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Chile’s Economic and Political Relationship with China

Juan Carlos GACHÚZ

Abstract: China’s foreign policy has been characterized in the last decade by a heightened interest in reaching out to Latin America, particularly to countries rich in natural resources and with potential markets for Chinese exports, and Chile is one of these countries. The paper shows that even though the Chilean economy has benefitted from the signing of the FTA, it also faces potential risks. To continue to benefit, Chile needs to boost exports in other potential export sectors (value-added products or services) and should attempt to attract more Chinese FDI to Chile’s export industry. The export of raw materials (particularly non-renewable ones) is not always sustainable in the long term. The roles of the Chilean state and the private sector in attracting Chinese investment and enhancing diversification of exports of value-added products are crucial for the future of the economy of Chile and its relationship with China.

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Introduction

Currently, China's relationship with Chile is one of the former's most solid in all of Latin America. Chile was the first Latin American country to sign a free trade agreement (FTA) with China (the other countries being Peru and Costa Rica). The Chile–China relationship started under the socialist government of Salvador Allende; in 1970, Chile was the first South American nation to establish diplomatic relations with China (Ministerio de Relaciones Exteriores 2009). After Allende was overthrown in a coup d'état, Pinochet took over and made significant changes to the nation's strategy of rapprochement with China. As opposed to many other countries and socialist governments, China continued and maintained diplomatic relations with the government of Pinochet, although they remained superficial. As Chile's foreign policy changed in the mid-1970s, Minister of Foreign Affairs Hernán Cubillos visited China in 1978 and subsequently signed agreements regarding cooperation in economic and commercial areas, science and technology, and in cultural activities. It was also during this time that FDI exchanges started, mainly in the mining industries.

In the 1990s, as the Chilean economy enhanced the diversification of its exports, the new government made its relations with the Asia-Pacific region a priority (Jenkins and Dussel Peters 2009). Subsequently, it was Chile who supported China's entry into the World Trade Organization (WTO) and recognized China as a free market economy. With the government of Ricardo Lagos, China's new role as a strategic partner was firmly established via an aggressive strategy that fostered closeness. This included the negotiation and signature of an FTA in the year 2006, the first in Latin America. Subsequently, China has signed FTAs with Peru and Costa Rica, along with coming to various agreements on commercial cooperation with Argentina, Venezuela, Cuba, Mexico and Brazil.

Based on a case study approach, this paper shows how China's main economic and political interests in this relatively small country of 17 million inhabitants is its mineral sector, particularly its copper and molybdenum. The outcome of the Chile–China FTA is an important issue for other Latin American countries seeking to sign similar agreements with China. Other countries have also drawn important lessons from the Chile–China relationship on other relevant topics (FDI, political relationship, potential risks, etc.). Data and relevant information concerning trade between Chile and China were mainly taken mainly from ProChile (the Trade Commission of Chile), which is part of the General Directorate of International Economic Affairs of Chile's Ministry of Foreign Affairs. ProChile is responsible for implementing and enhancing Chile's trade policy, and along with the Servicio Nacional de Aduanas de Chile (Chilean Customs), provides updated information about Chile's international trade. *China Daily*, *Xinhua* and *People's Daily* also proved useful sources in obtaining data on the Chinese agenda in Chile and information about trade between the two countries.

The paper is divided into seven sections: China–Latin America: Trade and Politics; Trade with Chile; China–Chile FTA: Negotiations and Outcomes; Foreign Direct Investment; China's Geo-economic and Geopolitical Interests in Chile; Risks and Recommendations; and finally, Conclusions. As we will see, China produces less than one-sixth of its own copper needs, but consumed 40 per cent of world's production of copper in 2010; it is of vital importance for China to look for source countries. Since 2007, more than one of every five tonnes of copper Chile produced has been shipped to China. Chile used China's interest in its copper to its advantage in the context of the FTA, which allows Chile to increase mineral exports to China and to diversify its exports to the Chinese market. Diversification of exports is what Chile lacks in its relationship with China. Currently, Chilean exports are almost 80 per cent cooper, iron and molybdenum.

