The Impact of China and India on Latin America

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China's integration into world trade represents a fundamental episode in the current economic dynamics[1]. With an average growth of 9.5% per year since 1978, China today occupies third place in the world economy. In mid-2007 the country became the leading world exporter, ahead of Germany.

China's boom has partly eclipsed that of another giant: India. Although the latter's contribution to world growth is less than that of China, the effects it has on the world economy should not be underestimated. Since the mid-1990s, India has in fact logged an average growth rate double the world average. This growth moreover goes hand-in-hand with the integration of Indian companies into world markets. They are even managing to compete with the major multinationals of developed countries on their own soil.

Most Latin American countries are not particularly threatened by China and India, and might even be able to enjoy an increase in their revenue given the rising prices of the commodities they export. But these countries also run the risk of growing too dependent on those exports, which in the long run could turn out to be problematic for the entire economy.

Competition and the makeup of commercial exchanges

The remarkable growth of these two Asian giants influences both industrialized and emerging economies, including Latin America. To gauge the effects, we

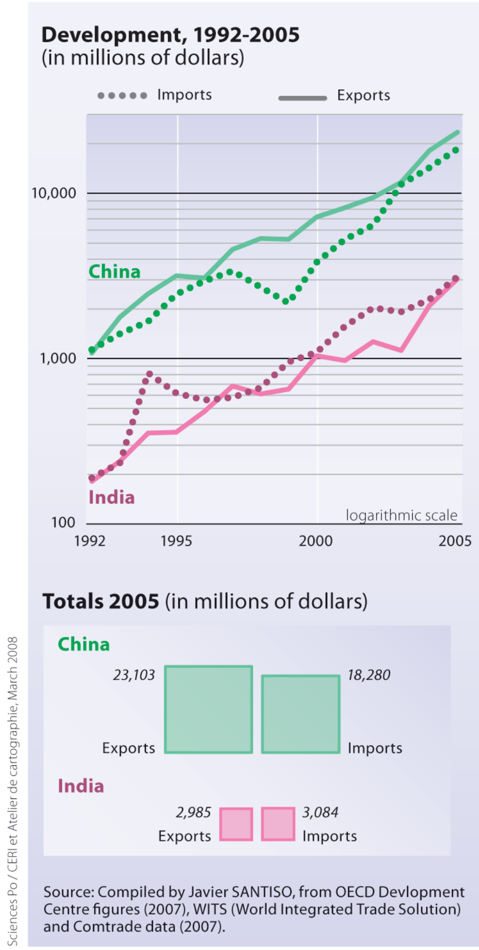
1 This chapter mainly draws its inspiration from the *Latin American Economic Outlook* 2008 report put out by the OECD Development Centre, presented in Paris on 29 November 2007 at the Maison de l'Amérique Latine. For more information on the Centre's activities, see the www.oecd.org/dev website, and on the topic of the Asian giants' impact on Latin America, the http://www.oecd.org/document/8/0,3343,en_2649_33731_38434504_1_1_1_1,00.html. website.

compared the trade structures in China and India with those of Latin America in order to identify possible areas of competition and then pinpoint complementarities and trade opportunities.

The contribution of China and India to the growth in world production is exceptional: in 2007, 27.9% of the world's growth could be ascribed to China and 7.9% to India. These trends in China and India have major repercussions on other emerging markets. Indian and Chinese companies are flocking to Africa and Latin America, attracted by raw materials (Santiso 2006; Goldstein *et al.* 2006). Chinese investors are also interested in Latin America: in 2004, this region was the destination for nearly 50% of China's foreign direct investment (FDI).

The increase in Chinese and Indian exports has sometimes aroused apprehension. Their gains in market shares, particularly China's, have led certain Latin American countries to worry about their own exports. Some fear that Chinese growth will occur at the expense of other emerging countries (Lora 2007). Moreover, in Latin American opinion polls, China appears as the least desirable foreign investor (Latinobarometro 2007). Exports of Chinese manufactured products are moreover hit by relatively steep tariffs in this region.

figure 71: **China's and India's trade with Latin America, 1992-2005**



Source: Compiled by Javier SANTISO, from OECD Devlopment Centre figures (2007), WITS (World Integrated Trade Solution) and Comtrade data (2007).

