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Latin America–China Trade and Investment Amid Global Tensions

A NEED TO UPGRADE AND DIVERSIFY

BY ANABEL GONZÁLEZ

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We extend a special thanks to HSBC for the generous support for this initiative, without which this report would not have been possible. The opinions expressed herein are strictly those of the author(s).

Atlantic Council
1030 15th Street NW, 12th Floor
Washington, DC 20005

ISBN-13: 978-1-61977-571-8

December 2018

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Setting the Stage

Trade frictions are undermining confidence in the global economy, and threatening to derail the recovery and depress medium-term growth prospects.[1] Rising protectionism and uncertainty are already taking a toll on investors, markets, and supply chains, while eroding the rules-based global trading system. The United States and China are at the center of this high-stakes escalating trade and investment confrontation, but underlying systemic issues amplify the impact beyond the two countries.

The prospects are troubling for Latin America and the Caribbean, given its trade dependence on both the United States and China, which collectively account for more than half of the region's total imports and exports.[2] Though tariff imposition may lead to some short-term opportunities for firms from third countries, such as Brazilian soybean producers, the region stands to lose from a return to a trading system in which power and politics—rather than market competition—allocate resources and inform business decisions.

The motivation to explore new openings, strengthen partnerships, and redraw economic cooperation provides a silver lining to this gloomy scenario. This is an opportunity for Latin America and China to explore fresh options to upgrade, diversify, and deepen their trade-and-investment relationship for enhanced regional benefit.

For nearly two decades, Latin America and China have built strong connections centered on trade. Commerce has multiplied eighteen times since 2000. China has also become a source of finance for the region, through both foreign direct investment (FDI) and lending—mostly for infrastructure and energy. Increasing trade and investment links have served both partners well, allowing China access to energy, metals, and food to fuel growth, and allowing Latin America—South American countries in particular—to unlock a new driver of growth and poverty reduction. However, the fact the region's exports to China are highly concentrated in commodities presents challenges and shortcomings, while potential opportunities remain untapped.

The time is right to explore new areas of business. China's rebalancing toward a new, consumption-and-services-driven growth model has weighted down considerably on commodity prices, but also opens new export possibilities for Latin America, ranging from value-added food products to services such as tourism. Advanced technologies and digital platforms are also transforming the trade landscape. Latin American and Caribbean firms should tap into China's role as a global leader in e-commerce with strategies that target the Chinese marketplace.

To realize these opportunities, policymakers should develop a shared vision and modernize the institutional trade-and-investment framework to govern bilateral flows, while addressing supply-side constraints and aligning productivity-increasing reforms. A mix of policy levers is critical to unlocking business openings. A deeper and upgraded Latin America-China partnership needs to be anchored in the context of a renovated and strengthened multilateral trading system.

IIP PHOTO ARCHIVE/FLICKR

Goods cross the Pacific Ocean to Latin America. China is the largest trading partner for Argentina, Brazil, Chile, and Peru.

The US-China Trade Conflict

The disruptive repositioning of US trade policy reflects a rise in protectionism and economic nationalism. Anchored in notions of fair and reciprocal trade, it pursues a reduction in bilateral trade deficits as an organizing principle.[3]

China is a key target—albeit not the only one—of this new US approach to trade policy. Initial measures to restrict imports of solar panels, washing machines, steel, and aluminum moved to a different level when, as a result of an investigation under Section 301 of the Trade Act of 1974, the United States concluded that a number of China's policies and practices related to technology transfer, intellectual property, and innovation are unreasonable and burden US commerce.[4]

To seek redress, the United States originally proposed a combination of tariffs, a World Trade Organization (WTO) dispute resolution, and investment restrictions, and started conversations with China aimed at securing a bilateral arrangement. On July 6, 2018, in the wake of unsuccessful high-level talks, the United States levied a first round of additional tariffs of 25 percent on $34 billion of Chinese goods. On August 23, 2018, a second installment followed on $16 billion worth of imports. China responded both times with retaliatory tariffs on an equivalent amount of US imports. A third installment, on $200 billion of imports from China, came into force on September 24, 2018, and more may come.[5] In addition, the United States has launched an investigation to determine whether imports of automobiles constitute a national security threat.[6] Though targeted at the lead automobile exporters, notably Germany and Japan, this would still hit China, given the interconnectedness of the automotive value chain.

> **"Escalating trade frictions and associated uncertainty have unnerved investors, rattled financial and commodity markets, disrupted supply chains, and alarmed farmers and consumers."**

Several concerns and questions underlie current trade frictions, and all countries, Latin American nations included, have a stake in their solution.

- First, what level of state intervention in the economy—via direct subsidization, market preferences, or other policy instruments to support state and state-backed actors—is compatible with a level playing field for trade.
- Second, are current WTO rules and enforcement mechanisms fit to address this challenge in the context of distinct national economic structures?[7]
- Third, do existing arrangements sufficiently govern new issues associated with the digital economy and technological innovation, including cross-border e-commerce, cross-border data flows, and others?
- Fourth, in the face of the changing geography of world trade, what should emerging economies contribute to the global trading system?

These are complex issues, some of which will not be solved soon: it is about fostering a new global consensus around best practices for trade in the twenty-first century.[8]

Unfortunately, current confrontational tactics are, at best, ineffective in addressing these questions. Escalating trade frictions and associated uncertainty have unnerved investors, rattled financial and commodity markets, disrupted supply chains, and alarmed farmers and consumers. The World Bank estimates that a US-China tariff escalation could reduce global exports by up to 3 percent and global income by up to 1.7 percent, with losses across all regions. Even if third-party countries could benefit from increased preference margins in the US and Chinese markets when the two trading partners impose additional tariffs, these gains are offset when investor confidence is shaken.[9] Additionally, global cooperation would be shattered.[10]

JAVIER/FLICKR

Argentina has seen an uptick in soybean imports from the United States, due in part to Chinese tariffs on the US-produced crop.

While the impact of tariffs in both countries cuts across many sectors, agriculture and other food products feature prominently on the lists.[11] These include soybeans, cereal, fish and crustaceans, beef, pork, and other meats, fruits and nuts, dairy, and forage products. The stakes are particularly high for US farmers, as China is a major market for agricultural products, accounting for about 14 percent of US total agricultural exports in 2017. The tariff announcement lowered US soybean prices and prompted Chinese importers to cancel purchases of corn, cut orders for pork, and reduce new purchases of soybeans.[12][13] Chinese farmers have also been impacted, as the third installment of goods subjected to additional tariffs in the US market includes products such as fish and crustaceans, pork and beef intestines, vegetables, fruits and nuts, and cereals, among others.[14]

"The stakes are particularly high for US farmers, as China is a major market for agricultural products, accounting for about 14 percent of US total agricultural exports in 2017."