China–Latin America: Trade and Politics

In the last decade, China has had a growing interest in strengthening trade and political relations with Latin America. President Jiang Zemin visited the region in 1993, 1997 and 2001, and during his last visit he declared increasing trade between China and Latin America a priority (Husar 2007). In November 2004 President Hu Jintao followed suit and in March 2005 Vice-President Zeng Qinhong continued with the visits. Since then, official and non-official visits have become common between China and Latin American countries. The increased exchange has resulted in the signing of commercial deals and an improvement in political relations. So far, China has signed FTAs with three Latin American countries – Chile, Peru and Costa Rica – while other countries like Mexico, Brazil, Argentina and Colombia have experienced sharp growth in exports and imports from China.

Latin America's trade with China has increased dramatically in the last few years; it grew more than 160 per cent from 68 billion USD in 2006 to 178.9 billion USD in 2010. Trade exchanges have benefitted both sides: In 2010 Latin American exports to China totalled 90.3 billion USD while they imported goods worth 88.6 billion USD. China enjoys a small surplus trade to Latin America of 1.7 billion USD.

In 2010 Latin American exports to the US and Europe decreased by 26 per cent and 29 per cent, respectively, while exports to China grew 11 per cent; in the short term, China could replace Europe as Latin America's second-biggest trade partner in the region. Bilateral trade between China and Latin America is not homogeneous but rather concentrated in few countries and few sectors: Latin American exports to China are mainly copper and soy, which account respectively for 30 per cent and 12 per cent of Chinese imports.

China's investment in the region grew from 15 billion USD in 2010 to 22.7 billion USD (through November) 2011. In 2011 China became the third-biggest investor in Latin America (9 per cent) after the United States (17 per cent) and the Netherlands (13 per cent) (UN Trade Statistics 2011). Latin America is the second most important destination for Chinese FDI, just after the Asia-Pacific region.

Additionally, a key issue for China's engagement in Latin America is the recognition of Taiwan by several Central American and Caribbean nations, as currently 12 of the 23 countries that have diplomatic relations with Taiwan are located in this region: Belize, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay, Saint Christopher and Nevis, St. Lucia, and St. Vincent and the Grenadines. China wants to convince these countries to not recognize Taiwan as an independent entity anymore but to instead see it as part of China, and in recent years China has followed Taiwan's "checkbook diplomacy", offering aid packages and increasing political and military presence in the area (Koleski 2011).

Trade with Chile

The signature of the Chile–China FTA has brought about an important increase of trade between the countries. Chilean exports to China increased from 4.4 billion USD in 2005 to 16.71 billion USD in 2010. Chinese imports have also grown significantly, going from 2.5 billion USD in 2005 to 8.29 billion USD in 2010. Therefore, trade grew from 6.9

billion USD in 2005 to 25 billion USD in 2010, as Table 1 shows. It is also interesting to note that even though Chinese exports increased more to Chile than vice versa, Chile maintains a surplus in its trade balance of approximately 8.4 billion USD, mainly due to the mining industry's exports (copper) (see Table 1).

Table 1: Chile–China Trade, 2000–2010 (in million USD)

	2000	2001	2002	2003	2004	2005
Exports (FOB)	907	1,021	1,240	1,865	3,227	4,445
Imports (CIF)	951	1,013	1,102	1,290	1,847	2,542
Total trade	1,858	2,035	2,342	3,155	5,075	6,988
Trade balance	44	8	138	575	1,380	1,903
	2006	**2007**	**2008**	**2009**	**2010**	
Exports (FOB)	5,033	10,051	10,005	11,892	16,719	
Imports (CIF)	3,599	4,931	6,287	5,117	8,296	
Total trade	8,632	14,982	16,831	17,009	25,015	
Trade balance	1,435	5,120	3,178	6,775	8,423	

Note: Given in value of USD in 2010.

Source: Calculated with data in ProChile 2011.

For the government of Chile, one of the main objectives of the FTA with China is to diversify and incorporate new products that can be exported to China. China is now the main destination of Chilean exports (see Table 3). The main Chilean exports are in the mining sector (see Table 4), concentrated primarily in two products: cathodes of refined copper (50.9 per cent) and molybdenum ores (2.3 per cent). In 2010 Chile exported 12.1 billion USD worth of cathodes of refined copper and copper minerals to China; in the same year Chile exported the same products to the US to the tune of 2.13 billion USD. The US has become the second main importer of Chilean copper (ProChile 2010).

