Honduras, Haiti and Jamaica did not share in this improvement in the terms of trade (UNCTAD, 2005, Figure 3.3).

increased prices of agricultural products and fuels. Brazil has benefited somewhat less because as an oil importer increased prices for other commodities have been partly offset by the increased oil price. In the case of Mexico, despite increased oil prices, the negative effect on prices of manufactured exports has meant that the terms of trade have not improved significantly (UNCTAD, 2005, Figure 3.4).⁷

This suggests that although in aggregate the impact of China's growth on the terms of trade of the Latin American and Caribbean economies has been positive, at the level of individual countries, there have been winners and losers. Whether a country is a winner or a loser depends on whether it competes with China or has an economy that is complementary to the Chinese economy in terms of the structure of exports and imports. It is also important to put these developments in the terms of trade in a longer term context. The recent increase has so far been fairly short-lived and, despite this improvement, the region's terms of trade are 30% lower than the level in 1980 (UNCTAD, 2005, Figure 3.2).

4. Major Consequences of China's Growth for Latin America and the Caribbean

The possible impacts of China's rapid growth and integration with the global economy for Latin America are many and varied. They depend in part on the relative significance of the different types of relationships described in Sections 2 and 3 for particular countries. Where the dominant relations are complementary then the Latin American country is likely to gain, whereas where competitive relations dominate, there are likely to be negative effects. This section considers the likely impacts of China on the region first of all on growth and then more specifically in terms of the implications for the poor.

a) Growth impacts

Most countries in Latin America and the Caribbean face serious balance of payments constraints so that a critical factor determining the impact of China on growth in the

⁷ UNCTAD (2005) does not provide a similar breakdown of the factors underlying changes in the overall terms of trade for other Latin American countries but it seems likely that the negative trends in the terms of trade of some of the Central American and Caribbean economies reflects their specialisation in a narrow range of labour intensive manufactures.

region is the effect that it has had on the balance of trade and the balance of payments. Since 2003 the overall trade balance of Latin America and the Caribbean with China has been positive (see Table 4).

However as Table 4 also shows, the regional average hides considerable differences between countries. Some countries such as Argentina, Brazil, Chile and Peru have trade surpluses with China while others, most notably Mexico and Panama, have deficits. The countries with large trade surpluses are those which, as was seen earlier, have been most successful in expanding exports of primary products to China. Even amongst these countries, there is concern that recently imports from China have grown rapidly and that these surpluses will not be maintained.

Bilateral trade balances only present a partial picture of the overall impact of China on Latin American and Caribbean trade. When account is taken of the effects of competition from China on exports to third markets, as well as the direct effects, the positive balances will be smaller and the deficits larger. Since the countries which are generally regarded as facing most competition in third markets (Mexico and Central America) also have deficits in their bilateral trade with China, the differences between countries in terms of the effects on the balance of trade are likely to be accentuated.

As discussed in Section 3 above, one of the ways of looking at the indirect impacts of China on the Latin American and Caribbean countries is via the effects on the terms of trade. Although there are no studies which estimate the extent to which changes in the region's terms of trade are a result of China's growth, it is possible to suggest the likely direction of change. Again this tends to reinforce the differences between countries as those whose terms of trade have improved most strongly have been exporters of primary commodities while exporters of labour-intensive manufactures have experienced stable or deteriorating terms of trade.

**Table 4: Trade Balance of Latin American and Caribbean Countries with China,
1995, 2000-2004 (\$ million)**

	<i>1995</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>
Argentina	96.9	319.7	706.9	1,054.2	2,281.9	2,402.6
Bolivia	-4.7	6.1	1.8	2.7	-5.0	6.0
Brazil	469.1	397.9	983.9	1,536.7	3,699.0	5,009.3
Chile	-180.2	555.0	487.6	566.9	961.1	1,987.8
Colombia	-38.5	-123.9	-180.0	-258.0	-337.8	-454.0
Costa Rica	7.1	-54.9	-36.7	103.0	462.4	486.9
Cuba	67.2	-147.3	-219.1	-194.8	-115.8	-135.9
Dom. Rep.	-38.1	-74.5	-38.1	-103.7	-144.6	-217.2
Ecuador	-15.9	5.3	-106.1	-181.1	-199.6	-251.4
El Salvador	-31.2	-62.2	-99.2	-130.7	-155.5	-193.1
Guatemala	-11.6	-134.0	-162.8	-244.0	-303.8	-349.8
Honduras	-31.2	-62.1	-65.0	-58.1	-74.5	-111.5
Jamaica	-17.2	-19.9	-51.2	-17.2	3.4	143.7
Mexico	-0.5	-847.0	-1,056.8	-1,749.2	-1,590.4	-2,833.1
Nicaragua	-5.3	-42.7	-34.4	-49.1	-69.0	-98.6
Panama	-585.4	-1,289.1	-1,238.0	-1,269.8	-1,451.5	-2,172.0
Paraguay	-78.3	-82.7	-69.3	-71.2	-113.5	-176.6
Peru	313.8	415.9	320.8	484.5	406.2	1,106.0
Uruguay	38.0	-141.7	-93.4	-16.8	-51.9	-99.2
Venezuela	-53.1	-161.7	-297.8	-188.1	342.9	142.5
Total 20 LAC	-99.2	-1,543.9	-1,246.8	-783.7	3,544.4	4,192.2