At the time of printing, all eyes were on Chinese President Xi Jinping and US President Donald J. Trump ahead of the November 2018 G20 meetings in Buenos Aires, Argentina

US-China Tensions: Three Scenarios for Latin America

How does Latin America fit into this trade-confrontation puzzle? With the region a big player in global agricultural markets, there is a view that Brazil and Argentina could benefit from the mounting tit-for-tat tariff standoff through higher commodity prices and new opportunities to supply Chinese and US markets.[15] Recent forecasts, which incorporate the impact of the additional tariffs, estimate lower US soybean sales and increased Brazilian exports to China.[16] Similarly, some firms in the electronics sector are considering shifting production from China to other locations, including Mexico.[17]

However, it is not clear how this will actually play out. Not only is the impact of tariffs on a given industry dependent on the microeconomics of the specific product and its supply chain, but, more importantly, the duration and outcome of this ongoing US-Chinese trade confrontation are not evident. There are at least three possible trade scenarios to consider at this stage, none of them overall favorable to Latin American or Caribbean countries.

KREMLIN/WIKICOMMONS

Scenario 1
Full-Fledged Trade War

A full-fledged trade war between the United States, China, and others would result in the abandonment of international rules and norms constraining the adoption of tariffs and other policy measures—maybe even with a de facto or de jure withdrawal of the United States from the WTO. Latin America would suffer the negative economic effects associated with the deteriorated trade environment, as it would from the systemic consequences of a power-driven trading system. However, conditions could favor specific products, in particular in the agricultural sector, as Chinese state-owned enterprises (SOEs) could shift import-sourcing firms.[18]

Bilateral tariffs would divert trade at the product level, creating short-term opportunities for Latin American exporters and competitors in other countries. If sustained, trade patterns would shift, and Latin America could attract stepped-up investment.[19] In this context of volatility and uncertainty, comprehensive preferential trade agreements (PTAs)[20] between Latin American countries and China could help anchor their trade-and-investment relationship in a rules-based framework.

Scenario 2
A Grand Bargain

A grand bargain between the United States and China could result and lead to some form of managed trade. China could commit, for example, to increase imports of US agricultural products and natural resources, to protect its exporters and investors in the US markets.

Signals in this direction have already appeared, with several high-level delegations from both countries engaging in negotiations aimed at extracting concessions from China.[21] This could represent a dangerous outcome for Latin American countries, as managed trade could have large trade-diverting effects and negative terms-of-trade effects. Diversification, both in terms of exports and markets, may be one way for the region to try to mitigate the costs and minimize the risks associated with this situation. Comprehensive PTAs could prove valuable instruments to protect against these dangers, through clear rules and improved market-access conditions.

"In the context of these challenging trade scenarios, there is a strong motivation for Latin America and China to explore fresh options to upgrade, diversify, and deepen their trade-and-investment relationship, not only to manage peril, but also to leverage new opportunities and strengthen economic cooperation."

Scenario 3
Continued Uncertainty

A third possibility is that trade frictions and policy uncertainty remain, but they do not escalate into a full-blown trade war. Here, the United States and China may find short-term bilateral patches, but the multilateral system is progressively weakened by actions counter to WTO rules and disciplines. Countries, including in Latin America and the Caribbean, may focus more on bilateral relationships—including through new agreements—with the aim of looking for enhanced certainty and new open markets.

In the context of these challenging trade scenarios, there is a strong motivation for Latin America and China to explore fresh options to upgrade, diversify, and deepen their trade-and-investment relationship, not only to manage peril, but also to leverage new opportunities and strengthen economic cooperation.

The Future of Latin America-China Trade

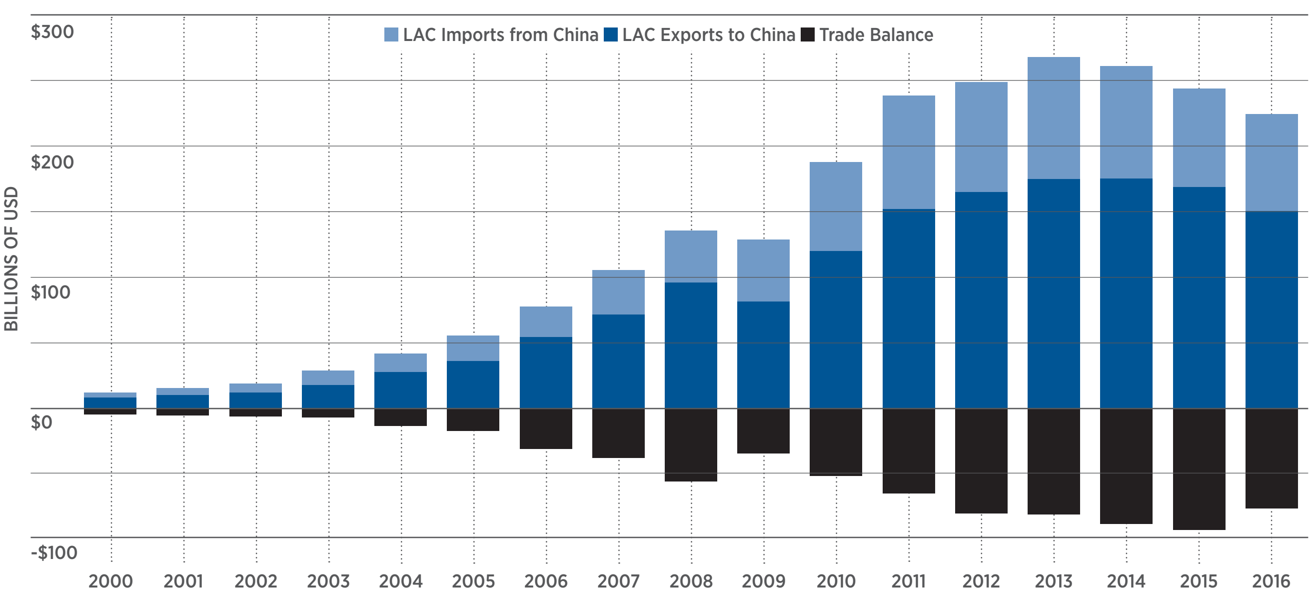
In less than two decades, bilateral economic relations between Latin America and the Caribbean and China have soared. First through trade—and more recently, through capital flows, in the form of both FDI and lending—China has become an increasingly significant partner for the region's growth, with potential for greater impact.