Table 2: Top 10 Chilean Export Companies, 2009 (in million USD)

Ranking 2009	Company	Industry	Exports 2009	Total %
1	Corporacion Nacional del Cobre	Mining	9,720	19.5
2	Minera Escondida Ltda.	Mining	4,373	8.8
3	Compania minera Dona Ines de Collahuasi SCM	Mining	1,667	3.3
4	Mineria Los Pelambres	Mining	1,484	3.0
5	Celulosa Arauco Y constitucion	Lumber industry	1,250	2.5
6	Noranda Chile Ltda.	Mining	991	2.0
7	Empresa Nacional de Mineria	Mining	838	1.7
8	Sociedad Contractual Minera el Abra	Mining	789	1.6
9	Empresa Minera de Mantos Blancos	Mining	743	1.5
10	CMPC Celulosa SA	Lumber industry	736	1.5
	Others		27,347	54.8
	Subtotal		22,591	45.2

Note: Given in value of USD in 2009.
Source: Calculated with data in ProChile 2011.

Table 3: Chilean Exports by Country, 2003–2009 (in million USD)

Ranking 2009	Country	2003	2004	2005	2006
1	China	1,836	3,212	4,390	4,921
2	United States	3,467	4,568	6,247	8,905
3	Japan	2,237	3,697	4,536	6,038
4	South Korea	1,014	1,804	2,211	3,405
5	Brazil	839	1,403	1,729	2,750
6	Netherlands	770	1,654	2,301	3,815
7	Mexico	920	1,303	1,581	2,286
8	Italy	905	1,339	1,658	2,812
9	Taiwan	582	957	1,282	1,533
10	Canada	414	778	1,069	1,289
11	Peru	425	526	724	925

Ranking 2009	Country	2003	2004	2005	2006
12	France	733	1,287	1,387	2,412
13	Spain	478	730	963	1,357
14	Germany	592	901	931	1,759
15	India	222	426	493	1,489
16	Argentina	323	447	624	759
17	Belgium	272	329	377	697
18	Venezuela	147	273	358	492
19	England	690	857	616	665
20	Colombia	284	309	347	489

Ranking 2009	Country	2007	2008	2009
1	China	9,950	9,851	11,539
2	United States	8,420	7,794	5,646
3	Japan	7,092	7,231	4,481
4	South Korea	3,849	3,881	2,916
5	Brazil	3,356	4,165	2,576
6	Netherlands	3,909	4,243	1,900
7	Mexico	2,368	2,218	1,466
8	Italy	3,455	3,404	1,320
9	Taiwan	1,749	1,958	1,299
10	Canada	1,201	1,415	1,213
11	Peru	1,034	1,488	1,210
12	France	2,390	2,277	1,186
13	Spain	1,338	1,978	1,119
14	Germany	1,661	1,815	1,053
15	India	2,211	1,744	908
16	Argentina	877	1,108	844
17	Belgium	755	776	842
18	Venezuela	866	1,253	771
19	England	679	660	583
20	Colombia	617	734	577

Note: Given in value of USD in 2009.

Source: Calculated with data in ProChile 2011.

Table 4: Chilean Exports by Product, 2009 (in million USD)

Ranking 2009	Product	2009	% Total 2009
1	Copper	25,436	50.9
2	Salmon	2,083	4.2
3	Chemical wood pulp	1,975	4.0
4	Wine	1,387	2.8
5	Molybdenum ores	1,127	2.3
6	Grapes	897	1.8
7	Gold	880	1.8
8	Services (mainly transport)	858	1.7
9	Fishmeal	607	1.2
10	Apples	444	0.9
	Subtotal	35,693	71.5
	Others	14,245	28.5
	Total	49,938	**100.0**

Note: Given in value of USD in 2009.
Source: Calculated with data in ProChile 2011.

In 2010 China produced 1.25 million metric tons of copper, and in the same year in this category, China overtook the US (1.13 million metric tons) and Peru (1.19 million metric tons); however, Chile remains the world's number-one producer (5.84 million metric tons), accounting for 32 per cent of worldwide production. China is currently the biggest copper consumer (approximately 7.9 million tons in 2010), accounting for almost 40 per cent of worldwide consumption.

