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Recent Chinese Engagement in Latin America and the Caribbean: A Canadian Perspective

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Abstract:

This paper explores the triangular impact of China's involvement in Latin America and the Caribbean (LAC) for Canadian interests in the region. It looks at the political dimensions of Sino-Latin American relations, considers issues that are of particular importance to Canadian policy in the Americas, and assesses whether these could be affected by Chinese activity in LAC. The report also examines sub-regional and country-specific dynamics and draws implications for Canadian foreign policy in the Western Hemisphere.

Paradoxically, the most direct implication for Canada may come indirectly through Sino-US relations in light of China's intensified involvement in LAC, a region that has traditionally been in the US sphere of influence. This reality is poised to become a new factor in Canada's calculations and strategy in the region. The paper concludes by tackling the question of how Canada should position itself in a scenario in which China is seen by some observers as seeking to counter-balance US influence in the Western Hemisphere. Annexes on China-LAC relations, patterns of trade and investment per sector of the economy complement this report.

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1. Introduction

There is little doubt in the Americas that China is revolutionizing world demand for raw materials and changing the map of global competitiveness. Between 2000 and 2005, Latin America's exports to China grew at an annual average rate of 38%. China's imports from the region rose from US$1.5 billion in 1990 to US$21.66 billion in 2004. By the end of 2005, China had become the second largest export market for Chile, Peru and Cuba, and the third-largest for Brazil. Today the region is China's main supplier of several products, including soy, fishmeal, sugar, copper, nickel and iron (ECLAC 2005, 2006).

These developments in Sino-Latin relations respond to a wider phenomenon of China's transformation into a major global player. Since embarking on the reform process in 1978, China has grown an average of 9.7% a year. Such remarkable rates of growth have expanded China's role in the world economy, from less than 1% in 1978 to about 4% today. Another facet of China's development is the extent to which China has integrated with the world economy through a burgeoning of trade and investment flows, particularly since the early 1990s. In 2004, the ratio of the sum of its exports and imports as a percentage of GDP exceeded 70%, higher than the largest industrialized countries such as the US, Japan, and the EU (O'Quinn 2005).

In per capita terms, however, China remains one of the poorest countries in the world. In fact, the central government has estimated that, with a per capita GDP currently hovering at the $6,000 level, it will take another 45 years before China can be considered a modernized middle-income country. A critical bottleneck to China's continued development is the country's scarcity of resources vis-à-vis its oversized population of 1.3 billion (Zheng 2005). Indeed, China needs a steady supply of minerals, metals, oil and other raw materials to fuel its industries and feed its population. At the same time, many Latin American countries welcome Chinese capital and imports as a means to generate much needed economic growth in the short-term. South America, in particular, has benefited from increased Chinese demand for commodities and lower prices for manufactures it purchases from China, enjoying four consecutive years of surpluses with China. Meanwhile, in Central America and Mexico trade deficits keep widening as countries face fiercer competition from China in textiles and maquila products in the United States market.

As China continues its integration in the world economy, Chinese diplomacy has pursued international political engagement with a vast array of multilateral institutions, including regional organizations such as the Organization of American States and the Inter-American Development Bank. By the sheer size of its population, the Chinese government is cognizant of the country's potential as a rising player in the international system. Concerns about how outsiders, or other countries, respond to China's rising status is nothing new for the country's leaders, and it has shown growing signs of multilateral initiative and diplomacy with regard to these sensitivities.

This kaleidoscopic picture of opportunities and threats raises many questions for the countries in the Americas and beyond. In this report, The Canadian Foundation for the Americas (FOCAL) focuses on three:

- What are the political dimensions to the intensification of Chinese engagement with Latin America and the Caribbean (LAC)?
- What have been the sectors and niches that China has systematically targeted in LAC?
- What does this mean for Canadian policy and interests in LAC?

The China-Americas project

In addition to our own research, the report draws on a series of meetings and publications on the topic undertaken by FOCAL during 2005-2006. These activities were held in the framework of the project The Economic and Political Impact of Chinese Engagement in the Americas, funded by Canada's Department of Foreign Affairs. Two central objectives of this initiative are a) to explore the triangular impact of China's involvement in Latin America for Canadian political and economic interests in the region, and b) to contribute to discussions on Canada's Emerging Markets Strategy by developing a sustained forum for multi-sectoral dialogue on Chinese economic and political engagement in North America, Latin America and the Caribbean.

The conclusion of this project comes on the heels of a change of government in Canada in January 2006. It also follows a successful visit of Chinese President Hu Jintao to Canada five months earlier during which Sino-Canadian relations were upgraded to "strategic partnership", joining countries like Argentina, Brazil and Mexico in the Americas. We hope that this report sheds new light on changing realities in the hemisphere as the new government considers future Canadian engagement in the Americas.

2. Political Dimensions of Chinese Engagement in LAC

There seems to be consensus that China's rising demand for natural resources is the main driver behind its growing interest in LAC, yet there are also political dimensions to the relationship. With the objective of exploring the political underpinnings of recent Chinese engagement in LAC, and assessing possible implications for Canadian policy in the region, this section looks at three features of Sino-Latin American relations: Taiwan and the one-China policy, China's solidarity with Third World countries and the use of regional institutions. It then reviews issues that are of particular importance to Canadian policy in the Americas and whether these could be compromised by Chinese activity in the region. Finally, it examines specific sub-regional dynamics and draw observations of relevance to Canada.

Taiwan and the One-China Policy. Although it is often stated that China attaches few conditions to its foreign policy overtures, be it aid or trade, the issue of Taiwan remains the exception. Since official UN recognition in 1971 and US President Richard Nixon's landmark visit to the People's Republic of China (PRC) one year later, the LAC region increasingly moved to diplomatically recognize the PRC over the Republic of China (Taiwan), as representative of the Chinese people. Prior to 1970, China's ties with the LAC region were heavily weighted on its ideological connection with Cuba, which recognized Beijing as early as 1960.

Beginning with Chile at the start of the 1970s, the PRC is now recognized by all LAC countries except for all seven Central American countries (Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama), four Caribbean countries (Dominican Republic, Haiti, St. Kitts and Nevis, and St. Vincent and the Grenadines), and one South American country (Paraguay). Paraguay has been the last beacon for Taiwan in South America, with the second-last country, Uruguay, abandoning Taipei for Beijing in 1988.

In the past, Taiwan has curried favour among these states by consistently providing technical and medical assistance in response to humanitarian and natural disasters common to the region (Watson 2004b). Similarly, Beijing has also used both bilateral and multilateral channels; for instance, in 2004 Dominica decided to cut ties with Taiwan when Beijing offered $122m in assistance over six years, as compared to Taiwan's annual aid of about $9m (Dumbaugh and Sullivan 2005). With 12 of the 26 countries that still have official diplomatic ties with Taiwan, the LAC region, and particularly Central America, represents a strategic knot that Beijing would like to eventually disentangle. This topic is dealt with in more detail under the subsection “sub-regional dynamics”.

Third World Solidarity and the Beijing Consensus. Along with other catch phrases such as “strategic partnership”, “win-win” diplomacy, and “peaceful rise”, used as shorthand to describe the nature of recent Chinese foreign policy motives, an added component is that of China’s commitment to solidarity with other developing countries. In speeches delivered before the Brazilian and Argentinean parliaments in 2004, President Hu stressed that China, “would forever stay on the side of developing countries.” (Lam 2004, p2). More recently, Cheng Siwei (2005), chairman of the standing committee of China’s National People’s Congress and President of the China-Latin America Friendship Association, outlined China’s expectations and commitments as the largest developing country and a permanent member of the UN Security Council (UNSC):

> “China pursues a relationship of mutual political support and mutual trust with Latin American and the Caribbean countries, by which the two sides can further strengthen communications, coordination and cooperation in major issues bearing on world peace and development, democratization of international relations, and protection of the legitimate rights and interests of developing countries.” (Speech delivered at the Organization of American States, Washington, DC on December 6, 2005)

Some Latin American countries have put this into question, however. Despite vague promises to help push for a permanent seat for Brazil in the UNSC, China actually opposed the joint bid put forward by Brazil, Germany, India, and Japan, during recent talks of UN reform, although this was seen as a snub to Japan, rather than to Brazil. The promise of Third World solidarity has been more grounded in World Trade Organization (WTO) trade negotiations where there are signs that China is indeed carefully leveraging its weight in favour of developing countries. China has acted with the G-22 coalition of developing countries in collectively bargaining against continued agricultural subsidies used by developed countries such as the US, Japan, and the EU, although China does not have significant agricultural export interests (Narlikar and Tussie 2004). Presumably, this was largely done in the interest of keeping the coalition together during the Cancun and Hong Kong ministerial meetings.

Related to the principle of Third World solidarity is the notion of a “Beijing Consensus”, developed by Cooper Ramo of the UK-based Foreign Policy Centre in 2004, and hotly debated in Chinese academic and policy circles since, especially as a preferred alternative to the so-called Washington Consensus. Largely based on its own unique path to economic reform, the Beijing Consensus is premised on principles of equity, self-determination and gradualism. In his December 2005 speech at the OAS, Cheng Siwei alluded to the Beijing Consensus by highlighting that after several decades of development China had finally found the path of ‘socialism with Chinese characteristics’ - the socialist market economy, a system that raises market efficiency and ensures equity by socialism. “I believe every country must look for a development model and path best suited to its national conditions. This model or path shall never be designed and imposed by certain experts from foreign countries or international organizations.” Ultimately, these pronouncements are premised on a multi-polar view of the world, meant to democratize and minimize U.S. unilateralism (Deng and Moore 2004, p118).

China’s use of regional institutions. One dimension of Chinese activity that may intersect with Canadian engagement in Latin American and the Caribbean is the use of multilateral institutions. Many observers see Chinese claims of Third World solidarity and Beijing Consensus as mere rhetoric designed to sway Latin American governments to vote along with China in multilateral bodies. They regard Chinese interest in Latin America as being mostly political. They believe China has found fertile ground in LAC countries susceptible to persuasion to vote with China on the human rights debate, given sensitivities about domestic sovereignty and traditional adherence to the doctrine of non-intervention.

Internationally, Chinese diplomacy has been active on a number of multilateral fronts. This includes the founding of the Shanghai Cooperation Organization (SCO) in June 2001, a body aimed at establishing a more institutionalized form of cooperation between China, Russia, Kazakhstan, Tajikistan, Kyrgyzstan, and Uzbekistan on issues such as trade and antiterrorism. This was followed by the signing of a Treaty of Amity and Cooperation, a non-aggression pact of the Association of Southeast Asian Nations (ASEAN), in October 2003. Of course, this is not to forget China's increasing role as a member of the World Trade Organization (WTO) since 2001, the UN Security Council (UNSC), and the Asia Pacific Economic Cooperation (APEC) forum.

In Latin America and the Caribbean specifically, China has institutionalized its dialogue through various channels, most notably as a permanent observer of the Organization of American States (OAS) in May 2004, and in the Inter-American Development Bank (IADB) in 2005. In addition, China is an observer to Parlatino and has ties with the Rio Group, the Andean Community, Caricom and Mercosur.

While Chinese membership at the OAS appears to have been relatively uneventful, China's bid to become a formal member of the IADB has been rather controversial. While the US and Mexico support the Chinese bid, there is concern among some Latin American governments that China plans to use the IADB as a driver for its instrumental investment in infrastructure in the region. In his December 2005 speech at the OAS Cheng Siwei (2005) stressed "In order to facilitate China's greater participation in major investment projects in Latin America and the Caribbean, China hopes to become a formal member of the Inter-American Development Bank". He "recommended" that Latin American governments support China's bid in the interest of broadening mutual investment and striving to become each other's major investment destination. According to the *Latin America-Asia Review* (2005b, p5), the growing dislike of the Chinese in Latin American foreign ministries is likely to frustrate this ambition, at least until public opinion decides to swing in the opposite direction, again.