Is Latin America really in competition with China and India?

A more in-depth study of trade structures provides a means of gauging whether this perception of Chinese and Indian commercial activities is justified. By comparison of trade structures, strengths and weaknesses can be identified in each sector as well as the opportunities that are taking shape. Nevertheless, the composition of trade does not explain everything, because the Asian giants have direct effects, via rising demand, but also indirect ones, via rising prices. The structure of trade nevertheless constitutes an important departure point for this analysis.

The effect of intensified Asian competition and local companies is an important question for Latin America. Our analysis shows that most of the countries figure 72: **Latin America Trade Competition vs. China and India, 2000-2005**

Source: Compiled by Javier SANTISO from OECD Development Centre (2007), WITS and Comtrade data (2007).

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on the subcontinent have little to fear from the intensification of trade with China and India.

Chinese exports represent competition for some other emerging countries and Latin America. To measure this competition, we compare the composition of each country's trade with that of China.[2] A high indicator, as determined by their specialization and conformity coefficients, reflects a similarity in export structures. When the structures are similar, export competition is considered to be intense. For most of Latin America, however, few elements support the idea of a threat from China and India. Other emerging economies such as Thailand, Hungary and Malaysia have much more to fear from stiff competition with Chinese exports. Competition with India is also relatively moderate.

Encouraging export destinations for Latin America

The boom of China and India can also be perceived as an opportunity, for countries subject to intense competitive pressure among others. To measure this possibility, modified specialization and conformity coefficients have been calculated, to compare the exports of Latin American countries with imports from China and India. The rapid development in the domestic markets of these two latter countries has gone along with a rise in the standard of living, which is a good sign for exports.

At first glance, the results do not seem to indicate the existence of a very strong complementarity between China and India on one hand and

2 The specialization and conformity coefficients (CS and CC) help to estimate the level of trade competition between two countries by comparing their export structures. If two countries (i, j) have exactly the same structure, then the two indexes are equal to 1 and their potential trade competition is high. In the opposite case, the two indexes are equal to zero.

most Latin American countries on the other. The economies of Southeast Asia—Korea, Thailand, Japan and the Philippines—display much greater complementarity with China. This situation cannot be explained by the lack of commercial opportunities, but rather by the fact that the trade potential is concentrated on a relatively limited basket of products.[3]

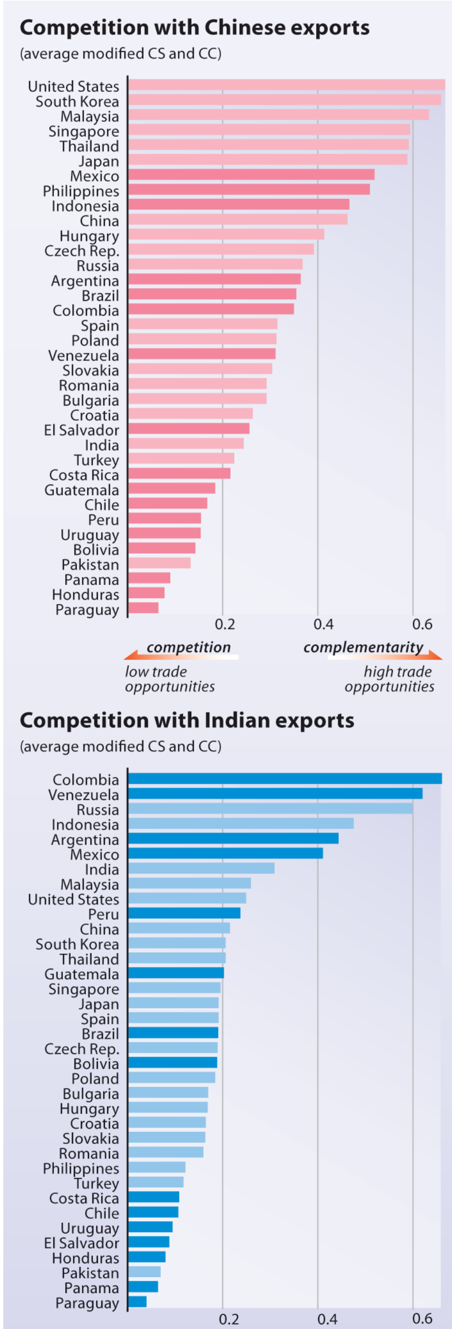
Furthermore, for countries benefiting from the greater potential for trade with India and China, inter-industrial trade possibilities prove to be numerous. Mexico for instance is a big exporter of telecommunications equipment and electric circuits, which China and India import in large volumes, but for which trade is not currently very regular.[4] In the case of Brazil, beyond the vast potential represented by commodity exports, other sectors are also promising for trade with China: aircraft, telecommunications equipment and motor vehicle parts. In its relations with both India and China, Colombia enjoys considerable trade potential due to its natural resources (particularly oil and coal) but also its manufactured products. Argentina finds its main export opportunities in its natural resources, but in future it could also take advantage of significant possibilities in the processed foods sector.