In summary, China produces less than one-sixth of its own copper needs, but consumed 40 per cent of world's production in 2010; therefore, it is of vital importance for this country to look for source countries.

Apart from the high consumption of copper in the automotive and electronics industries, copper is used in China in the construction of railways, airports, hospitals, schools, infrastructure, water projects, energy projects, new factories, houses, buildings, oil and natural gas refineries, power plants, wind energy turbines, solar power, airplanes, ships, machinery and many other sectors.

The mining industry is one of Chile's mainstays, and the government has actively developed policies of industrial development for this sector. Due to a large amount of copper resources, progressive legislation and a healthy investment environment, Chile has become the copper mining capital of the world, producing over one-third of the global copper output (ProChile 2009; Aduanas de Chile 2010).

Strategic metals and minerals are in short supply in China. Although Chinese reserves of copper and manganese are 5.4 per cent and 2.5 per cent of the world's total, respectively, China accounts for 40 per cent and 48 per cent of the world's total consumption of these metals, and some analysts suggest that China's copper ore consumption could reach 20 million tonnes per year in 2020. Given that there is a limited reserve of copper ore in China, imports of copper ore could increase to 12 million tonnes in 2020. In 2008, Chile and Peru accounted for over 50 per cent of China's total imports of this commodity (Valdez Mingramm et al. 2009).

Of 7,550 products exported by Chile, 2,805 were immediately free of tariffs. As of October 2007, an additional 1,947 were added to this list. As a consequence, 63 per cent of the products negotiated with China are free of any tariffs. Of the remaining products, 34 per cent negotiated in the FTA will become tariff-free in either five years (937 products) or ten years (1,611 products). By 2015, 97 per cent of all products exported to China will have no tariffs. With respect to Chinese exports to Chile, these are more numerous and diversified than vice versa. Most of these are consumer goods (electronics and clothing), although China also exports goods from the automotive and electronics sectors, mainly computers. In 2008, 50 per cent of computers imported into Chile came from China . In 2010, China provided 72 per cent of all imported computers (ProChile 2011).

In spite of the fact that Chilean exports to China have been increasing, there is growing concern about the nature of these exports and how Latin American countries have benefitted from China's trade. According to World Bank senior economist Augusto de la Torre,

> China has provided a significant economic boost to several countries in the region, but trade with China has failed thus far to result in productivity gains, technology diffusion, and learning spillovers in the region. In this regard, the China–LAC [Latin American countries] relationship stands in stark contrast to that between Japan and the East Asian Tigers, which benefitted tremendously from Japanese trade and investment (Arthur 2011).

Exports of raw materials, mainly minerals, have boosted Chilean exports, but due to the non-renewable nature of the minerals and the instability of international prices, exporting these materials is not always the best long-term strategy to achieve economic development. As Kevin P. Gallagher and Roberto Porzekanski caution:

> Rather than blaming China for Latin America's poor performance, we encourage the Latin American region to look inward for the source of its lack of competitiveness and slippage into a dangerous trend toward relying solely on primary commodities. This is a trend that plagued the region in the nineteenth century, and no one wants to go back to it (Gallagher and Porzekanski 2011).

In the case of Chile, the government seems to be aware of the situation; however, emphasis is still put on agricultural products, and little has been done to encourage manufacturing or industrial exports. Luis Schmidt Montes, Chilean ambassador to China, said that

> as China's second-biggest trading partner in Latin America, Chile expects to increase its exports to China and diversify these beyond mineral resources […]. China is the most populous country in the world but only occupies 8 per cent of arable land so there is a huge potential for food consumption in China (*China Daily* 2011c).

In spite of the huge opportunity that the Chinese market offers to import other goods, only a few Chilean exports have started growing in recent years, particularly wine and fish products.

Chile–China FTA: Negotiations and Outcomes

During the APEC conference in November 2005 in South Korea, Chile and China concluded their trade negotiations with the signature of an FTA. This agreement established the timeframe for tariff reduction (immediate, five and ten years), all while excluding some sensitive sectors of the respective economies, such as those representing 1 per cent of Chilean exports and 3 per cent of Chinese exports. It also excluded 152 products, including wheat, sugar, tires, some textiles, metal products and white linen. This FTA also addressed market access, commercial defense, rules of origin, phytosanitary rules, and barriers to trade, among other things. Additionally, the countries collaborated in other areas, such as in labour cooperation, security and the environment (CRS Report for Congress 2005).