While multilateral overtures made by China inevitably involve calculations over the political isolation of Taiwan, it would be a stretch to see Taiwan as the sole overarching concern that motivates Chinese policies in multilateral fora. For example, argues Cooper Ramo (2004), through fostering good international relations, China is safeguarding the peaceful international environment needed to secure its prosperity, and deterring the attempts of some to turn in into a pariah.

Implications for governance and other political considerations. These three interrelated dimensions of Chinese policy in the region are intrinsically political in nature, and expose a tension between pragmatism and ideology when it comes to assessing Chinese motives in LAC. While China seems to have left its own communist ideology behind, it is perhaps using the flag of socialism to enhance certain bilateral relations in the region. A related question is whether the Chinese government intends to interfere politically in the internal affairs of LAC governments. While there is no strong evidence in that regard, the often-blurred line between public and private Chinese sources of investment contributes to this tension. (Conversely, China is better placed to understand motives for national ownership and control over natural resources in LAC).

How these realities might affect Canadian policy in the region was the focus of a workshop convened by FOCAL with returning Canadian diplomats from Latin America in September 2005. A recurring theme was the possibility that China's increased economic and political interaction with Latin America may have an overall negative influence in the region. Politically, China's poor democratic credentials and lack of respect for the rule of law may reawaken "bad habits" in Latin America such as authoritarianism, and cause an erosion of efforts to improve human rights and stem corruption. Criticism of Chinese activity in Africa would seem to support this view, in particular with regards to Chinese investment and matters of corporate social responsibility (CSR).

In Peru, for example, reports on the malpractice of Chinese iron mining firm Shougang Hierro Peru SA have surfaced, revealing the protests of miners against unsafe labour and environmental standards, not to mention declining wages as the firm posts record profits (Economy 2005). In Brazil, managers from Gree Electric Appliances have reportedly complained that Brazilian labour unions interfere with everything from holiday work schedules to efforts to enforce discipline among workers. "It's simple in China", remarked a Ye Yonqing, a Gree investment executive, "the managers decide everything" (Millman and Wanacott 2005). Similarly in Brazil, proposals to build a hydroelectric dam in the Xingu River at Paquiçamba have raised concerns that local indigenous tribes and other residents will feel the brunt of the projects, to the benefit of state-owned Chinese companies needing vast quantities of electricity for their aluminum and steel plants (Rohter 2005). Often times hostility to Chinese investors has less to do with poor CSR practices, which are also prevalent among investors of other nationalities, but with the custom of insularity on the part of Chinese investors and their inexperience in working with local business, services and workers (*Idem*).

Another consideration is that China's avid demand for raw materials may lead Latin American countries to increasingly concentrate on the production of primary products, thus deviating from the production of higher value-added goods that would in the long run do more to create jobs and prosperity. However, such a view overlooks the underlying reasons behind difficulties encountered by LAC in moving into higher-value production prior to its increased engagement with China. At any rate, unless LAC countries take action to induce faster growth and make sustained investments to move up the value chain – as China itself is doing – patterns of low-value production in LAC will remain.

On the other hand, the proliferation of pirated goods of Chinese origin in Latin American markets is another controversial aspect of increased interaction with China. For example, free trade zones in Panama and Venezuela's Isla Margarita have become a point of entry for Chinese small manufactures and 'white' goods. There are also growing activities of Chinese organized crime networks that may have a negative impact on Canada's interest in keeping the region stable and prosperous.

Security concerns. In 2004 Chinese military officials visited the LAC region on 20 separate occasions, reflecting a wider effort by the Chinese to increase their military diplomacy. Activities included joint military exercises, bilateral and multilateral security information sessions, combined seminars on defence and security, and field trips. With a growing number of LAC military officers going to China instead of the US, there is concern that China is taking advantage of weakening US-LAC military links resulting from US moves to cut military aid to countries that refuse to sign agreements exempting US service personnel from International Criminal Court (ICC) jurisdiction. The 2002 American Service Members Protection Act ended military aid to 12 countries in LAC, including critical countries such as Mexico, Peru, Ecuador, Brazil and Bolivia.

“We now risk losing contact and interoperability with a generation of military classmates in many nations of the region, including several leading countries,” Army Gen. Bantz J. Craddock, commander of US Southern Command, told the US Congress in 2005. In March 2006, Gen.. Craddock reiterated these concerns at a hearing of the Senate Armed Services Committee. “Other nations are moving in. The PRC has made many offers, and now we are seeing those who formerly would come to the United States going to China”. The lack of training has prevented sharing US military “attributes and characteristics” with LAC militaries, including concepts of military subordination to civilian leaders, and principles of democracy, he said. He also noted that more Chinese non-lethal military equipment is showing up in the region. “It's a growing phenomenon” (Gedda 2006).

Linked to security concerns is the question of technological cooperation, given the potential dual use (commercial and military) of some of the initiatives. Cooperation in the aerospace, telecom, satellite and nuclear sectors stand out in this regard.

Aerospace:
Of all the countries in the LAC region, Brazil is by far the leader in technological capabilities, and has the most to offer China. The most prominent case is that of Empresa Brasileira de Aeronautica SA (Embraer), which decided to establish its first joint venture outside of Brazil in the northeastern Chinese province of Heilongjiang in December 2002. Its joint venture partners, Harbin Aircraft Industry Co. and Hafei Aviation Industry Co., are both owned by state-run China Aviation Industry Corp II (AVIC II), which holds a minority share of 49%. Interestingly, Embraer’s main competitor, the Canadian firm Bombardier has not entered into a joint venture, but in February 2006 reported to be in talks to buy and produce parts with AVIC I, the sister firm of AVIC II, which also happens to be developing a Chinese-designed regional jet, the ARJ21, with 100 seat capacity (Bloomberg 2006; National Post 2003).

Although the nature of technology transfer from Embraer to AVIC II is not known, given the technological weaknesses of the Chinese aerospace sector, it is clearly an area in which the Chinese have strong strategic and military interests, and where there could be much room for cooperation, and learning, particularly from the Chinese perspective (Segal 2004).

Satellite and Telecom:
Another, albeit less high profile, area of cooperation has been the China-**Brazil** Earth Resources Satellite (CBERS) project. Initially established in 1988, the stated objectives of the project are to produce satellites to survey environmental conditions, such as forests, oceans, urban growth and natural disasters, from space via real-time digital optical technology (*Financial Times* 2002).

CBERS-1 and CBERS-2 were launched in 1999 and 2003, respectively. CBERS-2 was expected to start selling its images commercially to other countries beginning in 2005, with sales expected to generate approximately $2.5 million per year, according to the Brazilian Science and Technology Minister Eduardo Campos. The partnership has planned a CBERS-3 satellite, to be launched into orbit by 2006, while CBERS-4 is expected to be launched by 2011 (*Financial Times* 2004b). For these, Brazil has increasingly boosted its share of funding, rising from a share of about

30%, to 50%, to a present level of 83%. These two satellites will cost approximately US$125 million. Brazil will supply the structure of the satellite, the energy generating system (including solar panels), the data collection system, the telecommunications system, on-board computers, microwave transmitters and two imaging cameras (*Gazeta Mercantil* 2005b).

Despite pronouncements that CBERS is simply a commercial endeavour, the technology has considerable scope for military application. For instance, security experts like Adam Segal have recommended that certain specific technologies be controlled. That is the case for defence-related systems integration techniques and software, high-resolution commercial imagery technologies needed for reconnaissance satellites, commercial sensor and laser technologies, and commercially applicable guidance and navigation technologies. The rationale is that US export control policies are likely to be more effective as US military technology has un-matched capabilities in these areas, which should make multilateral support for control more feasible (2004, p164).

Seen in this light, the CBERS project becomes much more strategic for both partners, particularly China. This is because "Without dedicated high-resolution imaging systems of if its own, China faces the risk of either battlefield blindness during any operation or reliance on its own lower-resolution imaging satellites" (Segal 2005, p165). Moreover, by allowing Chinese access to Brazilian satellite facilities, the project has potentially helped China to gain a better picture of the flight paths of US satellites (Ellis 2005, p11).

Aside from satellite cooperation with Brazil, China has also signed satellite and telecommunication agreements with **Argentina** and **Venezuela**. In the former, although China has helped Argentina field its first surveillance satellite, the level of cooperation does not appear to be on par to that of CBERS. It was announced that China would launch a telecommunications satellite for Venezuela, reducing the country's reliance on US telecom networks. Moreover, this effort has built upon discussions on how China could contribute to telecom modernization in Venezuela, with possible cooperation between China's Ministry of Information and the Venezuelan firm, CVG Telecom (Ellis 2005, p8, 13).

Nuclear:
One of the most significant developments has been possible China-**Argentina** collaboration on a new fourth-generation nuclear reactor, originally designed by Argentina's National Atomic Energy Commission (CONEA) in partnership with the firm INVAP, as part of the Argentine Center for Nuclear Reactors project (CAREM). Currently, CAREM and China are in talks over funding and cooperation of a 27-kilowatt prototype reactor, the initial stage of a 300-megawatt design that would meet the needs of small to mid-sized economies such as those found in the LAC region. (Ellis 2005, p13).

2.1 SUB-REGIONAL AND COUNTRY-SPECIFIC DYNAMICS

Growing LAC relations in trade and investment with China have led to the establishment of so-called "strategic partnerships" with key countries in the Americas (see Annex I, Table 2). This includes Argentina, Brazil and Mexico, and Venezuela with a "strategic partnership for common development". China's relationship with Chile, although not officially designated as such, can also be considered of a strategic nature not only in light of the strong trade relationship in minerals, and the recent signing of a free-trade agreement (FTA) (China's first in the Americas), but also due to Chile's high-volume deepwater Pacific ports through which goods can flow to and from China. Ties with other countries such as Cuba, Bolivia, Colombia, Ecuador, and Peru fall under the category of "all-round" cooperative relationships. The potential exists for these to be upgraded to "strategic partner" status, as China's interest in their energy resources is well known. This section briefly reviews Chinese engagement with sub-regions and countries that for different reasons are of special interest to Canada. These are Mexico, Brazil, Venezuela and Cuba, and remaining pro Taiwan holdouts in Central America and the Caribbean.

Mexico. Overall, there seems to be a sharp contrast in the Sino-Mexican relationship between cooperative political dialogue on the one hand, and tense economic relations on the other. Shared views of international affairs, similar stances in multilateral bodies, and the fact that several Chinese leaders studied at the Colegio de Mexico and speak Spanish fluently, are some of the elements that have contributed to a good political understanding between the two countries. Mexico was a driving force behind China's attainment of observer status at the Organization of American States, and currently supports the Chinese bid to formally join the Inter-American Development Bank. Protecting this positive dimension of bilateral relations from strained economic relations over allegations of Chinese dumping and piracy is an ongoing challenge for the Mexican Ministry of Foreign Affairs.

It is perhaps in the framework of the North American Security and Prosperity Partnership (SPP) that we can find the clearest triangular connections among China, Mexico and Canada. The SPP was established in March 2005 by the governments of Canada, Mexico and the United States largely as part of the aftermath of 9/11, but also in response to new geopolitical realities, particularly the rise of China and Asia in world markets and politics. The SPP is premised on the creation of common North American standards, regulations and linkages in areas ranging from transportation and energy to border controls and rules of origin, in order to protect and enhance competitiveness and security.

The three partners have identified the steel sector as one that requires concerted action in North America in order to confront the fact that China is poised to become a net exporter of steel in 2006. A working group on steel has already been set up under the SPP umbrella. Another sector likely to elicit a North American response is automobiles, which was very much the engine of continental integration during the 1980s and 1990s, and is currently a major employer in the three countries. According to the *Latin America-Asia Review* (2006, p13), China became a net auto exporter in 2005 and growth could be explosive in the coming years given over-capacity in the domestic market

Automobiles are indeed the next market frontier for Chinese manufacturers. For instance, one strategy to overtake competitors is to purchase sophisticated technology such as the DaimlerChrysler BMW car engine plant in Brazil, and transport it piece-by-piece back to China. The Chinese Lifan Group, with government backing, is currently the only bidder for the factory that would allow China to start producing some of the most fuel-efficient cars, like the Honda Civic and the Toyota Corolla, by 2008. This would significantly boost China's ability to catch up with leading automakers from Japan, Germany and the United States (Bradsher 2006).