Agriculture and agri-business in fact count among the most promising areas for Latin American trade with China and India. Latin American exporters in the sector may be able to take advantage of the changing behaviour of Chinese and Indian consumers as long as they move up the added-value and product quality chains, diversify, build brands and innovate.

3 For a more detailed study on trade opportunities between China and Latin America, see *Latin American Economic Outlook 2008*, OECD Development Centre, 2007.

4 These trade opportunities were identified by determining the sectors in which large shares of exports from Latin America corresponded to large shares of imports from China.

figure 73: **China's and India's trade opportunities with certain states, 2000-2005**



Source: Compiled by Javier SANTISO from OECD Development Centre, WITS and Comtrade data (2007).

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Argentina, Brazil, Chile and Uruguay all have agricultural sectors with a good potential for expansion. These countries should also benefit from open access to the agricultural products markets of the Asian giants, which they might negotiate collectively.

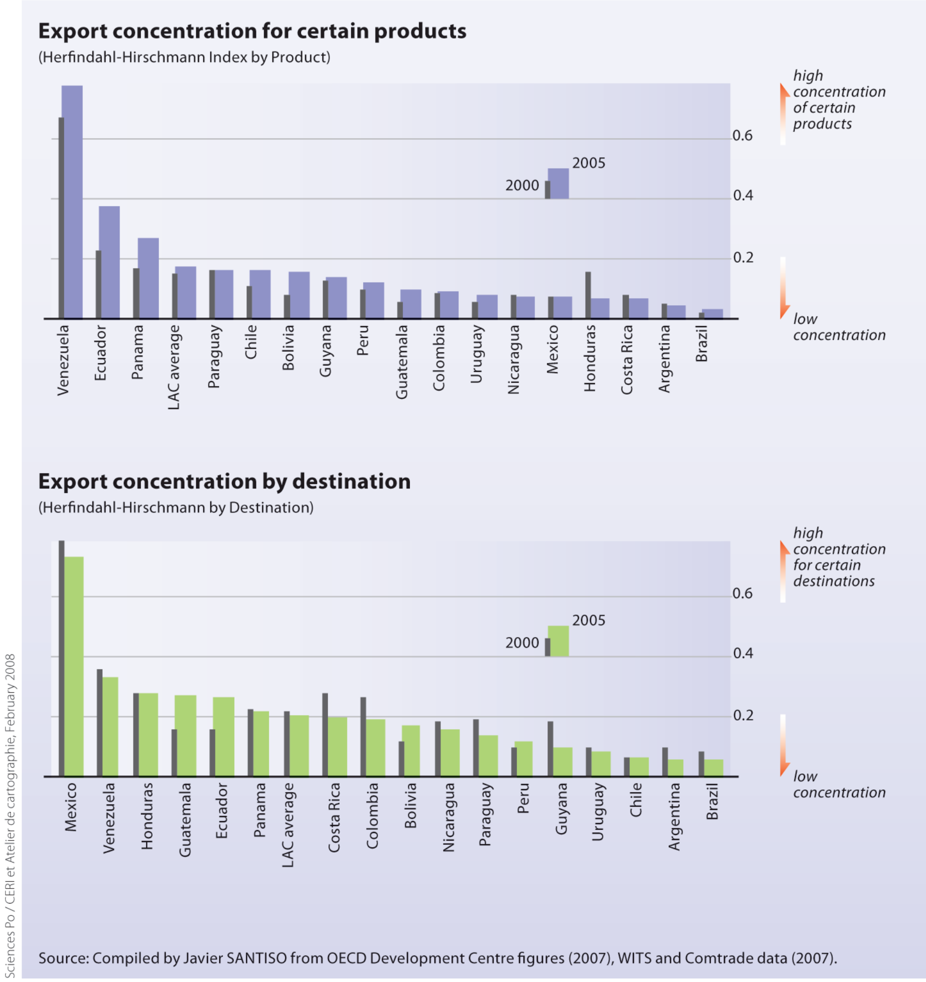
Our findings indicate that until now Latin America has little reason to feel threatened by the growth of these Asian giants. On the contrary, it could even draw significant commercial opportunities from it, including opportunities in the more "sophisticated" segments of the value chain (i.e. the agrifood business). Trade complementarity and opportunities between Latin America and Asia have an effect not only on the commercial imbalances but on the entire economy of the subcontinent, which must be careful not to become overly specialized in commodities and must take advantage of synergies between the development of trade and infrastructures.