In 2008, China and Chile signed a service trade pact supplementary to their FTA, the first of its kind between China and a Latin American country. According to the pact, the two nations will further open their service sectors to each other's markets on the basis of their commitments to the WTO; 23 industries in China, including computers, management consulting, mining, sports, environment, and air transport, and 37 in Chile such as law, architectural design, engineering and real estate, among others, were involved (*Xinhua* 2008). In August 2011, both countries signed a complementary agreement to enhance trade in services (*China Daily USA* 2011).

For both countries, this was an historic event that culminated in a new era for Sino-Chilean relations. For China, this was the first FTA of its kind ever negotiated. A high official from the Shanghai Federation of Industry and Commerce stated in an interview that

> China was particularly interested in the signing of an FTA due to the reliability of Chilean officers and companies working in China and the excellent work that the Chilean government has done to approach China (Anonymous 2011).

China and Chile worked together on sensitive issues, they agreed on eliminating subsidies for meat products and they worked together in the WTO for their regulation. As Michelle Bachelet, Chile's president at the time, affirmed:

> Chile is the first nation in the world that has negotiated an FTA of this kind with an Asian country that will allow for increased access of Chilean products into the Chinese market and that will strengthen our international standing in the world (Hald 2006).

According to the Chinese government, the implementation of the agreement will bring about important benefits for both countries:

> It will further open up their own services markets to one another, increase complementary advantages, promote international competitiveness, help improve the investment environments, create business opportunities, reduce trading costs and bring more benefits to the enterprises and people of the two countries. It will help boost an all-round cooperation in all sectors between the two countries, broaden the cooperative areas and improve [the level of cooperation in order to develop] a comprehensive cooperative partnership (China FTA Network 2006).

Nevertheless, there were some organizations opposed to the FTA. For Iván Vuskovic, president of the Chilean Small and Medium Enterprise Confederation, Confederación Nacional de la Mediana, pequeña, microindustria, servicios y artesanado (Conapyme), this FTA could bring competition challenges, along with more threats than benefits where

> a big market is opening up, a market with extremely low production and labour costs, and for which a local company may find many difficulties in competing. […] It is possible that we will be flooded with Chinese products, and this demands that the authorities support our micro, small and medium enterprises, which would find themselves at a terrible disadvantage under these circumstances (Hald 2006).

The FTA also put some specific sectors at a disadvantage. As Luis Schmidt, president of the National Society of Agriculture, states, "There were those not satisfied with what was achieved, such as the wine and milk industries (especially the case of powdered and condensed milk, whose tariffs will gradually decrease in ten years)", ten years being a very long period to achieve low tariffs, according to Chilean producers of milk and wine (TLC 2010).

Another important point of the FTA regards rules of origin. Chapter IV, Article 15 says that for a product to be of Chinese or of Chilean origin, it must be entirely produced in the country in question, or of materials from other countries, but with a regional content of no less than 40 per cent (TLC 2010). The FTA was an achievement for both countries because it will not impose heavy restrictive measures for other countries interested in investing in China or Chile. These rules of origin are much more lax than those of NAFTA, for instance. NAFTA imposed a 62.5 per cent of net cost requirement for passenger vehicles, light trucks and their engines and transmissions. In the case of heavy trucks, buses, specialty vehicles, tractors, their engines and transmissions, and most vehicle parts, the threshold increased from 50 to 55 per cent in 1998 and then rose to 60 per cent in 2002 (Gachúz Maya 2008)

Foreign Direct Investment

Chilean FDI in China is limited – in 2010 it totalled 212 million USD, only 0.4 per cent of Chilean investment abroad (ProChile 2010). Industry is the main sector for Chilean investment (188 million USD, 88.6 per cent of the total), then comes services (23.4 million USD, 11.03 per cent: mainly sea transport) and finally, agricultural products (less than 140,000

USD, 0.3 per cent). Chilean investment in China supports 1,500 (direct and indirect) jobs. Chilean investments are concentrated in Beijing, Guangdong, Hong Kong, Henan and Shandong.