Merchandise trade has anchored this partnership.[22] Rising from a low $12 billion in 2000 to $224 billion in 2016, trade has multiplied eighteen times, even while decreasing in the past three years because of lower commodity prices [see Figure 1].[23,24] China has become the region's second-largest trading partner, accounting for 9.0 percent of Latin America's total exports and 18.4 percent of total imports in 2016. While more modest, Latin America's participation in China's trade accounts for 6.4 percent of total exports and 5.4 percent of total imports.[25]

The trade pattern between Latin America and China can be explained by the relative comparative advantage of each region, as well as demand dynamics and supply constraints. China's rapid economic progress, coupled with an energy- and capital-intensive growth strategy, was highly complementary of Latin America's natural resource endowments and fueled export growth. In turn, manufactured imports from China increased significantly—originally involving low-skilled manufacturing, but evolving to more sophisticated manufacturing. Primary products and resource-based manufacturing, driven by minerals and metals, agricultural products, and fuel, account for more than 90 percent of Latin American exports to China [see Figure 2].[26] Manufacturing, on the other hand, dominates Chinese sales to the region, led by machines and electrical equipment, textiles, chemicals, metals, and others [see Figure 3].[27]

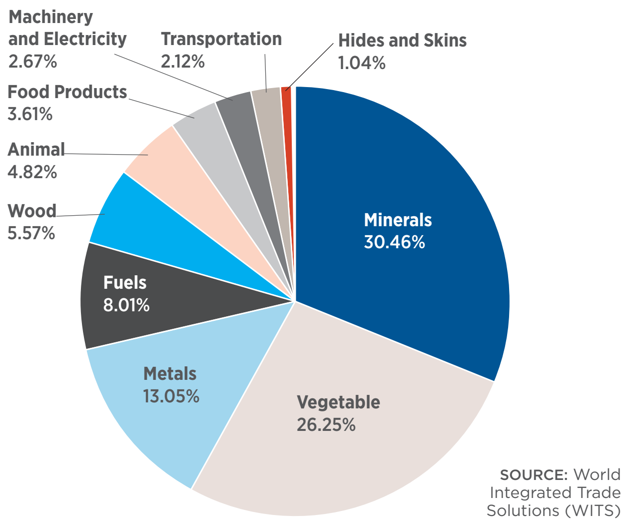
Six of China's main trading partners in Latin America and the Caribbean are in resource-rich South America: Brazil, Argentina, Chile, Peru, Colombia, and Venezuela. These countries' exports to China are concentrated in four products, which represent 75 percent of Latin American exports to the Asian country: copper, soybeans, crude oil, and iron ore [see Figure 4].[28] Mexico, which

FIGURE 1. Latin America and Caribbean (LAC)-China Trade Balance in Goods 2000–2016



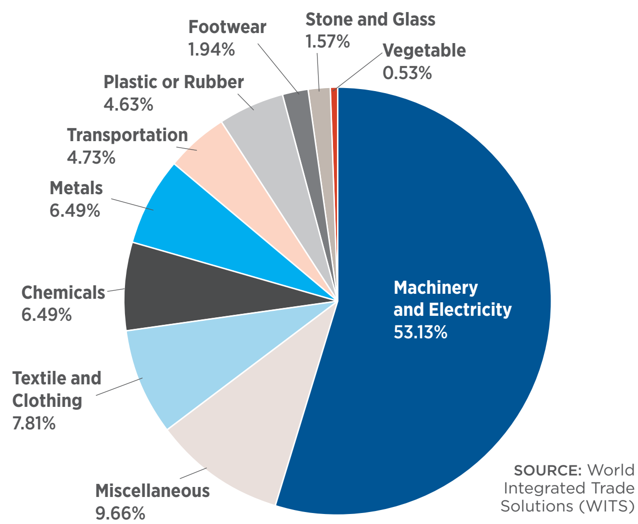
SOURCE: World Integrated Trade Solutions (WITS)

FIGURE 2. LAC Exports to China by Sector in 2016



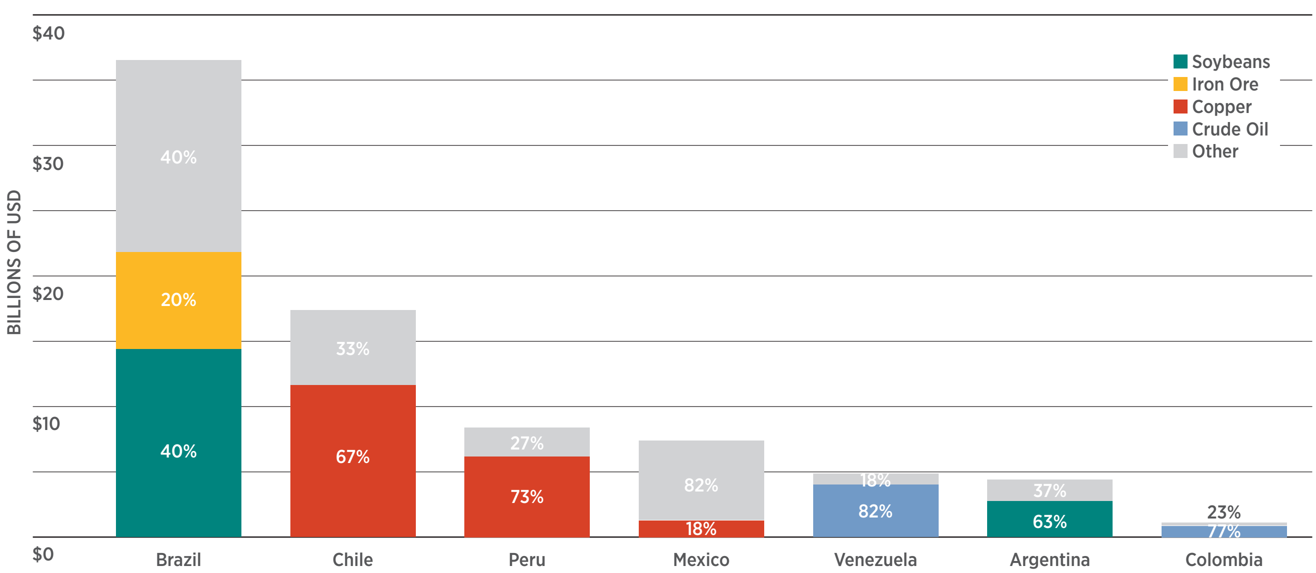
SOURCE: World Integrated Trade Solutions (WITS)

FIGURE 3. LAC Imports from China by Sector in 2016



SOURCE: World Integrated Trade Solutions (WITS)

FIGURE 4. Total LAC Exports to China in 2016, by % of Top Exports from Top Exporting Countries



SOURCE: MIT OEC

"Between 2005 and 2016, China invested close to $90 billion in Latin America and the Caribbean, representing 5 percent of total FDI in the region."