The risks of excessive specialization in natural resources

Out of the 19 principal Latin American and Caribbean exporters, 11 specialize in commodities (Mulder 2006), while both China and India are prime importers of these goods. The sector thus represents significant export opportunities for Latin America. Despite overall favourable perspectives, countries whose export structure relies primarily on commodities run the risk of finding themselves driven to concentrate on resource industries and neglecting the development of other sectors. The boom in commodity exports and the exceptional revenue it has generated involve a certain number of risks: the literature devoted to the "natural resource curse" sheds light on these dangers, some of which are related to macroeconomic performance, others to the low level of social development (Sachs and Warner 1995, Gylfason 2001, Auty 2001).

We observe the degree of commodity concentration in Latin American exports for the years 2001 and 2006 (a period corresponding to the emergence of the Asian drivers), calculated using the Herfindahl-Hirschmann index. This measure of concentration considers each commodity exported as a portion of total exports. When the share of a specific commodity is high, the index value rises. Here the index seems to indicate that raw material exporting countries could be in jeopardy because of their specialization in commodities. With a few exceptions, in particular Argentina and Costa Rica, most Latin American countries currently show a higher level of concentration of their exports than at the beginning of the century.

Specialization in natural resources highlights the need to innovate. Whereas the lack of diversity of commodities and the low proportion of intra-industrial trade could limit growth in the long run, Latin America displays modest results in terms of innovation. According to the ranking of global competitiveness by the figure 74: **Export concentration of certain Latin American states, 2000-2005**



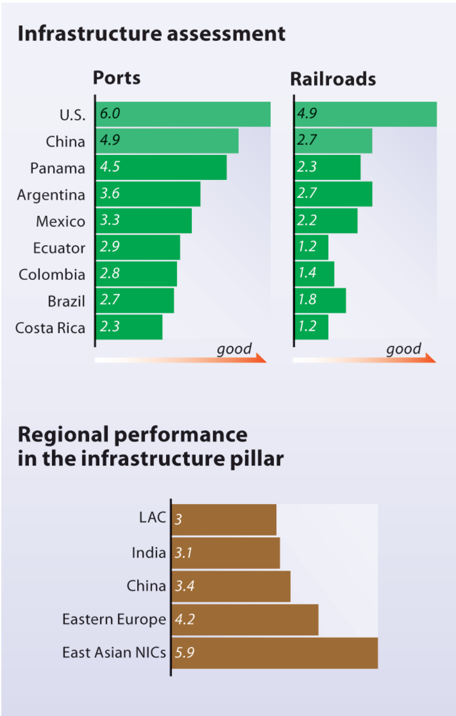
Source: Compiled by Javier SANTISO from OECD Development Centre figures (2007), WITS and Comtrade data (2007).

World Economic Forum in 2006, the region is located at the bottom of the ladder. Only Costa Rica, Brazil and Chile stand out, yet with fair to middling overall performances. Furthermore, Latin America concentrates most of its R&D efforts on basic research, with a fairly low level of private sector participation. Lastly, raising the level of education is a priority today in all the countries of the subcontinent, including those exhibiting the best performances, if only to strengthen the contribution of R&D.