FDI from China to Chile is also limited. Between 1974 and 2008, it reached 685 million USD, representing 0.2 per cent of the total Chinese investments abroad. FDI is hence one of the weakest links between the countries. In 2008, the Hong Kong company Elegance Ltd paid 600 million USD for 60 per cent of the assets of Bellavista Holding Group Ltd, a mining company in Chile. Also in 2008, Chile opened a CODELCO office in Beijing to promote Chinese investment in the Chilean copper and molybdenum industry (*BCN Asia Pacífico News* 2008).

Matías Mori, executive vice-president of Chile's Foreign Investment Committee (CIEC), points out along those lines that

> there are investment opportunities in Chile which are very attractive for Chinese investors, but there are still a lot of Chinese companies that don't know the comparative advantages that Chile has (*People's Daily* 2011).

To encourage Chinese investment in Chile, ProChile has restructured in the last three years, closing offices in the US (Atlanta) and expanding in China, where it currently has four offices (ProChile 2010).

FDI between Chile and China is a matter of concern for the Chilean government. China has made it a priority to invest in Chile, and even though trade has increased rapidly in recent years and the political relationship has been strengthened, Chinese FDI in Chile is minor compared to Chinese investments in Brazil. In 2010, Chinese companies invested about 17 billion USD in Brazil (*Businessweek* 2011).

Augusto de la Torre believes this situation needs to change, as Latin American countries do not benefit from the industrial and technology growth of China:

> The high growth experienced by the East Asian Tigers from the 1970s to the 1990s was characterized by large flows of intra-industry trade and FDI with Japan, and a significant diffusion of technology and knowledge. While East Asia functioned as trade network during its high growth period, Latin America's trade with China remains almost one-dimensional, the region's reliance upon raw materials exports to China has limited opportunities for technology diffusion and productivity growth (Arthur 2011).

China's Geo-economic and Geopolitical Interests in Chile

With the implementation its latest Five-Year Plan (2001–05), the Chinese government emphasized the importance of three fundamental factors for the development and expansion of the Chinese economy: 1) efficient and rational use of energy; 2) different sources of energy for diversification; 3) oil and natural gas explorations abroad. Nevertheless, China's interest in Latin America is not only economic but also political. *China's Policy Paper on Latin America*, an official document released by the Chinese government in 2008, highlights the fact that China is looking to establish not only economic relations with Latin America but also political ties (MOFA 2008).

The document stated that is a priority for the Chinese government and encouraged political cooperation with Latin American governments through the following actions:

1. High-level exchanges: According to the Chinese government, it is a priority to maintain the momentum of close exchanges with leaders of Latin American and Caribbean countries to increase mutual understanding and trust, step up exchange of experience on governance, and consolidate the political basis for the growth of relations with Latin American and Caribbean countries.
2. Exchanges between legislatures: China wants to strengthen friendly exchanges with parliaments of Latin American and Caribbean countries, the Latin American Parliament, the Mercosur Parliament, the Andean Parliament, etc., at multiple levels and through various channels on the basis of mutual respect; to deepen mutual understanding; and to promote cooperation so as to enrich and invigorate relations with Latin American and Caribbean countries.
3. Exchanges between political parties: The Chinese government has stated that China wishes to carry out friendly exchanges of various forms with political parties and organizations of Latin American and Caribbean countries on the basis of independence, full equality, mutual respect and non-interference in each other's internal affairs to learn from each other, increase mutual understanding and friendship, and strengthen mutual trust and cooperation (MOFA 2008). China's political engagement in Latin America has not received as much attention as the bilateral economic issues have. The political relationship between China and Latin America, however, is a priori-

ty for China's long-term objectives in the region; as China becomes a major power in economic terms, it will also look to increase its political influence in the region, *China's Policy Paper on Latin America and the Caribbean* clearly demonstrating that trend.

With respect to cooperation in international affairs, the document refers to the fact that China supports a new organization of the United Nations where Latin American countries can have more influence on the decisions taken by this organization:

> China stands ready to work with Latin American and Caribbean countries to strengthen the role of the United Nations, make the international political and economic order more fair and equitable, promote democracy in international relations and uphold the legitimate rights and interests of developing countries. China supports a greater role of Latin American and Caribbean countries in international affairs (MOFA 2008).