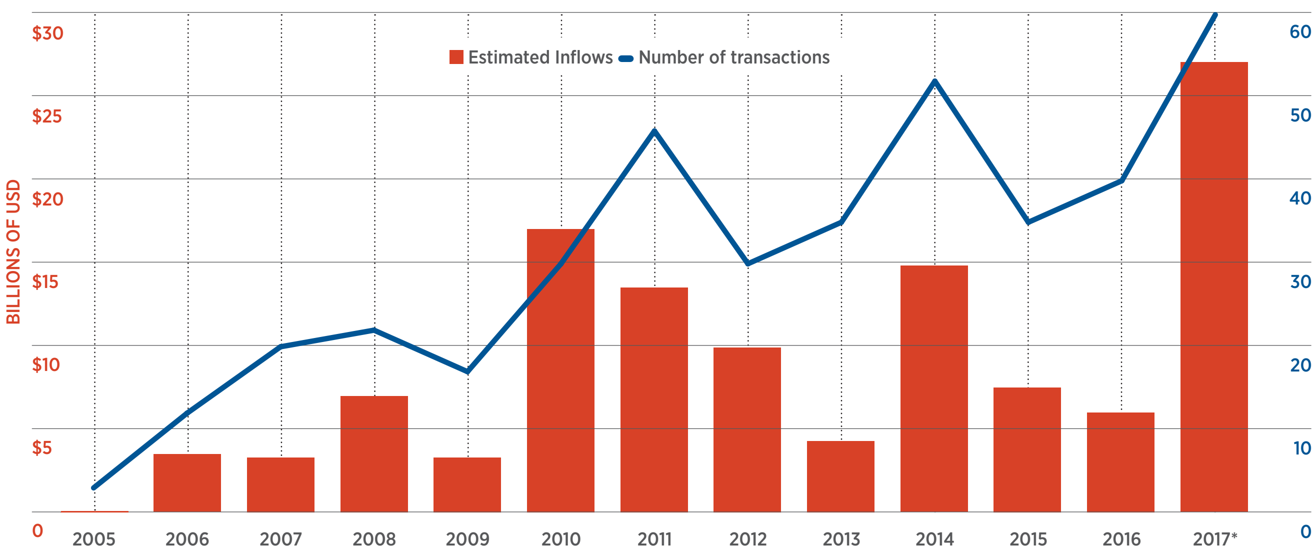
has become China's largest trading partner in Latin America and fourth in the region in terms of exports, exhibits a different and more diversified trade profile, owing to both countries' participation in global value chains (GVCs). In the automotive sector, Chinese inputs of auto parts and components are included in cars manufactured in Mexico for the US market.[29, 30] Broad agreement exists on the need to diversify exports to China, and to add value locally to resource exports.[31]

Likewise, Chinese FDI has surged in Latin America and the Caribbean over the past decade [see Figure 5]. Between 2005 and 2016, China invested close to $90 billion in Latin America and the Caribbean, representing 5 percent of total FDI in the region. Estimates for 2017 suggest that investment may have reached $25 billion, which would amount to about 15 percent of total FDI inflows.[32] Meanwhile, Latin American FDI in China, though dynamic, is less substantial, and is limited to a few companies, mostly from Brazil and Mexico.[33]

Chinese FDI in Latin America has historically been concentrated in specific countries and sectors, although this is changing. Since 2005, Brazil has been, by far, China's preferred destination to invest. Brazil, Peru, and Argentina have cumulatively received 81 percent of Chinese inflows to the region. More recently, however, Mexico has become an important destination for Chinese FDI, in line with changing investment interests.[34]

In terms of sectors, while mining has received more than a quarter of announced Chinese greenfield investment in Latin America and the Caribbean, metals and fossil fuels have lost share to increasing numbers of projects in telecommunications, real estate, food, and renewable energy.[35] Mergers and acquisitions, which represent the largest part of Chinese FDI in Latin America, are highly concentrated in energy, utilities, and mining.[36] In recent years, however, the importance of manufacturing and the services sector has increased.[37]

FIGURE 5. LAC: Estimated FDI Inflows from China, 2005–October 2017



NOTE: The estimate includes the value and number of mergers and acquisitions and projects announced.
*January–October.

SOURCE: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Financial Times, *fDi Markets*, and Bloomberg.

More than 80 percent of Chinese investment in Latin America comes from SOEs investing in energy resources. Examples include State Grid Corporation of China, Three Gorges Corporation, China National Petroleum Corporation, and Sinopec. This energy focus is in line with China's long-term energy needs. Additionally, SOEs have benefited from the government's large-scale stimulus during the financial crisis, and have dominant positions in the Chinese market.[38] One important point to note is the nascent interest of Chinese venture capital in Latin America, with the most prominent recent case being the early-2018 acquisition by Didi Chuxing of a controlling interest in 99, the Sao Paulo-based rideshare start-up, which made 99 the first Brazilian "unicorn"—or start-up company valued at over $1 billion[39]

China has also become a source of development finance through its overseas lending, mostly by the China Development Bank and the Export-Import Bank of China. Since 2005, the two banks have reportedly provided more than $150 billion in loan commitments to Latin American governments and SOEs.[40] In some years, Chinese lending exceeded combined finance to the region from the World Bank, the Inter-American Development Bank (IDB), and the Development Bank of Latin America.[41]

Over 90 percent of financing has been directed to four countries: Venezuela, Brazil, Argentina, and Ecuador.[42] Most of China's development finance is directed to infrastructure projects. Though Latin American and the Caribbean were not originally part of the Belt and Road Initiative (BRI), building a transport network connecting lands and oceans is at the center of Chinese cooperation with the region, with several funds to support infrastructure complementing development loans.[4344]

Chinese economic engagement with Latin America is underpinned by a series of high-level political documents and plans, the most prominent of which are the 2008 and 2016 policy papers.[4546] These documents confirm the region's importance to Chinese leadership, and set guidelines for the economic relationship. "Strategic partnerships" govern economic relations with individual countries, including Brazil, Venezuela, Mexico, Argentina, Peru, Chile, Costa Rica, and Ecuador.[47] These partnerships are mostly political in nature, with ministerial-level meetings and working groups addressing different issues.[48]

"The time is ripe for Latin America to explore fresh options to take its trade-and-investment relationship with China to the next level."

At the regional level, the China-CELAC[49] Forum is the main vehicle for engagement.[50] More specifically, in the trade and investment area, China has a dozen bilateral investment treaties with countries in the region, has free-trade agreements (FTAs) with Chile (2006), Peru (2010), and Costa Rica (2011), and has engaged in FTA talks with Panama since July 2018.[51]

While the strong growth of the Latin America-China economic relationship has brought significant benefits to both parties, it also raises important concerns. These worries range from trade and investment patterns reinforcing South America's concentration in natural resources to trade barriers that limit access of Latin American processed agricultural products and act as a disincentive for greater diversification and sophistication of production in the region. Other concerns include the dislocation impact of Chinese exports on Latin America manufacturing and the state-driven nature of Sino investments in the region.[52, 53, 54]

The time is ripe for Latin America to explore fresh options to take its trade-and-investment relationship with China to the next level. While a challenging global trade landscape demands reimagining partnerships and collaboration arrangements, China's rebalancing toward a new development model, and the shortcomings of the Latin-Sino trading relationship, suggest there is room to explore new options to maximize the benefits of trade and investment. These options require a more proactive role from Latin American and Caribbean nations in reshaping their relationship with China.

Spotlight: Three Areas of Business Opportunity

In 2014, in the context of the establishment of the China-CELAC Forum, President Xi Jinping highlighted the importance of a strengthened economic relationship with Latin America and the Caribbean through two ambitious goals: $500 billion in trade and $250 billion in direct investment over the course of the following decade.[55] Since then, official documents and high-level bilateral meetings have focused on selecting areas for cooperation necessary for these goals to be achieved.

In the second ministerial meeting of the China-CELAC Forum in early 2018, a number of topics were identified for enhanced engagement.[56] Most of these, if acted upon, could contribute to improved connectivity, and increased and more diversified commerce flows between Latin America and China.