Source: IMF, Direction of Trade Statistics

Note: this table is based on data reported by China on its trade with Latin America, so that a positive value indicates that China has a trade deficit with the country concerned.

In considering the balance of payments impacts on the region, account also needs to be taken of the effects on FDI flows. Bilateral investment flows are small relative to trade so that the balance of payments impacts are likely to be dominated by the trade impacts. The effects in terms of diversion of FDI to China are unclear, particularly at the level of individual countries, but if as one study suggests they have been negative for Mexico and Colombia (Herrero and Santabárbara, 2004), this would reinforce the negative trade impacts in those countries.

The effects of China on the trade balances of the Latin American and Caribbean countries will affect growth in the short run, but what of the longer term prospects? A concern expressed by several commentators is that the growth of China is leading to deindustrialization in the region with potentially deleterious effects on technological development and long-term growth (Mesquita Moreira, 2004; Blazquez-Lidoy, 2004, p.29, Lall and Weiss, 2005, pp.184-5). Certainly the evidence presented earlier in this report indicates that the pattern of specialisation in trade between China and Latin America and the Caribbean is based on the exchange of Chinese manufactures for Latin American primary commodities. Moreover since it is Latin American and Caribbean exports of *manufactures* to third markets that are most threatened by Chinese competition, this tends to further threaten industrial production in the region. The emerging pattern of Chinese FDI in the region also tends to reinforce specialization in primary products.

Although there is a *prima facie* case for supposing that the growth of China is tending to change the structure of production in Latin America and the Caribbean and that the boom in primary commodity prices could lead to Dutch Disease effects in the region (IDB, 2004, p.151), there are a number of questions that need to be analysed further. More evidence is required on the effects of competition from Chinese imports on Latin American and Caribbean manufacturing. To what extent have imports from China displaced imports from other countries or domestic manufacturing? Most of the literature on the impacts of China on the region has focussed on competition in third markets, while the effects of competition in the domestic market have been neglected.

b) Poverty impacts

A further question that needs to be addressed is the likely impact of the growth of China on the achievement of the Millennium Development Goals, particularly the goal of poverty reduction, in Latin America and the Caribbean. Poverty impacts depend not only on the rate of growth but also on the nature of that growth in terms of distribution. As Alan Winters has argued, there are three main channels through which trade “shocks” can affect poverty⁸:

- the enterprise channel
- the distribution channel
- the government channel

These correspond to the impacts on the poor as producers, consumers and beneficiaries of government expenditure.

Only one study of the impacts of China on Latin America has focussed directly on the poverty issue (Jenkins and Edwards, 2004). This combined the Winters’ framework with an analysis of the competitive and complementary effects of China’s growth on six Latin American countries (Bolivia, Brazil, Honduras, Mexico, Nicaragua and Peru).

As producers, the poor are more likely to benefit where new opportunities are created for unskilled workers and peasant producers. The growth of exports to China from the region is unlikely to have had positive effects. Mineral production is generally capital and skill intensive and creates little employment, except in the initial construction stages of opening a new mine. Although agricultural exports have more potential for creating employment or increasing peasant incomes, there are numerous historical examples where the expansion of export agriculture has had negative impacts on the poor as new commercial opportunities have led the rich and powerful to appropriate land previously occupied by low income rural households (Berry, 2001). Since the major agricultural export to China from the region is soybean which is grown on commercial farms, this is

⁸ For a comprehensive development of this approach, see McCulloch et. al. (2001).

unlikely to have had a positive impact on the poor. Indeed there are recent reports of 500 smallholders being relocated to make way for soybean production in Santarem, Brazil (Watts, 2005). Soybean production is also much less labour-intensive than alternative crops that it replaces and it has been reported that in Argentina more than 300,000 farm workers have lost their jobs (Observer, 2004). Unfortunately there is a lack of detailed studies on these effects.