The political relationship between China and Chile has been improving in the last decade; in 2001 President Jiang Zemin paid the first state visit to Chile. In October of the same year President Lagos paid an official visit to China after attending the APEC summit in Shanghai. In 2004, the two countries established an all-round cooperative partnership when Chinese President Hu Jintao visited Chile. In 2008, President Michelle Bachelet visited China and attended the Asian Forum in Hainan; she was the first Latin American leader (invited by the government of China) to participate in the forum (*Xinhua* 2011).

Hu and Bachelet reached a common understanding on establishing an all-round cooperation partnership in the new century characterized by long-term stability, equality and mutual benefits, including military cooperation. The above-quoted *China's Policy Paper on Latin America and the Caribbean* states that

> the Chinese side will actively carry out military exchanges and defence dialogue and cooperation with Latin American and Caribbean countries. Mutual visits by defence and military officials from the two sides as well as personnel exchanges in military training and peacekeeping will be deepened. Practical cooperation in the non-traditional security field will be expanded. The Chinese side will, as its ability permits, continue to provide assistance for the development of the army in Latin American and Caribbean countries (MOFA 2008).

This has already raised concerns in the US government, as a report by the Congressional Research Service entitled "China's Growing Interest in Latin America" demonstrates:

> While Beijing's interest in the region appears largely economic, they also have a political and diplomatic dimension and may have longer implications for US interests. […] China is using Latin America to challenge United States supremacy in the Western hemisphere and to build a third world coalition of nations with interests that may have well be at variance or even inimical to American interests and values (U.S.-China Economic and Security Review Commission 2010).

The strategic geographic location of Chile in the Pacific and the growing economic and political ties with China are also factors that explain why Chile was the only country in Latin America invited to participate in the Shangri-La Dialogue in Singapore in 2011; Chilean Minister of Defence Andrés Allamand was in fact one of the speakers in the plenary session (The International Institute for Strategic Studies 2011).

Following the Shangri-La Dialogue, China and Chile pledged to step up bilateral military relations as high-ranking officials from the two countries met in Beijing: Chilean Defence Minister Andrés Allamand made a five-day official visit to Chinese Defence Minister Liang Guanglie. *China Daily* reported that

> it was the second meeting between Allamand and Liang within days. They met earlier this month at the 10th Asian Security Summit in Singapore, also known as the Shangri-La Dialogue. The summit gathered defence chiefs and senior military officials from 27 countries in Asia and beyond. World security is faced with various challenges and all countries need to get united and counter the challenges in joint efforts (*China Daily* 2011a).

The Chinese defence minister commented that "China pursues development of itself by safeguarding world peace as it promotes world peace and development through its own development" (*China Daily* 2011a).

In an official meeting between Chilean President Sebastian Piñera and Chinese Vice-President Xi Jingping, Xi stated that further cooperation is needed and they should look to cooperate in the areas of bio- and information technology and energy; he also stressed the importance of China–Chile cooperation amidst increasing global challenges (*China Daily* 2011b).

The Chinese government's actions over the last decade show how important its economic and political relations with Chile are. The search for natural resources continues to be a priority for China as it grows and expands. Political influence and military relations with Latin American countries are also a priority for the Chinese government. It is therefore the responsibility of Chile to channel these needs and focus them on mutual interests so as to produce tangible benefits for both countries in terms of FDI and commercial exchanges.

Risks and Recommendations

Due to its geographical location (Pacific Basin) and an interest in diversifying its exports, Chile has established a strategy of rapprochement with China. This interest has coincided with China's strategy of rapprochement with Latin America, and both countries have strengthened their relationship in the last decade. In 2007, one year after the China–Chile FTA was implemented, China displaced the US as Chile's main trade partner. Chilean exports to China grew from over 4.9 billion USD in 2006 to more than 9.9 billion USD in 2007, while in the same period Chilean exports to the US decreased from over 8.9 billion USD in 2006 to over 8.4 billion USD in 2007. The increase of Chilean exports to China can largely be explained by the FTA (see Table 3).