Given factor endowments on both sides of the relationship, current patterns are expected to continue anchoring Latin-Sino trade and investment in the future.[57] Policy actions and investments, however, could spearhead other areas of economic activity that would open new prospects for Latin America to add value, diversify and modernize trade, foster inclusiveness, and spur productivity. The benefits of a richer and more balanced relationship would accrue for China as well, with greater diversification of products, markets, and firms, new opportunities for services trade, and increased e-commerce integration. Stronger, more balanced participation of Latin America in world trade would also help counter protectionist tendencies as the region would have a greater stake in the stability of the global trading system.

Three areas of business opportunity stand out as fundamental for a broader trade-and-investment partnership, all of which leverage demand dynamics and existing capabilities on either side of the Pacific. These opportunities include: facilitating commerce in processed agricultural and food products; expanding trade in services, particularly tourism; and leveraging Chinese advanced technologies, digital platforms, and capital to foster e-commerce and support productivity and innovation in Latin America.[58]

Opportunity 1
Improving Market Access for Processed Agricultural and Food Products

Extraordinary economic growth—coupled with rapid industrialization, significant urbanization, expansion of the middle class, changing demographics, and modern lifestyles—is driving China's increased demand for food, qualitative changes in diets, and new consumer preferences. Demand for proteins and processed foods is soaring, as is interest in fruits, vegetables, and wine. There is also rising attention to other food attributes, such as variety, convenience, quality, and, above all, food safety.[59] Online food shopping is increasingly changing the food landscape, with e-commerce giants JD.com and Alibaba backing major shopping sites for fresh produce.[60]

To address this soaring demand, China is relying on large-scale imports and strengthening food self-sufficiency strategies, particularly in grains. Major non-regional food suppliers to the Chinese market include Australia, Canada, New Zealand, and the United States. Latin American and Caribbean countries contribute 24 percent of total food imports, albeit highly concentrated in primary products to be later processed in China.[61] The food-security strategy is complemented by investments abroad in land and, increasingly, across the production chain.[62]

Chile's Success Exporting Fresh Fruits to China

With a basket of products that includes cherries, blueberries, plums, table grapes, apples, avocados, and kiwifruit, Chile was the second-largest exporter of fresh fruit to China in 2017. With exports amounting to $1 billion, Chile supplied 18 percent of the market, second only to Thailand and ahead of Vietnam, the Philippines, the United States, New Zealand, and Australia. Nectarines and pears are expected to come to market soon.

Several factors undergird Chile's success in conquering China's fresh-fruit market:

Strategic focus: China is a priority market for ProChile—Chile's export-promotion agency—and of the government as a whole, particularly when it comes to diversifying copper exports. With aim of building a relationship, ProChile works on the basis of a long-term strategy centered on introducing a new product every year, learning from past experiences and expanding contacts.

Preferred market-access conditions: the Chile-China FTA—the first one in Latin America—governs trade relations, while Chile's strong sanitary and phytosanitary agencies play a key role in leveraging the country's privileged sanitary status to open markets. Just recently, for example, the China Entry & Exit Biosecurity Society and the Association of Chilean Fruit AG signed an agreement to allow Chilean firms to implement a QR code for verification and monitoring of exports to the Chinese market, increasing efficiency in port-of-entry inspections.

Strong promotion: Chile has four trade offices in China—in Shanghai, Guangzhou, Beijing, and Hong Kong—as well as an agricultural counselor based in Beijing. A number of promotional and marketing activities are in place to increase the presence in the market, including high-level political support from special envoys. The "Enjoy your Red Moment" marketing campaign, for example, aims at expanding year-round consumption of cherries.

Aligned public-private partnership: ProChile works closely with associations of fruit exporters to improve quality, strengthen market positioning, and finance intelligence to identify trends and opportunities.

Going forward, Chile is exploring bringing dried fruits to the Chinese market, as well as keeping pace with technological advances, including by partnering with Chinese firms and training of domestic small and medium-sized firms to tap into expanding opportunities through e-commerce.

SOURCE: ELABORATED BY THE AUTHOR WITH INPUTS FROM JOSÉ PABLO RODRÍGUEZ, DIRECTOR OF COSTA RICA'S PROCOMER IN ASIA; DAMIEN KELLY, "THE RECIPE FOR CHILE'S FRUIT EXPORTING SUCCESS," PRODUCE REPORT, FEBRUARY 21, 2017, HTTPS://WWW.PRODUCEREPORT.COM/ARTICLE/RECIPE-CHILES-FRUIT-EXPORTING-SUCCESS; DAN SIEKMAN, "2017 CHINA FRESH FRUIT IMPORT AND EXPORT STATISTICS RELEASED," PRODUCE REPORT, MARCH 8, 2018, HTTPS://WWW.PRODUCEREPORT.COM/ARTICLE/2017-CHINA-FRESH-FRUIT-IMPORT-EXPORT-STATISTICS-RELEASED; AND CECILIA CASANOVA, "CHILE AND CHINA SIGN AN AGREEMENT TO IMPLEMENT A PILOT PROGRAM THAT VERIFIES THE EXPORT OF CHILEAN FRUIT TO CHINA," FRUITS FROM CHILE, DECEMBER 29, 2017, HTTPS://FRUITSFROMCHILE.COM/ES/CHILE-AND-CHINA-SIGN-AN-AGREEMENT-TO-IMPLEMENT-A-PILOT-PROGRAM-THAT-VERIFIES-THE-EXPORT-OF-CHILEAN-FRUIT-TO-CHINA/.

"Improved access for Latin American and Caribbean agriculture exports to the Chinese market requires a combination of actions on the part of countries in the region, as well as actions by China."

The Belt and Road Initiative (BRI) is now also a major driver of the "going global" Chinese agriculture investment strategy.[63]

Leveraging the changing agriculture and food landscape in China to export more value-added and processed products is an opportunity for many Latin American and Caribbean countries, given their global competitiveness in many traditional and nontraditional agricultural products.[64] Some producers are already breaking ground. Chile has become the main source of cherry imports into China, with 70 percent of the market in 2017, representing 80 percent of Chilean cherry exports.[65, 66] China has also become the number-one destination for Chilean wine. Only France and Australia export more wine to China.[67]

Not all countries have been able to replicate Chile's success. Well-known supply-side challenges in Latin America limit the region's ability to take advantage of opportunities, including high trade costs and low levels of investment in education and technology. But, Latin American agricultural exporters also face significant barriers to penetrating the Chinese market.

A report for the Inter-American Development Bank found that China's tariffs are high, and particularly stacked against Latin American and Caribbean exports, especially with respect to processed agricultural goods.[68] Latin American and Caribbean exporters need to contend with increasing negative trade preferences driven by China's growing network of trade agreements with some of the region's competitors, such as New Zealand and Australia.[69] The report found that agricultural exports would grow by 9.6 percent if China treated agricultural imports from the region the same way that it treats agricultural imports from Organisation for Economic Co-operation and Development (OECD) countries.[70]

In addition to tariffs, additional protection comes from the way value-added taxes (VAT) are applied to local and imported goods, with farmers enjoying a number of VAT exemptions, including the 11-percent tax on the sale of their products to wholesalers.[71] Nontariff barriers also exist in the form of state trading, tariff-rate quotas, and price controls. Technical barriers—most specifically, sanitary and phytosanitary measures with complex rules, and long and uncertain wait times to get products certified—act as deterrents to imports from the region.[72] National tax and trade policies in some Latin American and Caribbean countries also broadly discourage adding value to agricultural products.