Both Canada and Mexico will have to delicately manage mostly positive political relations with China in light of the increasing flare-ups that will arise from competition in these politically sensitive sectors of the economy. Well-paying jobs, strong trade unions, and competitive production have been hallmarks of the North American auto sector. All stand to suffer under imminent Chinese competition.

Cuba. China has long had warm relations with Cuba, and has consistently opposed US sanctions on the island at the UN and other international bodies. China also is increasingly becoming a key economic partner of Cuba; China is now Cuba's second largest trading partner after Venezuela and Chinese economic support has become a crucial component of the island's economic planning, notes Erikson (2005). During a 2004 visit President Hu and Castro agreed that China would invest $500 million in a new Cuban nickel plant, delay old debt payments for a decade - extending about $700m in interest-free loans and credits to the Castro government -, and provide $6 million in grants to Cuban hospitals, among other financial contributions.

> "It appears that Chinese economic support for Cuba serves as a prop for Castro's decrepit and bankrupt regime; indeed, in a February speech, Mr. Castro referred to China as 'motor' for his 'revolution'." (2005, p4) -- *US assistant secretary of State for Western Hemisphere Affairs, Roger Noriega (2005, p4)*

Indeed, a direct implication of China's current engagement with Cuba, as well as Venezuela's, is a likely delay in Cuba's evolution to an open and democratic regime. As Erikson notes "Cuba now has two important allies with a stake in the existing system and an interest in maintaining the island's political order" (2005, p418). This said, it is unclear what kind of role the Chinese government would be prepared to play in a post-Castro scenario, although its own reform experience suggests its preferences for improving upon existing government institutions over wiping the slate-clean (Gelb et al. 1993; Qian 2003). The US, and to an extent Canada, has always seen itself as a central actor in a post-Castro Cuba and China understands that. The government of Hugo Chavez in Venezuela would appear to be more of a worrisome factor, with more potential for direct confrontation with the US, than the current Chinese government.

Venezuela. The oil-exporting nation is arguably China's closest political ally in South America. Two dimensions stand out: energy and military linkages. A Strategic Energy Plan that extends until 2011, which commits Venezuela to increase oil exports to China, binds the two countries. In addition to the two oil fields currently operated by China (Intercampo Norte and Caracola blocks), in 2004 President Chavez sealed oil and gas deals that allowed Chinese companies to invest $350 million in 15 oil fields located in eastern Venezuela, as well as an additional $60 million investment in natural gas projects (Erikson 2005).

Along with Cuba, Venezuela has been the focal point of increased military-to-military contacts, with annual high-level meetings with Venezuela beginning since the late-1990s. The failed attempt to overthrow President Chavez in 2002 led to the expulsion of American military trainers, replaced almost immediately with Spanish-speaking Special Forces trainers from China's PLA. Also, since 1999, China has been operating listening posts in both the Santiago and Bejucal areas of Cuba, presumably to monitor US broadcast and military telecommunication signals.

With respect to intersection with Canadian interests, energy appears to be a primary consideration. In the case of Venezuela, Canada is both partner and competitor. Canada would want to grow its investment in Venezuela (for example, PetroCan), but it is not clear if China's presence will limit or push Canada out of the market (the CNPC has recently established an office in Caracas). There is a prevailing sense that energy is a critical area for Canadian business in Latin America; yet so far Canada has failed to increase its value-added activities in the region.

Brazil. Also a "strategic partner" of China, Brazil is Canada's largest export market in South America and a significant destination of Canadian investment. Home to half of South America's population and GDP, Brazil's stable and diversified economy, and solid institutions are well placed to handle growing interaction with China. Evidence of this is Brazil's enforcement of transparent practices such as public biddings and of limitations in the importation of foreign nationals to work in Chinese infrastructure projects, common in Chinese operations in Africa and in other Latin American countries. As a result, Chinese investment in Brazil has been considerably less than expected.[2]

While some observers have attached ideological significance to Sino-Brazilian relations mainly given the Third World rhetoric shared by the respective leaders and joint action at the WTO, pragmatic economic interests appear to be foremost in the minds of Brazilian government officials dealing with China. This said, extensive Sino-Brazilian cooperation in satellite technology has raised alarms in the US given the possible military applications associated with high-resolution satellite imagery. Of more direct interest to Canada might be the dealings between Canadian aircraft maker Bombardier and its Brazilian competitor, Embraer, with Chinese state-owned companies AVIC I and AVIC II respectively (see section on technological cooperation, pages 8-9 of this report). In the past, competition between Bombardier and Embraer led their respective governments to bitter disputes over illegal subsidies that spilled over other areas of Canada-Brazil relations. With both companies taking very different paths to the Chinese market, and Embraer seemingly gaining the edge in a nascent 100-seat aircraft market, the stage for further commercial rivalry is set.

Haiti. In Oct. 2004, China sent a 140 person "special police" peacekeeping force with plans to expand the number of officers by 125, as part of the 6000-strong UN Stabilization Mission for Haiti (MINUSTAH). This represented the first ever-Chinese participation in peacekeeping in the Americas, and increased Chinese involvement in LAC region security concerns. This initiative has also revealed frictions over Haiti's continued recognition of Taiwan. With MINUSTAH slated to expire by June 2005, UN Secretary General Kofi Annan and the interim Haitian government have requested that MINUSTAH be extended for a year in order to oversee the 2006 presidential elections. Reportedly, China pushed for only a six-month extension. This is not the first time that China has tried to persuade Haiti to change its mind. In 1996, China similarly impeded the extension of a UN peacekeeping operation in Haiti, with countries of the region, including Cuba, unanimously appealing the UNSC to end further Chinese political meddling in the mission (Dreyer 2005, p6).

It is believed that recently elected Haitian President Rene Préval has close ties to Taiwan, which may have contributed to finance his campaign as well as several development projects in his home village of Marmalade. While this makes it less likely that the Chinese government will succeed in getting Haiti to switch alliances under Préval, it may not stop the PRC from trying.

Haiti is arguably the LAC country where Canada has invested the most politically, militarily and in development aid in recent years. Canada welcomed the Chinese contingent because of the difficulties in getting troop contributions for Haiti. Still, it is clearly in Canada's interest to continue to closely watch Chinese involvement in Haiti. Another issue at stake is Canada's dependence on the Chinese vote at the UNSC to carry out its peacekeeping policy in the region as the case of Haiti (and previously of Guatemala/Minugua) clearly illustrates.

Central America and the Caribbean. This is the arena where China and Taiwan are playing their competitive game of "dollar-diplomacy" in the

[2] For Sino-Brazilian economic relations see "The New Axis of Trade" by Renato Amorim, published under the FOCAL project The Economic and Political Impact of Chinese Engagement in the Americas. Also see Annexes I and II of this report.

Americas. Another factor pressing Central American and Caribbean governments is concern over chronic balance of payments (BoP) deficit positions with the world. In Africa, China has forgiven $1.3bn in debt relief in 31 countries, and has agreed to abolish tariffs on 190 imported goods from 25 African countries. While overtures of this kind have not been seen in the Americas, calculations over increased purchases from China seem to be weighing in Central American capitals.

Guatemala and El Salvador appear most likely to change official diplomatic ties, with the business community in each lobbying for access to the Chinese market. Honduras and Nicaragua could also be considered likely candidates – especially if the Sandinistas win presidential elections in Nicaragua later this year. Conversely, Panama and Costa Rica, with relatively smaller BoP deficits, would seem under less pressure to alter their stance. In the Caribbean, the Dominican Republic has drastically improved its BoP position in recent years, while smaller island states St Kitts and Nevis, and St. Vincent and the Grenadines, appear to have track records similar to Grenada and Dominica, which switched recognition in January 2005 and March 2004, respectively.

Central America sees China as a direct threat to its economic interests. Chinese competition in textiles and the maquila industries in US markets will cost this region tens of thousands of jobs. The absence of a Free Trade agreement between the Central America Four (Guatemala, Nicaragua, El Salvador, and Honduras) and Canada will continue to be a sore point for those countries, as they seek some form of stability and market access in the wake of a perceived Chinese onslaught. With Canada wanting to play a central role in the Americas, free trade is an area where Central America (and other countries in the region) has looked to Canada for leadership. However, the US managed to negotiate an FTA with Central America before Canada, despite stiff opposition from domestic lobbies. More recently, the US came to Central America's rescue by signing an agreement with China setting limits on Chinese exports of 34 types of clothing (*Latin America-Asia Review* 2005a). This was intended to provide some breathing space to Central American textile producers until 2008. While free trade with Canada will not likely result in a major economic shift for this region, it could at least serve to maintain some influence in a region with weak democratic institutions and autocratic traditions.

3. Conclusions

Latin America, and especially South America, should seize this historic opportunity and take advantage of the unexpected boom in natural resource prices to strengthen technological and production linkages with China through joint ventures at home and in Asia. So far, Brazil appears to have made the most strides in this regard. With respect to Sino-Canadian relations, Canadian business organizations such as the Conference Board of Canada emphasize the need to go beyond the current strategy of supplying inputs and services to China through US multinationals operating in the Chinese mainland. Rather, they call on Canadian business to establish direct market presence, which allows for greater dynamic benefits and opportunities to accrue to the Canadian economy in the long run (Hodgson 2004).[3]

Regarding the **triangular effect** of Chinese activity in LAC for Canada, when we look at the various economic sectors, it is mining and energy that stand out. While this is bound to continue

[3] A joint venture between Nortel Networks and Huawei Technologies, announced in February 2006 is a positive development in this regard. The deal provides Huawei with a strategic foothold in the North American broadband-access market, and Nortel with the ability to compete in new market segments dominated by the likes of Cisco Systems, Alcatel, and Lucent Technologies; while also opening up future possibilities in the Chinese market (Kharif 2006; Hill 2006)

there are two other emerging sectors to watch: automobiles and steel. Canada is already contemplating a concerted North American response to deal with these politically sensitive sectors of the economy. With respect to the political dimensions of Chinese engagement with the region, neither the issue of Taiwan nor Third World solidarity, nor China's use of regional institutions, appears to challenge Canadian interests. Similarly, there is no evidence at this point of Chinese activity eroding progress made towards democratic governance and respect for human rights in the region. Along with civil society inclusion in the democratic process, protection of the environment, and corporate social responsibility, these have been pillars of Canadian policy in the region for over a decade, and it would clearly be at odds with Canadian interests if these were undermined.

In terms of **security**, Chinese military contacts and technological cooperation with Latin America do not currently pose a direct military threat to the US nor Canada. This said, US military ties to the region have traditionally been strong, and increased Chinese presence represents competition that may dilute US influence in the region. There are in fact growing concerns in US military and political circles that China is filling a vacuum left by the US as a result of cuts to military aid to nearly half of LAC. While limited, Canadian military contacts in LAC have tended to reinforce respect for human rights, subordination to civilian authority, and inclusion, and any attrition in this regard would run counter to Canadian military values.

From the examination of sub-regional and country-specific dynamics we found that the one country where Chinese involvement may be at odds with Canadian objectives is Cuba. Other areas to watch are Central America and Venezuela. Paradoxically, the most direct implication for Canada may come indirectly through Sino-US relations in light of China's intensified involvement in LAC, a region that has traditionally been in the US sphere of influence. Indeed, a central question at a high-level meeting convened by FOCAL in February 2006 was precisely how Canada should position itself in a scenario in which China is seen by some observers as seeking to counter-balance US influence in the Western Hemisphere.[4] The remainder of this report tackles this question that is poised to become a new factor in Canada's calculations and strategy in the region.

China as a counter-balance to US influence in the region? How should Canada position itself?