However, in order to not rely solely on mineral exports, Chile should boost its exports in other potential export sectors (value-added products or services) and should seek to attract more Chinese FDI in Chile's export industry. The export of raw materials (particularly of non-renewable materials) is not always sustainable in the long term. Chile should enhance its alternative exports of value-added goods if it wants to maintain competitiveness with China.

A very important factor in this new relationship between China and Chile is the political aspect. The FTA between the two countries has strengthened the political relationship between them, and cooperation in other fields has been promoted in other areas, even, as we have seen, in terms of the military. This marks a watershed in China's relationship with Latin America and is a matter of national security for the US government.

Chile needs to change the rules and regulations to create new entrepreneurial ventures and should support the exports of small and medium enterprises (SMEs), as these are the motors of the national economy. According to the Chilean Ministry of Economy, in the first six months of 2011, the SMEs (Pymes) contributed 262,430 new jobs – 90 per cent of the total. However, in the last ten years, there has been a decrease of 100,000 entrepreneurs in the country. Therefore, this topic should be a priority for the government. Currently there are 4,133 SME export companies; however, their participation in the Chilean economy is still minor (0.2 per cent of total exports).

Currently, the most important current policy to support SMEs is a 2.5 billion USD plan called Pymes 2.0, which is trying to enhance the development of new SMEs through low rate interest credits and by simplifying procedures. While this is a good effort, it is still not enough to face the challenge of having more SMEs exporting to international markets, including China. Additionally, the Chilean government's strategy should be to foster mutually beneficial associations – for example, by engaging Chinese advances in other areas such as biotechnology, agro-technology, and the mining and fishing industries, therefore including itself in the value chain of products that China needs to buy as it advances in these areas.

The next step in fostering and growing the relationship is the creation of Chilean–Chinese joint ventures. Through joint ventures, Chilean domestic enterprises would have an important stake not only in Chilean-based business but also in the Chinese market. Through joint ventures, Chile's industry would also benefit from developing new products to export to the Chinese market. The Chilean economy still faces a lack of high tech industries, causing it to rely mainly on commodity exports. Improvements in the development of higher value-added exports would benefit export diversification.

In 2009, the biggest ten companies accounted for 45.2 per cent of Chile's total exports; of this group, eight companies are focused on mining exports and only two companies export wood plaques and chemical wood pulp (Table 1). Apart from the successful exports of copper and iron, Chile should also enhance other exports that are already growing, such as wine and agro-technology industries.

The Chilean answer to *China's Policy Paper on Latin America and the Caribbean* should include concrete proposals to increase technical, scientific and technological cooperation between the two countries. University exchanges and the creation of technology parks should also be high on the list of priorities for Latin American governments.

The signing of an FTA with China is not a strategy that other Latin American countries should implement. Countries like Mexico or Brazil (with huge manufacturing industries) cannot follow the Chilean pattern, as local industries are not yet ready to face Chinese competition. With the signing of the FTA, trade between both countries has increased; however, Chile still faces several risks due to the nature of its exports. While China's exports of manufactured and value-added products to Chile are increasing, Chilean exports rely highly on mineral products and agricultural products. This is a lesson that other Latin American countries should learn from the Chilean case.

Conclusions

One of the objectives of the Chilean government in signing the FTA with China was to diversify and introduce new export products to China. This has happened only partially, but even with the addition of some new products exported by Chile, there is still a high concentration in the exports of minerals to China.

Currently, Chile is reporting a surplus in its balance of payments with China; however, this situation is not sustainable in the long term. Chile should diversify exports to China beyond minerals and agricultural exports: The problem, however, stems from the country's own shortcomings, and not from external trade with China.

Chinese FDI in Chile and Chilean investment in China are both limited. Five years after signing an FTA, both countries (with few exceptions) have shown little interest in making important investments (Chilean FDI in China is limited – in 2010 it totalled 212 million USD – and Chinese investment in Chile is also limited – in 2008 it reached 685 million USD). FDI could enhance trade and diversification between the countries; therefore it is a core issue, particularly for the Chilean economy. The role of the Chilean state and the private sector in attracting Chinese investment and enhancing diversification of exports of value-added products is crucial for the future of the economy of Chile and its relationship with China.

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