Infrastructure: a necessary development

One of Latin America's main assets is its relative proximity to its main markets, especially for the countries closest to the United States. Not only do Chinese exporters have to bear high transport costs, but the distance also implies delays that raise freight and transaction costs (Hummels 2001). This aspect is particularly important in sectors where time represents a strategic advantage. Adequate infrastructure can help strengthen Latin America's competitive trade position and enable the region to take advantage of its nearness to the United States. Yet investment in this area is insufficient. In fact, far from diminishing, the effects of distance on trade have increased in recent years (Deardoff 2004, Brun *et al.* 2005, Glaeser and Kohlhase 2003). Only rapid delivery, however, is an asset that will enable distributors to respond quickly and effectively to fluctuations in demand without having to bear the cost of holding large stocks (Evans and Harrigan 2003, Oman 1996). Latin American countries facing competition from the Asian leaders have every interest in identifying sectors and products for which time and distance are truly competitive advantages. This is the case with the garment industry, where fashions change often and quickly, but also with semi-finished goods in the automobile and electronics industries where lighter production systems impose just-in-time delivery.

figure 75: **Trade infrastructure in Latin America, 2006**



Source: Compiled by Javier SANTISO from OECD Development Centre figures (2007), CG/LA database (2006) and World Economic Forum (2005).

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Latin American countries would also do well to place their bets on key sectors by improving their infrastructure. Transport costs usually represent a greater obstacle than tariffs to entering the United States market (Clark *et al.* 2004). Paradoxically, transport costs of Latin American countries, except Mexico, are on the average similar to those of China, or even higher. The high cost of transport is not related to distance but basically to the quality of the infrastructure. A detailed analysis of shipping costs to the US market shows to what extent the efficiency of ports is a decisive factor (Clark *et al.* 2004). In the case of Mexico, neighbour to the United States, if the efficiency of its ports was brought up to a level comparable with that of France or Sweden, transport costs could be lowered by about 10%, and by more than 15% for Brazil and Ecuador. Competitiveness indicators highlight the great disparity in performance among Latin American countries. The region's geographical advantage does not show up in the data, with China's performance seeming to outstrip that of most Latin American countries. Commodity-reliant economies such as Chile and Venezuela concentrate their investments on transport infrastructure, whereas countries that depend more and more on the secondary sector, such as Mexico, invest more in energy needs. On the whole, it is estimated that for coastal countries, about 40% of the anticipated transport costs are linked to the quality of overland infrastructure (Limao and Venables 2000).

The main explanation for infrastructural weakness resides in the lack of sufficient investment and inadequate project implementation. Even if Chile's and Colombia's successes show how important it is to convert a rising growth rate into a rise in the infrastructure investment rate, most Latin American countries have not followed their example. The modernization of infrastructure is made difficult by unsuitable regulations, a lack of long-term planning and poor project management. A solid partnership between the public and private sectors is essential in this endeavour. Chile, and to a lesser extent, Colombia, have managed to make the best use of this type of partnership and have invested heavily in infrastructure since the mid-1990s (Calderón and Servén 2004). Despite huge efforts, Mexico has not managed to stimulate solid investment in this area. Similarly, Brazil has shown no notable improvement in the field of transport. It is particularly vital for Mexico and the Central American countries—the most exposed to competition from China and India—to build infrastructure that will reinforce their commercial efficiency and enable them by the same token to capitalize the extraordinary competitive edge that their proximity to the United States, still the world's leading economy, gives them.

A growing role for foreign direct investments

China's and India's growth has had repercussions on the trade relations of all Latin American countries. Even if the surge in exports from the Asian giants has given some cause for concern, the conclusions of the present study show that they pose little threat to most of the region's economies. On the contrary, they could derive considerable benefits from it, both directly by stepping up trade and indirectly by the rise in export prices of Latin American commodities as a result of these countries' rapid growth. However, even if the growth of China and India does not present an immediate threat to most of the Latin American countries, it draws attention to certain difficulties that the subcontinent is confronted with. The development of trade with China and India should increase markets for most Latin American states. Exports are, however, likely to be concentrated on commodities. So Latin American countries should by all means encourage innovation in relation to commodities, pursue diversification of their economies and invest in their infrastructure.

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