Improved access for Latin American and Caribbean agriculture exports to the Chinese market requires a combination of actions on the part of countries in the region, as well as actions by China.

- First, Latin American and Caribbean countries must give higher priority to documenting barriers, measuring their impact, and negotiating their removal, including through FTAs such as those currently in effect with Chile, Peru, and Costa Rica, and other accords to facilitate imports and exports.[73] At the same time, greater market openness in China for these goods—including through expedited sanitary and phytosanitary authorizations—would not only support trade diversification in Latin America, but would benefit Chinese consumers with very little risk, if any, of significant dislocation of producers or workers.
- Second, greater investments are needed by Latin American and Caribbean countries in trade intelligence, to regularly monitor the evolution of trade barriers to inform, with greater transparency, private-sector actions and investments, as well as agendas for trade negotiations.[74]
- Third, Latin American and Caribbean countries require high-level, public-private, proactive, and sustained export-promotion plans to introduce, market, and position their goods in the Chinese market. Latin American and Caribbean countries could learn from successful experiences, including that of Chile, and explore subregional or regional initiatives to tap into the Chinese market.

Opportunity 2
Expanding Trade in Services with a Focus on Tourism

Driven by technological change, reduced transportation costs, and increased tradability, trade in services has been growing relatively quickly. Today, trade in services accounts for around 20 percent of global exports.[75] Services play a key role in international production networks and supply chains. Very importantly, services exports offer a new source of growth for developing countries. For China, as it moves away from a manufacturing-driven economy to a more consumption- and services-driven growth model, trade in services is becoming more important. Chinese exports of commercial services amounted to $207 billion in 2017, whereas imports reached $450 billion. While services still amount to a relatively small share of both China's total exports (9 percent) and imports (14 percent), they have seen strong growth over the past fifteen years.[76]

Significant ongoing and future reforms should help China realize the potential of services for growth and jobs. Chinese service exports, such as those in telecommunications, finance, construction, and engineering, are already contributing to improved growth and competitiveness in Latin American and Caribbean countries. Likewise, China would benefit from Latin American service-export opportunities ranging from mining-related and back-office services to offshore services that support global networks of Chinese multinationals.[77] Tourism is recognized for its potential to spur job creation and regional economic development and stands out as a business opportunity for Latin America and the Caribbean to grow and diversify their trade with China.[78] Recently, tourism has performed well in China, and the industry has a solid base in several Latin American and Caribbean countries.[79]

China's increased outbound travel and tourism spending is reshaping the global tourism landscape. With rising incomes, loosened travel policies, and diversifying consumer demand, China's outbound tourism has increased substantially, from thirty-one million tourists in 2005 to 129 million in 2017.[80] At $261 million in 2016, overseas travel spending by Chinese tourists ranks first worldwide, and is on the rise.[81] For Chinese tourists traveling overseas, Asia, Europe, North America, Australia, and New Zealand are preferred destinations.[82] According to the World Tourism Organization, however, the Chinese outbound tourism market is transforming rapidly, and becoming more sophisticated, with increasingly diverse and individualized demands—in particular, from millennials and independent travelers.[83]

Only about 1 percent of China's outbound tourists visited Latin America or the Caribbean in 2017.[84] However, several countries are beginning to go after the Chinese traveler. For example, Mexico—currently China's leading tourism destination market in the region—has expanded promotional efforts and, more importantly, has seen the launch of direct flights to Beijing, Shanghai, and Guangzhou including the first-and-only nonstop flight between China and Latin America in 2017–2018.[85, 86] Rising interest has also been reported by Argentina, Brazil, Chile, Colombia, the Dominican Republic, Panama, and Peru, while the Caribbean is gearing up for increased Chinese tourism.[87]

Focused policies and investments could help realize the promise of this sector. Fully leveraging the potential of China's outbound market means overcoming challenges, from brand recognition and visa policies to more difficult issues like distance, connectivity, and language.[88] Understanding and catering to consumption trends is also relevant. Particularly indispensable to the travel experience of the Chinese tourist are mobile platforms, mobile applications, and cashless mobile payments.[89]

Addressing such obstacles has become a priority cooperation area between the Chinese and Latin American governments, with an emphasis on raising market awareness, increasing travel facilitation, and improving air connectivity and consumer protection.[90] For Latin America, capturing market share in Chinese tourism requires policy reforms in areas like visa procedures and air transportation, more intensive promotional efforts, and new public-private collaborations.

Opportunity 3
Leveraging Chinese Expertise to Foster E-commerce

E-commerce is rapidly growing, and transforming how the world trades. The United Nations Conference on Trade and Development (UNCTAD) estimates global e-commerce sales amounted to $25 trillion in 2015, up from $16 trillion in 2013.[91] Business-to-consumer (B2C) transactions—that is, when manufacturers or retailers sell their products to consumers over the Internet—reached about $2.3 trillion worldwide in 2015, up 20 percent from the previous year.[92, 93]

New technologies such as blockchain, machine learning, artificial intelligence, the Internet of things, and 5G wireless systems are continuously transforming the e-commerce landscape and expanding its potential.[94] Cross-border e-commerce—that is, selling goods and services to customers via e-commerce in a country other than that of origin—reached some $300 billion in 2015 and is expected to expand at an accelerated rate to reach about $1 trillion by 2020.[95, 96] Everything from fashion to electronics, beauty and cosmetics, pet care, food and beverage, and sporting goods is being digitally traded across borders, with practically every product category having the potential for a premium segment, according to DHL.[97]

China is a global powerhouse in e-commerce. With 521 million online shoppers and an e-commerce market worth $3.82 trillion, it holds close to 40 percent of the global e-commerce retail market.[98] Cross-border online purchasing of imports has been growing rapidly, with an estimated 25 percent of Chinese online buyers making a cross-border purchase in 2015.[99] Online cross-border purchases are projected to represent 7 percent of total Chinese imports in 2018, with the market value of Chinese cross-border e-commerce to reach $157 billion by 2020.[100, 101]

To serve consumers' interest in buying imported goods, Alibaba, the largest digital marketplace in China, is partnering with merchants across the world to sell on its dedicated cross-border e-commerce platform, Tmall Global.[102] Today, eighteen thousand brands from seventy-four countries are on offer in Tmall Global. Tmall's plans for six new procurement centers—in Asia, North America, Europe, and Oceania—will facilitate cross-border e-commerce even further.[103]