In the case of manufacturing, it has been suggested that the growth of China as a major source of low wage labour may have been one of the reasons why the opening of the Latin American economies in the 1980s and 1990s was accompanied by a growing gap between the wages of skilled and unskilled workers (Wood, 1997). There is certainly anecdotal evidence of Chinese competition leading to job losses in export industries. 300,000 jobs were lost in the Mexican *maquila* between 2000 and 2002 and firms such as Phillips, Black and Decker and Sanyo were reported to have relocated production to China (Santos Navarro, 2005). At the sectoral level, studies of the Mexican garment industry (CANAINTEX 2005; CNIV 2005; Cornejo 2005; Dussel Peters 2005/a/c; Rueda Peiro et. al 2004) and the electronics industry (Dussel Peters, 2005/a) found that employment had declined as a result of competition from China in the US market. There are also reports of plant closures and job losses in the Central American garments and textiles industry (see Box 1). Job losses in the garment industry are of particular concern because the industry is often a major employer of unskilled poor women workers who are often migrants from rural areas. There are few detailed studies which have analysed the extent to which such job losses can be attributed to Chinese competition. However there is enough evidence to raise questions about the viability of labour-intensive manufactured exports as a major strategy for poverty reduction in Latin America in the future.

The impact of the growth of China on the poor as consumers has not been studied in any detail. If Chinese imports significantly reduced the cost of living for low income families then there would be potential for poverty reduction. Jenkins and Edwards (2004, Table 10) find that the proportion of imports from China which can be classified as basic consumer goods (food, beverages, tobacco, garments and footwear) are relatively low in

the six countries which they studied, although they did account for around a fifth of total imports from China in Bolivia and Nicaragua. There is no evidence however on the extent to which imports from China have led to reduced consumer prices in the Latin American countries. Thus the role of the distribution channel in terms of poverty is uncertain.

The third channel to be considered is via government expenditure. One of the potential benefits of increased trade for Latin America and the Caribbean is an increase in government revenues.⁹ This raises the question of the extent to which governments in the region are able to capture some of the benefits from increased exports to China and from increased prices for primary products?

Rent appropriation by governments is potentially greatest for oil and minerals because of the extensive involvement of the state in these sectors, either through direct participation in ownership or through royalties and taxes. Studies of various Latin American countries show considerable variations in the degree of rent appropriation among oil and mineral exporting countries (UNCTAD, 2005, Annex to Ch. III; Gottschalk and Prates, 2005, p.23). These reflect the extent of state ownership in the sectors and the incentives given to private investors. On the other hand, where exports are agricultural products, governments are less likely to appropriate significant rents.

Although the growth of China has clearly played an important part in the recent growth of primary product exports and the increase in their prices, there have been no studies which attempt to quantify the effect that this has had on government revenues in the region. The impact on poverty will also depend on the extent to which any increases in revenue will lead to greater pro-poor expenditures on the part of the governments of the region. There are positive signs in Chile where the newly elected President has plans to increase social expenditure from the large surpluses being generated by the state owned copper industry.

⁹ Conservative commentators see this as a disadvantage since it may lend support to state industries and ruling oligarchies and delay the reforms that are required in the region (Johnson, 2005).

5. Key Knowledge Gaps

There are still a number of uncertainties and gaps in our knowledge concerning the implications of China's growth for Latin America and the Caribbean. Here we will concentrate first on data issues and secondly on areas which have up to now received relatively little attention in terms of research.

a) Data issues

There are some question marks concerning the accuracy of the data on trade between China and the region. This has been highlighted in the case of Mexico by the differences between official Mexican figures on its trade with China and the corresponding Chinese statistics on trade with China. According to Mexican sources, Mexico had a trade deficit of US\$14 billion with China in 2004, whereas the corresponding figure given by the Chinese authorities is only \$2.8 billion (Dussel Peters, 2005/b, Cuadro 1). Although not as extreme as in the Mexican case, several other Latin American countries show significant discrepancies between their data on trade with China and those reported by the Chinese authorities.¹⁰ It has also been found in the Mexican case there are considerable differences in reported trade for products at a high level of disaggregation. This gives rise to possible differences in results according to which data set is used when analysing trade with China. While some of these differences may be unavoidable, research in this area would be facilitated by the development of a common data set which avoids major discrepancies.

The lack of accurate and up-to-date statistics on foreign investment flows and stocks is a further limitation for research and policy in this area. Given the concern that announcements of Chinese investments are not always followed by actual investment a clear distinction needs to be drawn between planned and disbursed investments.