In US policy circles there appears to be a tension between those who adhere to the theory of benign expansion of Chinese activity in the Americas, who think it is confined to seeking out trade and investment opportunities, and those who believe that 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 well be inimical to American interests and values."[5]

While the prevailing view of the Bush administration appears to be closer to the theory of benign expansion, the overall conclusion of the US Congressional hearings held during the Spring and Fall of 2005 was to continue to closely monitor China's outreach to Latin America, particularly in the field of intelligence, communications, and cyber warfare, and their possible applications in the region.

[4] See, http://www.focal.ca/projects/privatesector/china/events_e.asp

[5] Hearing testimony of June Dreyer, U.S.-China Economic and Security Review Commission, Western Hemisphere Subcommittee, House International Relations Committee, Aril 6, 2005.

From Canada's perspective, a watch-for-now approach seems fitting. While Canada may on the surface follow a similar path to the US, it is in Canada's interest to differentiate itself from the US and avoid the binary paradigm "China threat, China opportunity" or "a power to be contained, a market to be exploited". Rather, Canada's interest would be best served by continuing with the Canadian tradition of engaging with China on a broad agenda and creating an environment conducive to joint action. Sinologists have long advised a holistic approach when dealing with China.[6]

To some extent, Canada is already doing this at the bilateral level. Sino-Canadian relations were recently invigorated by the successful visit of President Hu Jintao in September 2005 and resulting "strategic partnership". Agreements to revamp the physical infrastructure of ports, roads, rail lines and pipelines to accommodate a substantially expanded connection to goods and people from Asia hold the potential to "transform Western Canada... and the entire political economy of Canada" (Evans 2005).[7]

While Canada and East Asian countries have gone to great lengths not to frame increasing links to the Chinese economy in terms of seeking to counter-balance US influence in the region, we have not seen a similar calculation in Latin America. Rather, countries like Venezuela and Cuba have gone out of their way to make statements that antagonize the relationship between China and the US, especially around the issue of diversion of provision of oil. Clearly, it is in Canada's interest to avoid a face-off between the US and China in the Western Hemisphere. Canada enjoys the advantage of being able to raise issues that the other two cannot without provoking suspicion and resistance.

The issue of energy stands out. **Energy security** is one of China's greatest vulnerabilities, thus a key Chinese concern. Failure to secure sufficient provision of energy can undermine its development plans, choke growth and unleash instability and chaos. There is arguably no other topic around which Canadian, Latin American and Chinese interests intersect so clearly. As a prime provider of energy security at a time of high demand, a valuable move for Canada could be to articulate its regional policy around this concept (Hester and Weintraub 2006). This would allow Canada to revitalize various initiatives in the areas of regulatory frameworks and corporate social responsibility, for example, while advancing Sino-US-LAC cooperation. Canada could indeed build on its constructive relationship with China and create a broad agenda around the issue of energy security, which could include discussions on Chinese and Canadian initiatives in Latin America.

Concerns over de-industrialization are also common among all countries of the region when it comes to China, even if in some cases these can be tempered by the decreased dependence on the US market that the Chinese alternative represents. At any rate, rather than succumbing to a knee-jerk reaction towards its emergence, Canada can use it as an opportunity to encourage economic development strategies that stress **higher value-added** production capabilities. The timing is propitious as several Latin American governments are advocating a more active role of the state in economic and social development. Given its own technological and social development, Canada can play an important role in this debate; the outcome of which could have a significant impact on

[6] In "The Beijing Consensus" Cooper Ramo elaborates on the importance of an environmental approach to policy and decision making when engaging with China (p.57-58)

[7] This said, good relations between Canada and China could potentially be jeopardized by Parliamentary approval of Bill C-357. The private member's bill provides for an improved framework for economic, trade, cultural and other initiatives between the people of Canada and the people of Taiwan (Taiwan Affairs Act).

reducing poverty and inequality in the LAC region. This is an area of intervention that the Canadian International Development Agency could explore in its programs supporting private sector development and public sector reform in the region.

Another area in which Canada could make a difference in the absence of stronger US engagement in LAC is **military training**. Reported replacement of the US by Chinese instruction to military officers in LAC, and ensuing concerns over transfer of democratic values, could motivate Canada to increase training programs in the region in areas of core Canadian military values such as respect for human rights, peacekeeping/conflict resolution and inclusion. An example of such an initiative that could be extended to other countries is the existing program between Canada's Royal Military College and Bolivia to bring more indigenous people into the Bolivian Armed Forces. Such a move would probably be welcome by both US and LAC governments and militaries. Such an initiative could be part of Canada's pending repositioning vis-à-vis LAC, in light of changing realities in the region and the vacuum left by the US.

ANNEX I: OVERVIEW OF CHINA-LAC RELATIONS

Much of the increased economic linkages were given a boost by an April 2001 13-day tour to Chile, Argentina, Brazil, Venezuela and Cuba by former Chinese President Jiang Zemin. This was followed by Defence Minister Chi Haotian's visit to meet with his Colombian and Venezuelan counterparts, and the National People's Congress head Li Peng's trip to Uruguay, Argentina, and Cuba (Watson 2005, p2). More recently, current President Hu Jintao was in the LAC region in November 2004 in conjunction with an APEC summit in Santiago, Chile. Prior to the summit, President Hu visited Argentina, Brazil, Chile, and Cuba, reaching agreements in a wide range of sectors from energy cooperation, to infrastructure financing, to commodity purchasing contracts, to deals in telecommunications, education, and tourism sectors. He also proclaimed that China would invest up to $100bn over the next decade into the LAC region. Similar to the Jiang tour of 2001, Hu's trip was followed with Vice President Zeng Qinghong's visit in January and February 2005 to Mexico, Venezuela, Peru, Trinidad and Tobago and Jamaica. At the last location, he attended the first ministerial meeting of the China-Caribbean Economic and Trade Cooperation Forum, initiated by China in 2004. During this trip, Zeng signed about 50 cooperation agreements in energy, economic cooperation, transport, telecommunications, and other fields, following up on the President's recent footsteps.

President Hu was also recently in Mexico for a two-day visit on September 11 2005, as part of his trip to NAFTA countries in conjunction with the UN General Secretary Meeting on UN reforms. This flurry of Chinese diplomacy has not been one-sided in any way. Key LAC region leaders have led several high-level trade and investment delegations to China, including Bolivian President Morales in January 2006, Brazilian President da Silva in May 2004, Argentine President Kirchner in November 2004, and Venezuelan President Chavez in December 2004 (Noriega 2005).

In contrast, US President George Bush, for his part, spent limited time in Santiago, before departing for a four-hour stay on an island off the Colombian coast (Watson 2005). More recently, the Summit of the Americas in Argentina in early November 2005 also included stopovers for President Bush in Brazil and Panama over the same weekend. Overall in 2004, President Hu spent more time in the LAC region than President Bush. Moreover, Chinese vice-president, Zeng Qinghong has spent more time in the region in the past few months than has his US counterpart Dick Cheney over the past four years (Landau 2005). Going back even further, Ratliff (2005) notes, "Indeed, Hu's predecessor, Jiang Zemin, took two long trips to Latin America, in 1999 and 2001, and in all probability spent more time there than any serving U.S. president in history."

Trade. Trade between China and LAC has been on a dramatic rise at the turn of the century. Two-way trade has grown from a level of $200m in 1975, to $2.8bn in 1988, to $5bn by the mid-1990s, to $26bn and $40bn by 2003 and 2004, respectively. As shown in Table 1., from 1990-2003 trade with LAC as a percentage of total trade has grown in the US (5.1%) and China (1.4%), while experiencing declines in the European Union (EU) (-0.2%) and Japan (-0.5%). Table 1 also hints at the continuing weight of the US in LAC trade, with the share of total US trade with LAC just below 20%, while the same ratio for EU, China, Japan, and Canada all remain under 5%.

Table 1. Share of trade with LAC as % of total trade (%)

COUNTRY	1990	1994	1998	2000	2001	2002	2003
US	13.3	15.3	18	18.8	19.1	18.9	18.4
EU	2.1	2.4	2.3	2.2	2.3	2.1	1.9
Canada	2.4	2.7	2.8	3.0	3.3	3.3	3.3
China	1.7	1.9	2.5	2.5	2.9	2.8	3.1
Japan	3.6	4	4.3	3.4	3.4	3.1	3.1

Source: **Adapted from Funakushi and Loser 2005.**

Structurally, exports from the Latin American region to China have been generally in food and raw materials, while imports from China are principally concentrated in textiles, apparel, shoes, machinery, televisions, and plastics (Funakushi and Loser 2005). Despite this comparative imbalance, the region has managed to reverse its chronic trade deficit with China, common since the mid-1990s, into a growing surplus of about $6bn in 2004 (Lin 2004, p11-3).

Investment. Investment flows between the LAC region and China have similarly been growing from a relatively nascent beginning. Although FDI inflows to China have increased significantly since the early 1990s, the LAC region has generally not been a major source of this influx. FDI in China has been largely dominated by investments from Hong Kong, Taiwan, and Macao, followed by other large players such as the US, the EU, and Japan (IADB 2005, p123-4). As reported in China's official statistics, however, LAC has consistently accounted for just over 10% of FDI inflows into China as of 2000, reaching 12.91% of China's total inward in 2003. However, if the Cayman Islands and Virgin Islands are excluded from the group, the proportion of FDI in China originating from the LAC region falls to just below 0.5% in 2003 (Lin 2004, p14).

Chinese FDI stock abroad are also expanding from a low base, estimated at $33.2bn at the end of 2003, representing about 0.5% of the world's FDI stock, and nearly 3% of its own GDP (IADB 2005, p130; UNCTAD 2004, p27). In 2003, an estimated 41% of this FDI outflow went to Hong Kong, US, Japan, and Germany. Cumulative FDI in LAC, therefore has been slight, amounting to about 7% of total outward Chinese FDI stock in the period from 1979 to 2002 (UNCTAD 2003, p4). This puts LAC in fourth place, behind Asia, North America and Africa in descending order. In terms of annual flows, however, LAC has accounted for 36% and 49% of annual Chinese FDI outflows, in 2003 and 2004 respectively (Dumbaugh and Sullivan 2005, p2; Ellis 2005, p4).

WTO Market Economy Status. Having joined the World Trade Organization (WTO) in 2001 under non-market economy status, Chinese exports are more vulnerable to Western protectionism since the burden of proving that Chinese goods have been dumped in other WTO member economies is made much easier than for full market economies. Although China agreed to live with this status until about 2015, it has actively embarked on a campaign to convince other countries to drop this label as soon as possible. While the presence of market mechanisms have been increasingly deployed since the beginning of reforms in the late 1970s, foreigners still view China's government as highly interventionist through the distortion of input factors such as interest rates, energy prices, and land ownership, not to mention the continuing role of industrial policy and state-owned-enterprises (SOEs) in influencing the structure of the economy. Despite the fact that China has persuaded some two dozen countries, such as New Zealand, Singapore, Malaysia, and Thailand, of its market worthiness, major trading partners like the

US and Europe have not followed in these footsteps (Green 2004, p1).

During his tour through the LAC region in November 2004, President Hu managed to secure market economy status (MES) from three of the region's most important economies, namely, Argentina, Brazil and Chile as well as Peru. However, a rising tide of cheap Chinese imports combined with the slow pace of promised investment inflows has driven many, particularly domestic industrial associations, to complain that MES was granted too hastily amidst all the fanfare of Hu's visits – without garnering very much in return. This has led, for instance, Roberto Giannetti da Fonseca, head of trade issues at Brazil's Federation of Sao Paulo Industrialists (FIESP), to accuse China of sourcing raw materials with little to no value added, and reselling the processed materials in the form of consumer goods back to Brazil (Economist 2005b).

FIESP contends that Brazil's industrial surplus of $101.5m in 2002 has turned into a $2.1bn deficit in 2005, putting much blame on MES recognition of China (Latin American Weekly Report 2005). In response to intense lobbying by the shoe, toy and textile sectors, Brazil issued a decree in early Oct. 2005 allowing local companies to request safeguard measures such as quotas or higher tariffs against Chinese imports. The industrial lobby in Argentina has been equally if not more vocal in successfully convincing the Kirchner government to impose licensing requirements on imports of Chinese shoes and toys, including those coming from Brazil (Moffett and Samor 2005). Colombia, on the other hand, which has yet to grant China MES, introduced safeguard duties ranging from 61% to 87% on textile and apparel imports, after Chinese imports surged by 56% in the first half of 2005 (Bussey 2005).

