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Is Chinese FDI pushing Latin America into natural resources?

by
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Chinese foreign direct investment (FDI) in Latin America is a recent phenomenon. Although the China National Petroleum Corporation and other companies have been present in Peru, Ecuador and Venezuela since the early 1990s, large projects have been pursued only since 2006, following an extended period of high commodity prices. The Economic Commission for Latin America and the Caribbean (ECLAC) estimated that there were US$ 15 billion of Chinese FDI inflows into Latin America in 2010, 90% of which were in extractive industries.[1] This further contributed to the already high percentage of Chinese FDI flows to the region that are in natural resources. At a time of high economic growth fueled by commodity exports and strong currency appreciation (particularly in Brazil), FDI into extractive industries strengthens the region's specialization in primary products at the expense of manufacturing and other activities.

Because of the size of their investments (and their potential to grow over the coming years), Chinese companies are singled out for aggravating this problem. Nevertheless, Chinese companies are still far from having a dominant position in the region's extractive industries. The highest concentration so far is reached in copper mining in Peru, where Chinese companies will control 25% of production by the end of the decade if all planned investments are implemented. In the oil industry in Brazil, Sinopec will have access to one billion barrels of reserves, only a small fraction of the 30 billion that Petrobras will handle. In fact, China's most important contribution to the region's extractive industries is not through FDI but through trade: the county is the most important destination for the copper, soya and iron ore produced in the region.

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[1] ECLAC, "Foreign direct investment in Latin America and the Caribbean 2010 (Santiago: ECLAC, 2011), LC/G.2494-P.

Another reason for focusing on FDI from China is the special role that its Government plays in the international expansion of its companies. Not only are the largest Chinese multinational enterprises (MNEs) state-owned, but the Chinese Government vets investment projects abroad and promotes those that fit its development strategy with significant financial support. This means that Chinese MNEs could in principle respond to a centralized strategy that deliberately concentrates higher value-added activities in China, while pushing companies to expand mining and oil extraction in Latin America and Africa, in this way mitigating China's lack of natural resources. However, this is difficult to prove, as a close look at the strategy followed by Chinese oil and mining companies in Latin America shows that it is similar to that of their European and North American peers: they look for vertical integration and a hedge against price fluctuations.

Beyond that, Chinese FDI in Latin America is not limited to oil and mining operations. There are investments in other sectors, and these are likely to increase in the coming years, offering Latin American countries opportunities to improve infrastructure and develop certain manufactures beyond today's focus on the extractive industries. It should be remembered that Japanese and Korean outward FDI also started as primarily resource seeking, until rising local costs and technological progress pushed their companies into other types of investments. [2]

Infrastructure construction is a sector in which important Chinese investments can be expected in the next few years. But Latin American Governments and Chinese companies should move away from commodity-for-infrastructure deals (as it is done in Africa and some Latin American countries), toward a more transparent and market-based framework for undertaking projects.

In manufacturing, Chinese companies are attracted by the large and growing internal market in Brazil.[3] Much as China did 30 years ago, Brazil and other large economies could leverage their attractive internal market by requiring Chinese MNEs to build local capacities through using local suppliers or setting up joint ventures with local companies. In the case of Mexico and other countries specialized in export-oriented manufacturing, Chinese investments have been very modest, but there is now a new window of opportunity as rising labor costs in China during the past few years are closing the wage gap with Mexico. The current focus on competition with Chinese exports in international markets can slowly shift toward integrating Mexican manufacturing into the production networks of Chinese companies.

Chinese FDI continued to flow into Latin America in 2011, and the majority is still into natural resources. However, Chinese companies do not have different strategies from other mining and hydrocarbon companies, and Latin American governments concerned with excessive specialization in primary products should respond with integrated strategies that include macroeconomic management, fiscal measures and industrial policies. Attracting FDI into manufacturing or infrastructure (including Chinese FDI) can also help to expand capacities in other sectors.

[2] ECLAC, "Foreign direct investment in Latin America and the Caribbean 2000" (Santiago: ECLAC, 2001), LC/G.2125-P; ECLAC, "Foreign direct investment in Latin American and the Caribbean 2006" (Santiago: ECLAC, 2007), LC/G.2336-P.

[3] Conselho Empresarial Brasil-China, "Investimentos Chineses no Brasil: Uma nova fase da relação Brasil-China," (May 2010), available at: http://www.cebc.com.br/sites/500/521/00001674.pdf.

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The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Ms. Lisa Sachs, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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