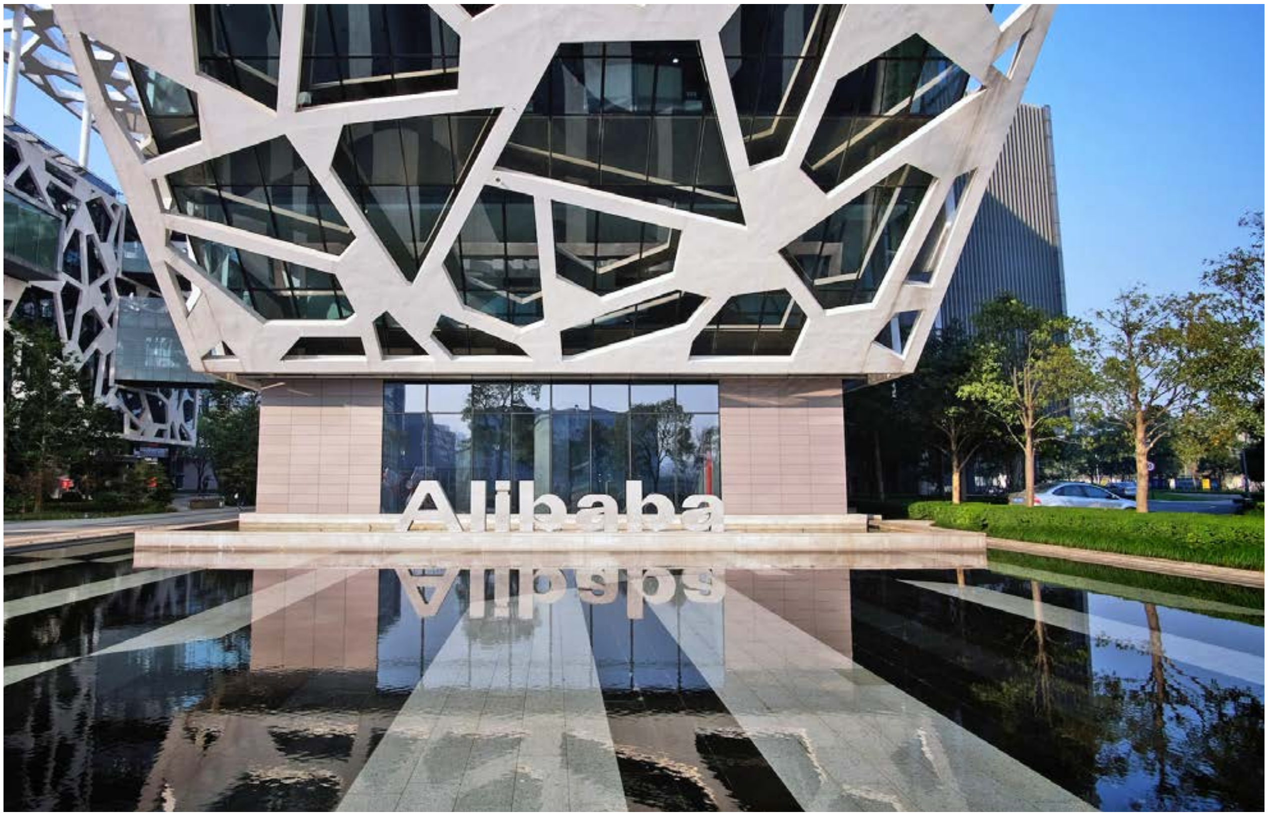
In Latin America and the Caribbean, e-commerce is still relatively limited, with a market worth $57 billion, but cross-border e-commerce is growing rapidly.[104] For now, it is mostly consumer-driven. Latin American and Caribbean sellers are not taking much advantage of cross-border e-commerce markets, as indicated by the low rate of growth in international parcel dispatches.[105] But, things are changing, and Latin American and Caribbean firms are beginning to leverage the potential of cross-border online selling.

Recent surveys of more than 1,400 Latin American and Caribbean companies show three key trends: online sellers are more internationalized relative to firms that neither buy nor sell goods or services online; online sellers are more diversified in their export markets relative to offline sellers, especially firms that sell on global e-commerce platforms; and companies that sell online appear more likely to sell to markets outside the region. However, as many as 36 percent of the surveyed firms reported no online sales, and the firms that have online sales tend to derive a limited share of their revenue from exports.[106]

One key feature of e-commerce is that it fosters inclusive trade by opening new possibilities for companies, including small and medium-sized firms, by reducing the cost of entry, facilitating access to information, building trust, and supporting scalability. The challenges, however, are not to be underestimated. In addition to the market access, financial or logistics constraints faced by traditional traders, cross-border e-commerce is hindered by information- and communication-technology infrastructure, digital literacy, consumer and legal protections, and cybersecurity.[107]

Latin American and Caribbean firms perceive cross-border e-commerce as challenging due to difficulties associated with accessing trade finance, clearing customs for e-commerce imports and exports, excessive costs of online payments, and possible lack of interoperability of digital regulations with trading-partner markets.[108] Removal of these barriers would result in substantial payoffs in exports and export diversification, in particular for smaller firms.[109]

Latin America and the Caribbean would benefit from leveraging China's experience, providers, and marketplace to tap into the potential of cross-border e-commerce. Tmall Global and other specialized cross-border e-commerce platforms like JD Worldwide, Suning Global, and Amazon China Global Store host foreign sellers and manage currency issues.[110] Some of these firms have begun to explore opportunities in Latin America and the Caribbean. For example, Alibaba has signed three memoranda of understanding with governments in the region—partnering with Brazil's national postal service, supporting the sale of Argentine food and wine in China, and sharing



BRIDGET COILA/FLICKR

Chinese tech giant Alibaba, competes with Amazon and Mercado Libre for Latin American consumers. The region represents two percent of the world retail market.

best practices in logistics and payments with Mexican firms.[111] Alibaba also entered into a nascent partnership with Ecuador to feature Ecuadorean goods in Tmall and in Tabao, a consumer-to-consumer platform.[112]

Several recent initiatives are also putting the focus on promoting exports to China. For example, China hosted the first China International Import Expo in late 2018, under the umbrella of the BRI.[113] A second example is Alibaba's new platform to connect one million US businesses with Chinese consumers.[114] A third example is the inauguration of the Digital Free Trade Zone (DFTZ) in Malaysia, a joint project with Alibaba to establish a regional logistics hub aimed at facilitating e-commerce for small and medium-sized firms.[115] With a focus on Latin America, another example is the new Hengqin China-Latin America Economic and Trade Cooperation Park, set up in the city of Zhuhai and expected to facilitate the provision of legal services, policy research, and support for trade facilitation and e-commerce.[116] Given the state of e-commerce in Latin America and the Caribbean, the potential to explore and scale up new promotional initiatives is significant.

Countries should focus on three types of actions to access the transformative potential of cross-border e-commerce with China—including for processed agricultural goods and food products, as well as for tourism. First, policy initiatives are needed to develop a solid framework to underpin e-commerce, and to reduce trade frictions caused by fragmented regulations and policy spillovers, both multilaterally, in the WTO context, and in comprehensive PTAs. Second, sustained domestic efforts are needed to facilitate e-commerce, including through an improved regulatory environment for e-payments and continued improvements on trade facilitation and logistics. Innovative programs could be piloted, such as expedited customs-clearance programs or a bilateral logistics hub along the lines of the DFTZ. Third, a concerted public-private strategy is needed to tap into China's leading role in e-commerce, and help Latin American firms to sell in China. Such a strategy would include investing in export promotion and working with leading e-commerce firms in China to prepare, train, and enable Latin American and Caribbean producers to serve the Chinese market at scale.