In some cases, the impact of China seems small. In the shoe industry, for example, Chinese imports amount to only about 1% of Brazilian production, according to official Brazilian statistics. However, these numbers do not account for goods smuggled into the country or that are simply not invoiced for purposes of tax evasion. The Economist believes that some two-thirds of Brazil's pirated products originate from China (2005b). Other countries of the region are experiencing similar trends. In Mexico, import duties on some Chinese products can be as high as 500%, but this has still failed to slow the influx of goods, while also fuelling the payoff for successful smuggling (Bussey 2005).

Table 2. KEY CHINESE PARTNERSHIPS IN THE AMERICAS

COUNTRY	STATUS OF BILATERAL RELATIONSHIP	ONE-CHINA POLICY?	PRC MARKET ECONOMY STATUS?	3RD WORLD SOLIDARITY?	PACIFIC PORTS?
Argentina	Strategic Partnership	Yes	Yes	Maybe	No - but possible link to Chile
Bolivia	Long-term, stable, equal and mutually-beneficial cooperative partnership	Yes	No	Maybe	Only via Peru and Chile
Brazil	Strategic Partnership	Yes	Yes	Yes	No
Canada	Strategic Partnership	Yes	No	No	Yes
Chile	Long-term, stable, equal and mutually-beneficial cooperative partnership	Yes	Yes	No	Yes
Colombia	Long-term, stable, equal and mutually-beneficial cooperative partnership	Yes	No	No	Yes
Cuba	Long-term, stable, equal and mutually-beneficial cooperative partnership	Yes	No	Yes	No
Ecuador	Long-term, stable, equal and mutually-beneficial cooperative partnership	Yes	No	Maybe	Yes
Mexico	Strategic Partnership	Yes	No	No	Yes
Panama	Trade ties	No	No	No	Canal limited in size
Peru	Long-term, stable, equal and mutually-beneficial cooperative partnership	Yes	Yes	Maybe	Yes
Venezuela	Strategic Partnership	Yes	Yes	Yes	No

ANNEX II: COUNTRY-SPECIFIC PATTERS OF TRADE

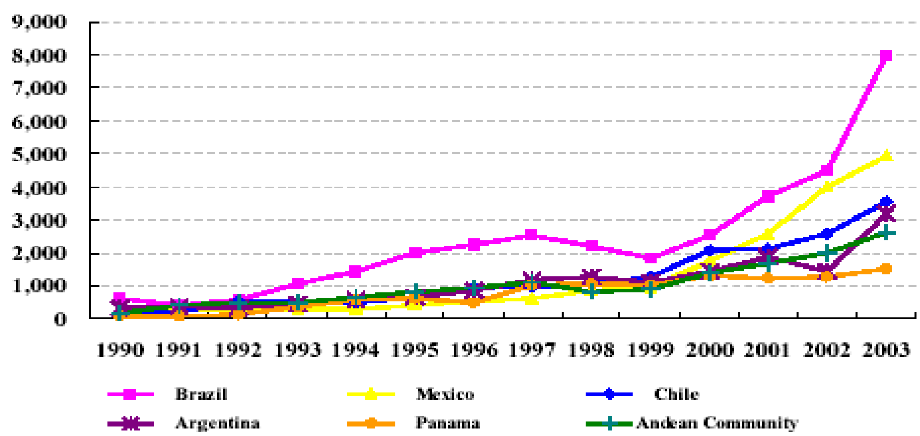
In 2004, the LAC region's top five exporters to China were: Brazil ($8.7bn), Chile ($3.7bn), Argentina ($3.3bn), Mexico ($2.1bn), and Peru ($1.5bn). In terms of China's top five export destinations in LAC, they are: Mexico ($5bn), Brazil ($3.7bn), Panama ($2.2bn), Chile ($1.7bn), and Argentina ($852m) (Dumbaugh and Sullivan 2005). This has been generally consistent with trade patterns since 1990, as shown in Figure 2. Moreover, Table 2 highlights the growing share of exports and imports with China as a share of these countries' respective bilateral totals.

Table 3. China's Presence in Selected Americas Trading Partners in 1998 and 2004

	Exports					Imports			
	1998		2004			1998		2004	
Country	Ranking	Share	Ranking	Share	Country	Ranking	Share	Ranking	Share
Brazil	13	1.8	4	5.6	Brazil	12	1.8	4	5.9
Mexico	31	0.1	6	0.5	Mexico	6	1.5	2	7.3
Chile	9	2.9	3	10.0	Chile	7	3.8	4	7.4
Argentina	8	2.5	4	9.2	Argentina	8	3.6	4	4.3
Peru	4	4.1	2	9.8	Peru	19	1.3	6	3.3
Panama	19	0.7	16	1.1	Panama	24	0.4	11	2.0
Canada	5	0.6	4	1.2	Canada	3	3.6	2	5.6

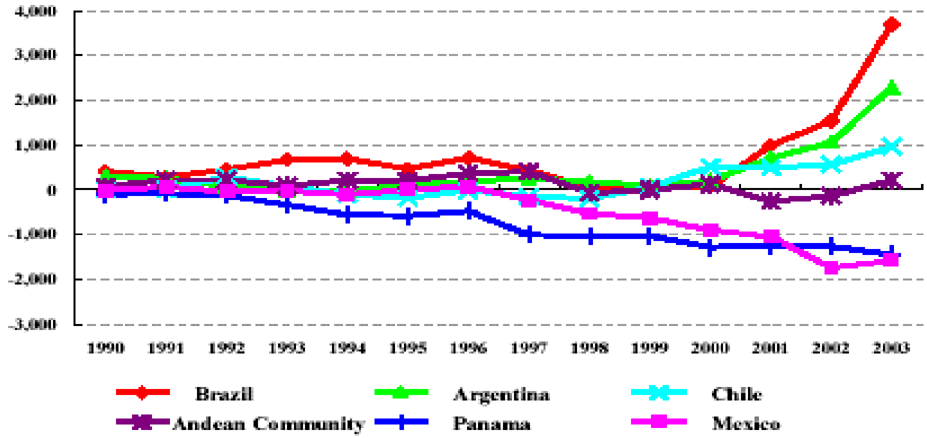
***Source:* IMF Direction of Trade Statistics.**

Figure 1. China's total trade with top 5 LAC countries and Andean Community, 1990-2003 ($m)



***Source:* Funakushi and Loser 2005, p3**

Figure 2. China’s trade balances with top 5 LAC countries and Andean Community, 1990-2003 ($m)



Source: **Funakushi and Loser 2005, p3**

However, in combining Figures 2 and 3, an important distinction can be made. While all countries have increased trade with China, Brazil’s growing bilateral trade with China, for instance, is leading to growing trade surpluses, while Mexico’s growing bilateral trade with China is leading to stark deficits. As can be roughly verified with other countries present in both Figures, much of the trade balance would seem to be based on the relative complementary structure of production and export of their economies vis-à-vis China’s. For example, much of the bilateral trade between China and Brazil, Chile, Argentina, and increasingly countries of the Andean Community, is known to be based on natural resources (raw materials, energy) and foodstuffs - key needs for China’s growing economy. On the other hand, other countries such as Mexico, and countries of Central America (not shown) are experiencing the opposite effect as their export structures rely relatively more on labour-intensive, low technology manufactures, similar to China. In 2003, for instance, China replaced Mexico as the second largest exporter to the US economy, behind only Canada. 2003 also marked the first post-NAFTA year in which Mexico lost market share in the U.S. import market. Moreover, Mexico has reported the departure of some 300 maquiladoras to China, constituting a loss of about 250,000 jobs for Mexicans over the period 2001-2003 (Funakushi and Loser 2005, p5).

The China threat? While there is no accepted methodology for quantifying a ‘competitive threat’ with the aggregated data that they use, findings from Lall and Weiss (2005) generally support the broad evidence provided above. Overall, they contend that China is not a direct threat to the bulk of LAC exports, in terms of comparable export structures, with a few exceptions:

- In **fashion products**[8], particularly for smaller Central American economies and Mexico, but also in **other low technology goods**[9], again of interest to the former group of countries.
- **Engineering products**[10], where China is currently a major exporter of machinery

[8] Defined as: textile fabrics, clothing, headgear, footwear, leather manufactures, travel goods (Lall and Weiss 2004, p7).

[9] Defined as: pottery, simple metal parts/ structures, furniture, jewellery, toys, and plastic products. (Ibid. p7)

[10] Defined as: engines, motors, industrial machine pumps, switchgear, ships, and watches. (Ibid. p7)

and consumer durables. This may impact on similar exports from Mexico and perhaps Brazil.

- And finally, in **electronics**[11], which is mainly of concern for Mexico and Costa Rica.

They note that, in these terms, the potential for threat to LAC is statistically much lower than similarities found between Chinese exports and those from other East Asian countries.

As Mexico and Costa Rica, respectively, are increasingly integrated into global supply chains managed by multinational corporations (MNCs), and hold disproportionate shares of non-resource based manufactures within LAC as a whole, they are much more susceptible to the impact of falling trade costs that make distant locations look more attractive. Thus, as China continually upgrades its production capabilities, certain higher technology production facilities in Mexico and Central America may find lower-cost China hard to resist (Lall and Weiss 2005). This said, there might be other factors, such as intellectual property rights, influencing business decisions. For example, it has been reported that companies such as Bombardier, Hewlett-Packard and Motorala are switching operations from China back to Mexico allegedly because of better intellectual property protection (*Latin America-Asia Review* 2005b, p.1).

With respect to China's impact on NAFTA relations, Mexico holds clear advantages in some sectors, such as in the US motor vehicle import market, where China's share was 0 between 1998-2002. In other sectors such as: auto parts (29%); television receivers and video monitors (49%); measuring, testing, and controlling instruments (24%); electric motors, generators, and related equipment (29%); Mexico continues to hold strong market share in higher value sectors despite startling but still modest Chinese inroads. However, in lower technology goods such as footwear, toys, dolls, etc. and apparel (to a lesser extent), China has a much stronger if not dominating share in the respective US markets over Mexico (Dobson 2004).

Insofar as much of the LAC region has hitherto failed to diversify its production structure into dynamic areas of growth, it may face a more serious threat as specialization in resource-based and primary products combined with rapid Chinese growth in labour-intensive manufactures may further constrain such efforts. Nevertheless, the American market seems to be the main China-LAC competitive arena to keep an eye on, as exports to the US accounted for 21% of PRC's exports, and 55% of LAC's in 2004. In the same year, by contrast, LAC accounted for only 3.0% of Chinese exports, while China took in 3.4% of LAC's exports (IMF Direction of Statistics 2005).