¹⁰ Countries for which exports to China are significantly less or imports from China are significantly more than reported by the Chinese authorities are Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Nicaragua, Peru and Venezuela as well as Mexico. Data for 2003 on reliability of trade statistics from the International Trade Centre web page at <http://www.intracen.org/menus/countries.htm>

b) Research gaps

Most of the previous studies on China's impact on the region have focussed on the competitive threat posed by China to Latin American and Caribbean manufactured exports to third markets and, to a lesser extent, the exports of primary products from the region to China. Relatively little attention has been given to the growth of imports from China, although these have increased significantly and are now giving rise to concern amongst governments, firms and workers in a number of countries. This is particularly acute in those countries which have a trade deficit with China. A careful investigation of the role played by factors such as labor costs, productivity, scale, government intervention and geography, particularly at the sectoral level, could shed a critical light on the dynamics of Chinese competition in Latin America and the Caribbean and thus help to formulate more effective public policies. Such research could also help deepen understanding of the competition faced by Latin American countries in third markets.

The discussion of exports from Latin America and the Caribbean to China has been mainly descriptive. Very little attention has been given to explaining the differences in export performance between countries, the timing of the export boom from the region, and to identifying the obstacles to increased exports to China. Some recent studies (including López Córdova et. al., 2005) have achieved important results in analyzing China-Latin American trade. This analysis could be deepened for the bilateral trade relationship and at a more disaggregated level of the HTS. Further research in these areas can help the design of policies to take better advantage of China's growth.

As was pointed out earlier, there has also been relatively little research on the FDI aspects of China's relations with Latin America. This partly reflects a lack of data (see above) and is also an area where more research would be valuable.

The most important gap in terms of research has been the lack, up to now, of detailed analysis of the outcomes for Latin America and the Caribbean of China's growing

economic significance, especially in terms of the impacts on poverty, as was seen in the previous section. There is a need for more country studies and studies of specific value chains which can trace through the impact on industrial production, employment, wages and other variables at the national and sectoral levels. Analysis of specific value chains to understand their respective strengths, specialization in specific segments, firm-strategies, as well as short, medium and long-term scenarios (in both China and Latin America and the Caribbean) would be particularly valuable. The most relevant value chains would depend on the country concerned. For example in Mexico textiles, electronics, autoparts and automobiles, and food and beverages would be of particular interest.

6. Conclusion: Challenges Facing Policy Makers

A better understanding of the dynamics of the economic relations between China and Latin America and the Caribbean is vital in order to identify effective policies that can help countries in the region to deal with the many challenges brought about by China's emergence. It is also important for Chinese policy makers to understand the impacts that China's growth is having in other developing regions and the possible responses to the challenges which China poses. Nevertheless, one should not overestimate the extent of such impacts and it is important to bear in mind that economic relations with China are still far less significant for the region, both as a whole and for individual countries than relations with the OECD countries.

The main challenge for Latin American and Caribbean policy makers is how to respond to the increased competitive strength of China. This is not only an issue for those countries such as Mexico which face competition from China in export markets but for all countries as their domestic markets are increasingly subjected to competition from Chinese imports. There will be pressures to respond through protectionist measures against imports from China and where evidence exists of dumping by exporters, this is justified.¹¹ However this should not be used to hide an underlying problem of

¹¹ Where smuggling is a major problem and this harms domestic producers, action to tighten customs procedures and border controls are also necessary.

competitiveness in the region and will not help meet Chinese competition in export markets. Here there is a need for countries to improve their capacity to differentiate and diversify their exports away from standardized labour-intensive products. Countries also need to exploit their geographical advantages, for example in terms of their proximity to the US market. This is particularly true in the case of Mexico and the Central American and Caribbean countries.

The countries which have become successful exporters of primary commodities to China also face a number of challenges. They need to diversify what is still a very narrow range of products exported and find ways of increasing the degree of processing of some of the products currently exported. They also need to find mechanisms for dealing with the potential Dutch Disease effects associated with an export boom. In terms of achieving the poverty reduction targets of the MDGs, attention needs to be given to the distribution of the gains from increased exports, particularly ensuring that some of these go to benefit the poor through governments capturing part of the increased revenue and increasing pro-poor expenditures.

Chinese policy makers need to take into account their impact on Latin America and the Caribbean and the likely responses from the region. The initial emphasis in most Latin American countries was positive, seeing China as a new and booming market for their commodity exports. This is likely to evaporate over time and be replaced by growing concerns over competition from Chinese imports and frustration if export growth tends to slow down. In response to the latter, China needs to consider how its policies may be constraining the expansion and diversification of Latin American and Caribbean exports. As far as imports from China are concerned, it is important that the region is not used as a dumping ground for Chinese exports which face increased restrictions in Europe and North America as a result of the new arrangements that have been introduced over the past year. China also needs to bear in mind that what may be quite marginal volumes from the point of view of its own gigantic economy can loom very large in the much smaller Latin American and Caribbean economies.

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