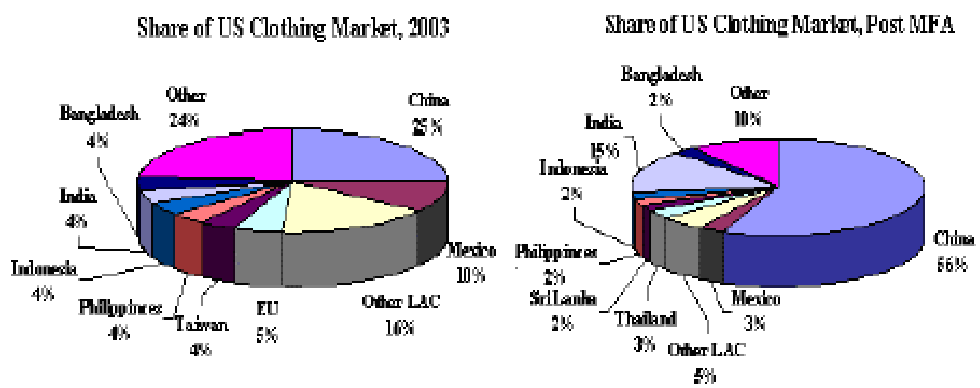
Post-MFA. Figure 4 focuses on the impact of China's clothing exports to the US following the end of the Multi-Fibre Agreement's (MFA) quota system on textile and clothing sectors in January 2005. China's share is estimated to have more than doubled since 2003 to 56%, Mexico's has fallen to 3% (down 7%), while the share from 'Other LAC', presumably including many Central American countries, has also declined by 11%, capturing a 5% share in the early post-MFA era. A November 2005 agreement between the US and China setting limits on China's exports of 34 types of clothing until 2008, should provide a respite to Central American textile producers (*Latin America-Asia Review* 2005a, p.15),

In terms of country-specific investment patterns, outgoing Chinese FDI to the LAC region is consistent with growing trade patterns with Brazil, Mexico, Chile, Argentina, and Peru. Venezuela is also an increasing destination for Chinese FDI, and thus potentially a growing bilateral trade

[11] Defined as: office/data processing/telecommunications equipment, TVs, transistors, turbines, and power generating equipment. (Ibid. p7)

partner. Areas of particular interest have been in the extraction and production of natural resources, but have also included manufacturing assembly, telecommunications, and textiles (IADB 2005, p130-1). With President Hu claiming that China will invest up to $100bn in the region over the next decade, where these funds end up and how they are to be used will be key questions influencing the future pattern of trade between China and LAC countries.

Figure 3. Share of US Clothing Market, 2003 and post-MFA



Source: **Funakushi and Loser 2005, p6**

ANNEX III: CHINESE INVESTMENT IN LAC BY ECONOMIC SECTORS

As China has interests in several sectors within individual countries of the LAC region (and around the world), detailing them all would be beyond the scope of this paper. The rest of this section takes a more specific look into areas where Chinese engagement with LAC countries have been most concerted; areas of so-called strategic partnership. This section hopes to shed light on the quality and scope of these partnerships so as to better assess the claim of 'win-win' cooperation, and ultimately, implications for Canada.

ENERGY

Oil and Gas. As mentioned earlier, China's rapid economic expansion has required it to seek-out resources to further fuel its growth and reduce bottlenecks caused by scarce inputs. China's oil consumption represents about 25% of its total energy use, second only to coal, of which China is the largest producer and consumer, representing about 70% of the total (in 2003). China became a net importer of oil in 1993, and surpassed Japan as the second largest petroleum consumer after the US in 2003. With domestic production hovering between 2-4m barrels per day (bpd) since 1980, net oil imports have been estimated by the US Department of Energy's Energy Information Administration (EIA) to grow from about 3m bpd in 2004, to nearly 11m bpd by 2025. This will significantly alter China's oil dependency, increasing net imports from about 55% currently to just over 75% of all consumption in 2025 (EIA 2005c; USCC 2004, p154-56).

China's stated policy goals are to reduce reliance on imports through the diversification of energy consumption, and the sourcing of imports, as well as the efficiency of their use. In order to attain these goals, Beijing employs a two-pronged energy strategy on the basis of: a) increasing domestic energy output, and b) securing access to diverse international oil deposits, preferring to acquire the source as opposed to buying oil on the market. The latter strategy has emerged in the past ten years, with China's national oil companies[12] acquiring equity stakes in oil projects in various countries, including: Australia, Azerbaijan, Burma, Canada, Ecuador, Indonesia, Iran, Iraq, Kazakhstan, Oman, Peru, Sudan, Venezuela, and Yemen (USCC 2005, p167). However, the unstable Middle East region still supplies significant amounts of oil to China, although Angola emerged as the top country-supplier in 2004. (Zweig and Bi 2005)

So far the LAC region energy resources has not been prominent among the current list of global oil suppliers to China, but this appears set to change given the recent bout of diplomatic activities. Although **Venezuela**, for instance, exports a far greater amount of oil and related products to the US (about 1.4m bpd) than to China, China's volume of 12,300 bpd in 2004 has grown to 70,000 bpd in 2005. Moreover, recent statements have set a target of 300,000 bpd in Venezuelan oil exports to China by 2012, representing 15-20% of Chinese oil import needs. Recent deals support these statements as China's state-owned CNPC (China National Petroleum Corporation) has been allowed access to 15 mature oil fields in Zumano area of Anzoategui state (proven reserves of 1bn barrels, peak production of 50,000 bpd), as well as

[12] In 1998, the Chinese government reorganized state-owned oil and gas assets into two vertically integrated firms, China National Petroleum Corporation (CNPC), and China Petroleum and Chemical Corporation (Sinopec). Prior to restructuring, CNPC focused on oil and gas exploration and production, while Sinopec handled refining and distribution. Currently, both firms no longer abide by a strict division of labour, although there is still some degree of specialization. Moreover, regionally speaking, CNPC concentrates its activities in the north and west of China, while Sinopec focuses in the south of China. A third major state-owned enterprise, China National Offshore Oil Corporation (CNOOC) is responsible for offshore exploration and production, accounting for about 10% of China's domestic crude oil production. (EIA 2005c)

a stake in the joint development of the Orinoco tar belt with Venezuela's state oil company Petroleos de Venezuela (PdVSA) (reserves of 20bn barrels, peak production of 300,000 bpd). The latter project has been estimated to require an investment between $3-4bn, dwarfing the $1.5bn already invested by China in the country. Agreements recently signed also include associated investments in natural gas extraction, construction of refineries, as well as other oil infrastructure such as a potential pipeline to connect to Colombia's pacific ports (Ellis 2005, p6-8).[13]

Supplying about 11.8% of all US oil imports in 2004, which represented 68% of all Venezuelan oil exports in 2003 (EIA 2005b), President Chavez has openly stressed his desire to reduce his country's dependence on the US import market. Speaking to business executives in Beijing in December 2004, Chavez remarked that,

> We have been producing and exporting oil for more than 100 years, but these have been 100 years of domination by the United States. Now we are free, and place this oil at the disposal of the great Chinese fatherland (Zweig and Bi 2005).

While causing much consternation in Washington, many analysts have stepped in to evaluate the viability of President Chavez's assertions. Three main economic arguments emerge: time of transportation, refining capacity, and manner of transportation. Firstly, it takes about 4 days for Venezuelan oil to reach the Gulf Coast for refining. This compares to 43 to 44 days to reach China via Africa, or 24 to 25 days from the Panama Canal (Wilson 2005). Secondly, refineries on the Gulf Coast, which receive about three-quarters of Venezuelan exports to the US, are specially designed for heavy, high-sulfur Venezuelan crude oil. China, as it stands now, does not have refineries that can process such heavy oil and Venezuelan refineries are reported to be at capacity (EIA 2005b). Thirdly, in order to transport oil to China, Venezuela would also have to augment its tanker capacity. According to some estimates, Venezuela would need about five times the number of tankers in order to supply China.

Despite these various obstacles, there are signs that they are being addressed in some manner. For instance, it is well known that President Chavez is engaged in pipeline infrastructure negotiations with both Panama and Colombia that would sidestep the Canal's size restrictions that do not allow the passage of large aircraft carriers supertankers, or vessels over 100,000 tons. Although neither of these projects has been approved, the Panama option, for example, would expand the capacity of a 20-mile long pipeline that currently parallels the Canal eight-fold; thus permitting about 800,000 bpd to be transferred from the Atlantic to the Pacific side of the country. Needless to say, such an upgrade would greatly improve the economic viability of oil shipments to China from Venezuela (Ellis 2005, p6, 14-5, 17-8). A further development involves Venezuela spending $2.2bn on oil tankers through 2012 to triple its fleet size. PdVSA currently has 21 tankers, and plans to purchase another 42, including at least 14 supertankers, allowing the country to carry 45% of exports in 2012 compared to 26% now.[14] With regards to refining capacity, a joint venture between CNPC and PDVSA in 2001, called Orifuels Sinoven SA (Sinovensa) that was

[13] Wilson, Peter (2005); Alexander's Gas & Oil Connections (2005c, 2005e); Wang Ying (2005); BBC Monitoring International Reports (2005).

[14] Wilson, Peter (2005). Ibid. Interestingly, another estimate suggests that shipping 300,000 bpd of crude and products translates into monthly shipments of at least four very large crude carriers (VLCC), each with an approximate capacity of two million barrels each. This presents a challenge as only PDVSA's Curacao Isla refinery has the capacity to load large tankers. Currently, Venezuela's terminals cannot load supertankers. (Alexander's Gas & Oil Connections 2005c, 2005f).

slated to bring a 6.5m metric tonnes per year Orimulsion plant online by 2004, would seem to be an important initiative in transferring technical capabilities involving heavy crude oil (more below in section on alternative fuels) (EIA 2005b; Ellis 2005, p7).

More than just the reallocation of Venezuela's oil, President Chavez also aims to have *more* at his disposal. PdVSA plans to invest $26bn between 2004-2009 with the intention of expanding hydrocarbon reserves and boosting domestic oil production to at least 5bn bpd. In light of the increasing demands placed on PdVSA's finances by the government[15] and significant amounts of its production supplied on preferential terms[16], the EIA notes that "it is unclear how the company will be able to afford its ambitious investment plans." Conversely, with total Chinese investment set to rise to $5bn in the next few years (short term), combined with a declining Venezuelan share in total US oil imports since 1996 (EIA 2005b), Chinese oil trade and investment flows with Venezuela would seem to have much potential to rise sharply in the medium term.

Along the Atlantic coast, China's Sinopec entered into cooperation agreements with **Brazil**'s state-owned oil company Petroleo Brasileiro SA (Petrobras) for joint oil exploration, production, refining, product sales, petrochemicals, pipelines, and technical assistance. As Brazil is still a net importer of crude oil, Petrobras is hoping to boost oil shipments to China, doubling the amount to 50,000 bpd, which is equivalent to about 18m barrels per year – a stark contrast to the ambitions visible in Venezuela. As such, the partnership seems less based on oil exports, as opposed to leveraging the individual abilities of each firm. For instance, Petrobras opened a representative office in Beijing in May 2004 during President da Silva's visit to the Chinese capital, while Sinopec has been interested in participating in the building of a new refinery, pipelines, and a natural gas liquefying plant in Brazil. Both have signed a memorandum of understanding regarding a 1,225 km, $1.3bn gas pipeline linking the southeast to the northeast of Brazil. More recently, however, the project has been delayed due to higher project costs cited by the Chinese partner, making the entire project less feasible for Petrobras.[17] With regards to exploration and production, there is a sense of specialization and skill transfer as Petrobras has been tasked with deep-sea activities in the China Sea, while Sinopec is in Brazil assisting the recovery of mature oil fields. Moreover, the Sinopec-Petrobras agreement also allows for cooperation in third countries, including Petrobras concessions in Ecuador and Iran. CNOOC and CNPC, it should be noted, are also in talks for joint operations with Petrobras along the same lines as Sinopec's agreement.[18]

In **Argentina**, as part the promised package of $20bn in Chinese investment over 10 years, President Hu has committed about $5bn to the oil industry over five years. The tentative deal, signed

[15] PdVSA will directly provide $2bn a year to a special development fund to finance infrastructure projects throughout the country, outside the purview of the Venezuelan Central Bank and in addition to the royalties, income taxes, and dividends, received the Government from the firm. Moreover, the company will also provide a further $2-3bn per year for social programs. (EIA 2005b)

[16] Under the San Jose Accord, renewed in Aug. 2004, Venezuela and Mexico supply a total of 160,000 bpd of crude oil to 11 Central Countries at less than market prices. From China's point of view, the Accord encompasses a number of strategically important countries, namely: Barbados, Belize, Costa Rica, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Nicaragua, Panama and the Dominican Republic. More recently in 2005, Venezuela signed a preliminary agreement with 13 Caribbean countries, under the initiative of 'Petrocaribe' that will supply them with crude oil and petroleum products under preferential terms and prices. (EIA 2005b; Alexander's Gas & Oil Connections 2004d).

[17] Alxeander's Gas & Oil Connections (2004c); Gazeta Mercantil (2005a).

[18] Alexander's Gas & Oil Connections (2004f);Veljsquez, Juan (2005);
Alexander's Gas & Oil Connections (2005i, 2004e).

during the President's November 2004 tour in the region, has Argentina's newly established state firm Energia Argentina SA (Enarsa) working with a Chinese subsidiary of the Angolan state-owned company Sonangol. The Chinese partner, China Sonangol International Holding (CSIH), will jointly explore potential new fields as well as upgrade mature wells in concessions off the coast of Argentina (Alexander's Gas & Oil Connections 2004a).[19]

On the Pacific coast, China's energy interests are also well represented in oil assets, particularly in Ecuador and Peru. In **Ecuador**, for instance, the Chinese consortium Andes Petroleum, which includes both CNPC and Sinopec, successfully acquired the oil assets of a Canadian firm, Encana Corp. in Sept. 2005 for $1.42bn. With the deal, the CNPC consortium receives about 75,000 bpd from five production blocks (Dorine oil field), with proven reserves of about 143m barrels. In addition, the consortium also takes-over Encana's 36% stake in the 500km long OCP (Oleducto de Crudos Pesados - Heavy Crude Pipeline) pipeline, initially spearheaded by Encana in 2001, that has a capacity of 450,000 bpd. The OCP is credited with increasing oil production in Ecuador, as its completion doubled the country's oil pipeline capacity. The pipeline is significant insofar as it is the only other pipeline in Ecuador besides the SOTE (Sistema Oleducto Trans-Ecuatoriano – Trans-Ecuadorian Pipeline) pipeline, built in the early 1970s, which is prone to natural disasters, and is run by the state-owned Petroecuador. Overall, Ecuador holds the third-largest proven oil reserves (4.6bn barrels in 2005), and is the fifth-largest producer of oil in South America, producing 534,800 bpd oil products, of which 528,200 bpd was crude oil. With low rates of consumption, Ecuador is a significant exporter, over 50% of which goes the US, accounting for about 2.3% of total US oil imports and placing the country second, behind Venezuela, as South America's largest single source. (EIA 2005f).[20]

In December 2003, CNPC acquired a 45% share of Pluspetrol Norte (PN), the **Peruvian** unit of Argentine firm Pluspetrol. PN is the largest foreign operator in Peru, and accounts for over one-half of Peru's entire crude oil production of about 94,120 bpd (2004). Although national production has been on a declining trend since 1980, proven reserves are estimated at 253m barrels, primarily concentrated in the northern part of the country. The acquisition expands the number of oil fields operated by CNPC subsidiary, Sapet, in offshore northern Peru, while also positioning CNPC in planned Pluspetrol oil ventures in Ecuador, Venezuela, and Colombia. Significantly, the acquisition leaves Pluspetrol with a majority 55% in PN (Ellis 2005, p15-6).[21]

In **Bolivia**, with the second-largest natural gas reserves in South America (24.0 trillion cubic feet), Chinese interests are less focused on crude oil extraction. In December 2004, the Chinese firm Shengli Oilfield International Exploit was set to sign about seven contracts worth at leaset $1.5bn with Bolivia's state oil company YPFB (Yacimientos Petroliferos Fascales Bolivianos) spanning: exploration and production for 10 blocks; construction of at least one thermoelectric plant, a polyethylene plant, two refineries, and a pipeline to connect the wells to these plants; 250,000 residential connections; and doubling YPFB's service station network to 80 outlets. Although the agreements have been delayed due a controversial new domestic hydrocarbons law that has yet to be resolved, sources indicate that

[19] CSIH emerged when Sonangol rejected an April 2004 agreement whereby Shell would sell its 50% stake in Angola's Block 18 Greater Plutonio project to India's ONGC (Oil and Natural Gas Corp.). By October, Sonangol accepted a bid by Chinese interests, coupled with a $2bn aid offer to rebuild infrastructure destroyed in the civil war (Dreyer 2005; Ellis 2005, p12-3; EIA 2005g).

[20] Alexander's Gas & Oil Connections (2005a, 2005b); The China Daily (2005a).

[21] EIA 2005e; Alexander's Gas & Oil Connections (2004g, 2004h).

Shengli was able to arrange these contracts because of its acceptance of a minority stake, with a controlling share of 51% going to YPFB (EIA 2005a).[22]

With Ecuador and Peru located on the Pacific coastline, they potentially play a strategic shipping role not only for the export of their domestic products to China, but also for goods originating from across South America. For instance, increased oil shipments from Pacific cost terminals would help alleviate China's concerns over its dependence on the Middle East and the so-called the 'Malacca Dilemma'[23]. However, indigenous movements and violent protests currently pervade these countries, as well as neighbouring Bolivia, as locals demand increasing benefits from oil and mineral extraction activities in their respective countries. Such conditions could prove to be a double-edged sword for China, and its approach to this issue will help reveal its own understanding of 'win-win' partnerships. On the one hand, China's posturing as a defender of 'third-world' interests could help elicit the support of indigenous movements in unseating incumbent multinational extractive industries; however, on the other hand, if China's presence simply reinforces the status quo, these movements could play a destabilizing role by further fuelling anti-globalization and isolationist sentiment and thus denying access to natural resources. Under such a scenario, the potential spread of President Chavez's Bolivarian revolution could very well clash with the nature of Chinese interests in the region. (Ellis 2005, p16, 24-6)[24]

Left out of the discussion thus far has been **Colombia**. With South America's fifth-largest proven oil reserves (1.54bn barrels) and 4.0 trillion cubic feet of natural gas reserves, Colombia's resource endowment would seem well aligned with China's interests (EIA 2005d). However, China has not pursued relations with Colombia aggressively, suggesting attentiveness to the strong security and aid ties linking Colombia and Washington. President Uribe was the only leader to receive President Bush during the latter's visit to the region in conjunction with the APEC summit of 2004, whereas President Hu chose not to visit Colombia at all. Although strategic interests are prominent, particularly related to pipelines and pacific ports, China has chosen a more indirect approach, content to see Venezuela actively engaged on the matter. To some, this case, as well as President Hu's point of not stopping in Venezuela during his tour, reveals a degree of careful calibration and attentiveness to American sensitivities on behalf of the Chinese leadership in its rising involvement in the region. To be clear, Watson speculates that Beijing is doing this in order to maximize economic benefits, without alarming Washington. As she puts it, "This will be an interesting test of the sophistication of Chinese strategy in Latin America." (2005, p7) Similar thinking surrounds China's approach to **Mexico**. Although regarded as a 'strategic partnership', Chinese investment in Mexico was only $200m in 2004, a relatively small number vis-à-vis Chinese investment inflows in other large South American countries mentioned earlier. Although Mexico's constitution limits potential incoming investment by prohibiting the participation of foreign firms in the oil sector, some also see Mexico's close proximity to the US as a deterrent to aggressive Chinese

[22] Alexander's Gas & Oil Connections (2004b); Rigzone (2005).

[23] The Malacca Dilemma refers to China's concern about the sea-lanes through which oil tankers must travel to reach its industrial north-east. With about four-fifths of imported oil traveling by tanker through both the Strait of Malacca and the Taiwan Strait, a disruption in either could possibly lead to an energy crisis at home. The potential conflict with Taiwan has this added factor, while a US naval presence at Diego Garcia in the Indian Ocean, and India's navy at the mouth of the Straight of Malacca, also pose key energy security concerns for China. On this issue President Hu has commented that "certain powers have all along encroached on and tried to control the navigation through the strait." (Zweig and Bi 2005, p32-3)

[24] Alexander's Gas & Oil Connections (2005d; 2005g).

investment, at least in the near term (Ellis 2005, p19).

With regards to the Caribbean, as mentioned earlier, newfound reserves in **Cuba** in the order of 100m barrels of lower sulphur content crude oil was discovered off the coast of western Pinar del Rio province in December 2004. Discovered by two Canadian companies, Sheritt International and Pebercan, that currently account for 60% of Cuban oil production, Cubapetroleo has entered into a joint production agreement with Sinopec that could potentially increase domestic production above the current level of 80,000 bpd. Cuba consumes approximately 150,000 bpd, with about 53,000 bpd of the difference imported from Venezuela on generous financing terms (Dreyer 2005).[25] In light of Cuba's oil deficit position, Chinese interests to export oil back to mainland China would not seem to be prominent in this case.

Alternative Fuels. CNPC-PdVSA's $300m joint venture in 2001, would seem to go against the grain in the **Venezuelan Orimulsion** sector, where Bitumens del Orinoco (Bitor), PdVSA's Orimulsion company, announced in April 2005 that it would cease production of the boiler fuel alternative within twelve months.[26] Citing high oil prices, the company has claimed it is more profitable to sell its heavy and extra-heavy crude varieties as upgraded synthetic crude oil (syncrude) or blended crude oil. Overall production is reportedly at a level of 40,000bpd, down from a peak of 100,000bpd, according to the EIA. Other reports, from 2001, indicate production rising from 4.85mmt to 6.23mmt in 2000 and estimates made by Bitor are for 13mmt in 2002, and 22mmt in 2006. At the time, the largest importers of Orimulsion were: Italy (2.75mmt), Denmark (1.10mmt), and Canada (750,000mmt). The planned shutdown of production has caused some controversy. In August 2005, New Brunswick Power (NBP) filed a $1.6bn suit against PdVSA, accusing it of breaching a contract to supply NBP's Coleson Cover power plant. Although NBP admitted never having signed a contract, PdVSA has shown its intention to supply the company anyway. On a side note, Canada was an early importer of Orimulsion, its first shipment received in 1988.

Moreover, despite statements that it would only produce Orimulsion up until the fulfilment of contractual obligations, PdVSA has gone ahead with Bitor's Sinovensa joint venture firm with CNPC. According to the terms of the joint venture, CNPC receives 70%, while Bitor gets the remaining 30% of the planned annual 6.5mmt production. Since November 2003, CNPC has built two 600-megawatt thermoelectric plants in Zhanjiang, in southern Guangdong province, specially outfitted to burn the Orimulsion fuel for

Box 1: Orimulsion

Seen as cheap and dirty alternative to coal or fuel oil, Orimulsion is a patented product developed by PdVSA in the early 1980s, that can be purchased at a relatively low cost due to lack of global demand. Made of two-parts heavy petroleum or bitumen, one part water and a small percentage of additives (emulsifiers), Orimulsion is a variant of the extra heavy, high sulphur crude common to the region. Unlike petroleum, it does not float on the water immediately after a spill, making it much harder to clean up, and thus potentially posing a higher environmental transport risk as well.

Although banned in the US and Britain, Venezuelan authorities contend that more than 90% of the sulphur can be removed before burning, making Orimulsion no more hazardous and even cleaner than fuel oil or coal. Nonetheless, the Venezuelan oil industry has been working on cleaner versions of the fuel, Bitor has also been involved in meetings held at the World Bank's International Financial Corporation (IFC) with environmental groups and energy industry representatives.

[25] Alexander's Gas & Oil Connections (2005j).

[26] Unless otherwise indicated, information pertaining to Orimulsion has been sourced from: EIA 2005b; Ellis 2005, p7-8; Alexander's Gas & Oil Connections (2001, 2000).

electricity. Each will consume 1.8mmt annually, to be completed by the end of 2006. The remaining 1mmt or so of its annual 4.55mmt share, will be stored in a Zhanjiang depot, the largest of its kind in the country (People's Daily 2002). Currently, China has become one of the largest importers of the fuel at 1.5mmt annually, accounting for a majority of Venezuelan exports to China (Wilson, 2005).

Whatever the merits of the fuel, Venezuela currently possesses the world's largest proven orimulsion reserves, almost double the amount held in Saudi Arabia, the second largest source. China is a natural partner, especially given CNPC's involvement in the Orinoco extra-heavy tar belt. Sales to China, however, seem to be part of a larger strategy to increase the market for Orimulsion in Asia. Efforts made by President Chavez to promote the fuel go back at least to an October 2000 tour to a dozen countries in Asia, securing agreements with Japan, South Korea, Philippines, India, and even Northern Ireland.

It should also be noted that through PdVSA's US refining and marketing affiliate, Citgo Petroleum Corp, Venezuela possesses refineries that have deep conversion units to transform cheaper low-value fuel oil, like heavy crude, into higher-value products like diesel and gasoline, thus turning a healthy profit. Of late, President Chavez has complained about the terms under which Citgo's network of eight refineries and 14,000 gas stations operate in the US. Venezuela, under contracts signed prior to Chavez coming to power in 1999, sells crude oil to the US, via Citgo, at a discount rate of two dollars a barrel because its refineries handle the heaviest of Venezuelan crude. Although reports indicate that the government is not intending to sell off the company's assets, some analysts believe that Chavez may do so in the medium term, only after assessing the profitability of each refinery Inter-Press Service (2005).

Moreover, the recent announcement of Chinese-**Canadian** 'strategic' relations encompasses cooperation in the oil and gas sector, with potential for Chinese involvement in Canada's oil sands (deposits of bitumen) (Jones 2004). These deposits have proven reserves of 180bn barrels, making Canadian oil resources second only to Saudi Arabia. This link with "unconventional" production methods to make syncrude could give Canada some overlap in the budding relationship between China and Venezuela in the energy sector (Oxford Analytica 2005). As many LAC-China agreements involve partnerships in third countries as well, this would seem like a viable avenue for further Canadian engagement with both China and Latin America. Canadian firms in Cuba, for example, who also deal with heavy crude deposits, could be candidates for further engagement with China in the LAC region. Recent bilateral visits in January and September 2005, have led to agreements for joint research and study of oil sand technologies, including a joint declaration on science and technology cooperation focusing on climate change and sustainable energy fields.[27]

A second, albeit also still modest, area of cooperation relating to alternative energies revolves around **Brazil's** dominant role in a burgeoning **ethanol** industry.[28] A renewable fuel that burns significantly cleaner than oil, China initiated its ethanol push in 2001 as a component in its Tenth Five-Year Plan (2001-2005), providing 10% ethanol-blended gasoline for vehicles in a five-city (Zhengzhou, Luoyang, and Nanyang; Harbin and Zhaodong) pilot project in two provinces (Henan, and Heilongjiang Province respectively). This has been extended in 2004 to

[27] Deutsche Presse-Agentur (2005); China Daily (2005c); Office of the Prime Minister (2005).
[28] Unless otherwise indicated, information on ethanol has been sourced from: Macedo (2005); Liu (2005); Alexander's Gas & Oil Connections (2005h); Whelan (2004); Benson (2004).

include nine provinces. Furthermore, all pilot area gas stations will be required to fully switch to ethanol mixtures by the end of 2005. These efforts have made China the third largest ethanol producer after Brazil and the US, producing about 3.7bn litres in 2004. On his 2004 tour through the LAC region, President Hu stressed China's interest in Brazilian ethanol and in April 2005, a delegation of Chinese experts travelled to Brasilia, Sao Paulo and Rio for a four-day information session to learn about ethanol's production process, automobile industry applications, as well as the legislation regulating the sector.

Brazil is currently the world's largest producer and exporter of ethanol, producing 10.4bn litres annually in 2004, according to the Sao Paulo Sugarcane Agroindustry Union (UNICA). Given the likelihood that oil prices will remain high, there is a renewed interest in ethanol from foreign investors, who have been asked to help upgrade pipeline and storage capacity at ports and refineries, the weakest link in Brazil's ethanol export ambitions. Nonetheless analysts believe Brazil is well positioned to benefit from a boom in global ethanol consumption, with competitiveness in technology, high sugar-crop yields, and low costs for land and labour.

While it may take decades for flex-fuel to catch on in other nations that do not have the same infrastructure as Brazil, there is no doubt that in ethanol, Brazil has a high-value strategic niche. Brazil's 25-year experience with ethanol could make the country an important partner of China's, especially given Beijing's track record of simultaneously experimenting with several competing technologies in various sectors of its expansive domestic market. (Linden 2004, p23; Suttmeier and Yao 2004, p30).

On a further note, Brazilian aerospace company Embraer has also been tinkering with ethanol in its operations, announcing the first mass-produced cropduster aircraft powered by ethanol. The company boasts more engine power, lower maintenance costs, and fuel prices one-quarter that of traditional aviation fuel, as key selling points in its marketing strategy.

MINING, RAW MATERIALS, AGRI-FOOD, INFRASTRUCTURE

Beyond the issue of energy, China's demand for inputs has reversed the trend of declining international commodity prices witnessed in the past 20 years. As it continues along its path of industrialization, domestic demand for such raw materials has outstripped supply, requiring Beijing to go abroad to secure sources.

Of all LAC countries, **Brazil**, is best placed to complement China in this regard, with about 37.5% of its exports to China centred on agricultural products in 2003, and the remainder consisting of iron ore and its derivatives, and lumber. According to the IADB, Brazilian agricultural exports to

Box 2.: Ethanol and Brazil's Auto Sector

The Brazilian government's push to create a domestic alternative energy market did not stop at fuel production. Subsidies, tax breaks, and regulatory requirements were also aimed at domestic automakers, providing incentives to manufacture cars that ran exclusively on ethanol. In March 2003, Volkswagen's Brazilian (VW-B) subsidiary, rolled out its first flex-fuel engine - capable of using gasoline, ethanol, or any mixture of the two – in its TotalFlex Gol subcompact model.

Today nine automakers in the country, including Fiat of Italy, Ford Motors and GM of the US, and France's Peugeot have all developed fuel-flex models, although VW-B has kept a 36.5 share of the market. Sales of duel-fuel cars have been booming, representing 24% of all new-car sales in the first nine months of 2004, increasing to 284,500 units sold as compared to 48,100 in the same period in 2003. In 2005, flex-fuel automobile sales were estimated to double to reach 40% of all cars sold in Brazil. Overall, fewer than 20% of Brazil's cars run exclusively on ethanol, however, all gasoline in the country is a 25% ethanol blend.

China are highly concentrated, with soybeans (a single tariff line) accounting for 79.7% of the total. The entire soy supply chain, which includes soy oil and soy meal, totalled 93.1% of all Chinese agricultural imports from Brazil. Brazil is also pressing to diversify its agricultural exports, particularly with regards to beef, poultry, fruits and juices as the Chinese population gradually changes its consumption pattern to include more meats, milk, oils and processed foods. In this regard, sanitary and phytosanitary standards (SPS) are crucial in ensuring smooth trading relations, with agreements signed during President Hu's visit in November 2004. For instance, in 2004 China imposed a temporary zero-tolerance policy on the presence of the fungicide carboxin in soy seed shipments, effectively suspending imports from Brazil at a time when international prices were lower than the contracted price (Lampton 2005, p6). Another contentious issue has been that of value-added processing - while soyabean exports have soared, soy oil exports have decreased significantly. Upon it's entry into the WTO, China erected a temporary tariff-rate quota (TRQ), to be phased-out by 2006, that has helped give rise to a domestic crushing industry (IADB 2005, p103).

In the mining sector, the Brazilian firm Companhia Vale do Rio Doce (CVRD), the largest diversified mining company of the Americas, has signed a number of long term iron ore supply contracts with Chinese firms over the past few years: Beijing Shougang Group, Shanghai Boasteel Group, and China Steel Corporation. The most recent accord commits CVRD to supply 11.3m tonnes of iron ore between 2004 and 2012 to Shougang, an increase of the previous contract of 4.4m tonnes between 2004 and 2008. Baosteel will receive approximately 14m tonnes a year, beginning in 2010. Moreover, Boasteel has entered into a joint venture with CVRD, with a $1.5bn slab steel mill planned to be built in the northern state of Maranhao. Joint activities, however, also include coal and metallurgical coke ventures in Henan and Shandong provinces of China.[29] Besides iron ore, other minerals of interest to China include bauxite, zinc, and uranium. With regards to bauxite, the mineral that contains alumina, CVRD has partnered with Chinese aluminium producer Chalco to build a refinery worth $1bn, also in northern Brazil (Wheatley 2004).

Similar to Brazil, **Argentina** heavily relies on soyabean exports to China. About two-thirds of Argentina's bilateral trade consists of agricultural products, 60% of which is related to the soy industry. Although efforts to diversify exports to China were initiated in 2003, it was not until November 2004 when both parties reached a SPS agreement to open the Chinese market to imports of meat and fruit (apples, pears, citrus fruits).[30] With regards to minerals, although Argentina's deposits are not comparable to Brazil's, the Chinese firm, Ling Cheng, was allowed in mid-2004 to reactivate a mineral field located in Patagonia. This is significant since the field is the only proven iron ore deposits in Argentina (Ellis 2005, p13).

In **Chile**, the Chinese state-owned firm Minmetals Nonferrous Metals Co. Ltd. has been active in seeking mining assets such as Canada's Noranda Inc., which is a major producer of copper, nickel and zinc. Although Noranda eventually merged with Falconbridge Ltd. in March 2005, Minmetals has nonetheless agreed to form an alliance to mine copper with the newly merged entity.[31] Minmetals, however, was successful in forming a $2bn joint venture with Chile's largest copper producer, Corporacion Nacional del Cobre de Chile (Codelco). For Codelco, the deal provides grants the company greater access to capital to further develop copper projects, while also representing

[29] Magnavita (2005); Financial Times (2004a); PR Newswire (2004).
[30] Latin America News Digest (2004); BBC Monitoring International Reports (2003).
[31] Brieger (2005); Reuters (2005).

the first time a foreign company has been permitted to invest in the domestic copper industry. For China, the joint venture ensures a long-term stable supply of about 55,000 tonnes per year of refined copper over 15 years. Chile, of course is a key player in the global copper industry, accounting for about 37% of world production. Copper comprises of 38% of total exports, 20% of which is delivered to China (China Daily 2005b). Beyond minerals, Chile is also a potential emerging exporter of foodstuffs, although trading levels are still comparatively modest (Ellis 2005, p9).

Venezuela-China relations have also spilled-over into the agricultural sector. Deals signed in China in December 2004, for instance, commit China to providing agricultural machinery and credits, allowing Venezuela to increase its food production (Ellis 2005, p8). With regards to **Mexico**, as it is running the largest LAC region trade deficit with China, recent bilateral talks have stressed the need to increase agricultural and mining exports in order to rebalance their relationship (Grogg 2004).

In **Bolivia**, the main Chinese mining attraction is in its large tin reserves, which usually also contain other strategic minerals such as silver, zinc, lead, and bismuth. **Cuba**, for its part, has the world's largest proven nickel reserves estimated at 800m tonnes. Agreements established with the Chinese are three-fold: first, contracted sales have been made to Minmetals at 4,000 tonnes per year between 2005-2009; second, Cuba will receive financing for construction of a refinery with production capacity of 22,500 tonnes; third, joint ventures will be created to mine new quarries, with 51% ownership going to Cuba. Currently, there are three nickel deposits, found on the eastern province of Holguin. Two deposits are operated by Cubaniquel, a state-run firm, while the third is mined by Sherritt International of Canada (Grogg 2004).

Aside from infrastructure related to the transportation of crude oil and natural gas, China has also vowed to invest in infrastructure projects in key LAC region countries in order to help them get their wares to market. Railway, seaport, and road projects estimated to cost in the billions, have been discussed most extensively in Brazil, Argentina, Venezuela, and Chile. However, these projects have been slow to materialize partly with both sides to blame. In Brazil, the government has been slow to publish its regulatory framework regarding joint public-private investments (Barham 2005). Conversely, there have been many suspicions that Chinese infrastructure projects would be assigned exclusively to Chinese firms, suppliers and labourers, thus creating few spillovers and linkages to the local economy (Economist 2005b, 2005d). As Cai Runguo, the Chinese alternate observer to the OAS, has explained, "Chinese entrepreneurs have very little knowledge of [South America], and when they have begun to invest or explore the possibilities of investment they have encountered difficulties." (Lampton 2005, p8).

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