Mobilizing to Realize Opportunities and Mitigate Risks in a Challenging Global Trade Context

There is a significant opportunity, and need, for Latin America and China to move trade-and-investment partnerships to the next level. From the Latin American perspective, a revitalized connection with China would increase the added value of exports, diversify and modernize trade, foster inclusiveness, and spur productivity and innovation. These areas of focus would be beneficial to China as well: allowing it to access more diverse products, markets, and firms, increase integration via e-commerce, open new investment possibilities, and gain a more balanced partnership.

To realize the possibilities, and mitigate risks, policymakers would need to develop a shared vision, strengthen the institutional framework to govern bilateral trade and investment flows, and address supply-side constraints to increased trade and investment. Deliberate initiatives and strategic actions are required to put in place the policy levers that will help unlock identified areas of business opportunity.

A Renewed Vision and Institutional Framework, with Aligned Productivity-Enhancing Domestic Policies

The current Latin America-China trade-and-investment relationship is aligned with China's development strategy, as well as with its priorities for the region. While benefits have also accrued to Latin American and Caribbean countries, a new shared vision would require Latin America to move toward diversification, value addition, and productivity, as well as bringing more firms to benefit. Moving forward, a McKinsey report notes that countries have the chance to shift from an abundance mindset to a productivity mindset—with increased focus on greater and more secure access to the Chinese market, as well as leveraging China's leadership in the digital economy to drive growth.[117]

China also has the opportunity to evolve its vision for the region toward a more balanced partnership, in which Chinese consumers, firms, and investors would benefit from new products, new markets, and new alliances in a region with more than 630 million people moving into middle-class status. Given the importance of the Belt and Road Initiative in shaping China's trade-and-investment policies, Latin America's participation in the BRI would benefit from close alignment with this new vision.

The expansion and deepening of China's network of FTAs is key to strengthening the institutional framework to grow and diversify China-Latin America trade and investment flows, as preferential agreements enhance market efficiency, contribute to a better policy environment, and can complement multilateral institutions. Moreover, they are critical for the region to counter the risks associated with the three global trade-alternative scenarios outlined: a full-fledged trade war, a managed trade setting, or the progressive weakening of the multilateral trading system.

A recent development, however, may complicate the pursuit of FTAs between China and Latin American countries. In the recently concluded United States-Mexico-Canada Agreement (USMCA), article 32-10 calls on parties to notify each other if they enter into negotiations of a trade agreement with a non-market economy, opening the possibility to terminate the USMCA and turn it into a bilateral deal.[118] Though, in the Latin American context, this provision would effectively only apply to Mexico upon the USMCA's entry into force, it may act as a deterrent for other countries

"To realize the possibilities, and mitigate risks, policymakers would need to develop a shared vision, strengthen the institutional framework to govern bilateral trade and investment flows, and address supply-side constraints to increased trade and investment."

engaging in trade negotiations with China.

At the moment, China has FTAs in place with Chile, Peru, and Costa Rica, and negotiations with Panama have advanced. China has expressed an interest in exploring additional potential agreements. Bearing in mind the potential deterrent effect of the USMCA on new negotiations, one possibility would be an FTA with the Pacific Alliance countries, crafting an accord that would expand and build upon the Chile and Peru FTAs. Most recently, China has highlighted Uruguay and other Mercosur members as potential FTA partners.[119]

Negotiations of an FTA with China would most likely present political economy challenges, particularly for those countries with relatively closed economies, and which have not entered into a PTA with a major global trading partner, such as Brazil and Argentina. Given that evidence shows deep PTAs boost trade among members, and therefore have positive growth effects, it merits the start of an organized exploratory process to further understand the scope, opportunities, and risks associated with a potential preferential agreement.[120]

In the current, challenging global context, FTAs—and related documents, such as sanitary permits—could provide increased market access, bring greater certainty to trade actors, and protect against potential risks associated with managed trade or a weakened multilateral trading system. Moreover, FTAs could also be used to spearhead complementary initiatives to foster trade diversification, including through digital trade, and outward FDI in both directions.

To realize the benefits of a renewed trade-and-investment partnership with China, Latin American and Caribbean countries need to address the pressing challenge of low productivity growth. Constraints are country-specific, as are priority measures to address them. That said, greater policy focus and critical actions are required to:

- close the infrastructure gap and improve trade logistics, so as to reduce trade costs;
- strengthen and expand human capital by enhancing quality education and skills training aligned to market demands, and by bringing more women into the labor market;
- foster innovation and technology-adoption capabilities;
- improve the business environment, including through greater transparency, better governance, and increased competition in key services industries; expand access to capital; and,
- strengthen macroeconomic fundamentals.

Productive development policies are also required to broaden and diversify the export base, including by leveraging new technologies.[121] A strengthened partnership with China could also help in implementing some of these measures through increased trade and investment.

Policy Levers and Actions to Unlock Business Opportunities

While the potential for strengthened engagement builds on demand dynamics and existing capabilities in Latin American and Caribbean countries and/or China, they will not come about automatically. A specific set of policy actions and strategic initiatives—embedded in the context of a new vision of the relationship, strengthened institutional framework, and aligned productivity-increasing domestic policies—is required to unlock and realize their potential.

With the caveat that differences in Latin American and Caribbean countries will impact their ability to tap into these new possibilities, and that challenges and limitations also vary per country, the following key policy recommendations may help deepen the trade-and-investment partnership between Latin American countries and China in a way that is beneficial to the region. Though current Latin America-China trade-and-investment patterns will continue to weigh on the relationship, the right policies and initiatives may help improve market access for processed agricultural and food products, expand trade in services with a focus on tourism, and leverage advanced technologies, digital platforms, and capital to foster e-commerce and support the start-up scene.

Recommendations

RECOMMENDATIONS TO UNLOCK BUSINESS OPPORTUNITIES IN THE LATIN AMERICA-CHINA PARTNERSHIP

	FOR LATIN AMERICA AND THE CARIBBEAN	FOR CHINA
To improve market access for processed agricultural and food products	Document trade barriers, measure their impact, and negotiate their removal, including through potential FTAs. Invest in market intelligence and monitoring capabilities of trade barriers to inform the private sector and guide a negotiation agenda. Strengthen export-promotion plans to introduce, market, and position goods in the marketplace, including by leveraging e-commerce platforms. Learn from and disseminate positive regional experiences, e.g., that of Chilean exports of fresh fruits. Explore potential for collaboration across countries and subregions in LAC to develop a trade-negotiations agenda to facilitate exports of processed agricultural goods.	Commit to greater market openness and certainty—even within the current import regime— including through expedited and transparent mechanisms to issue sanitary and phytosanitary permits. Reduce tariff and nontariff barriers to priority products, in the context of negotiations. Build on China's e-commerce capabilities and positive regional experiences to support renewed export-promotion initiatives to sell in the Chinese market.
To expand trade in services with a focus on tourism	Revise the policy framework to facilitate Chinese travel, e.g., by expediting visa issuance. Improve air connectivity with a view to increasing direct, and especially nonstop, flights. Invest in market intelligence to further understand consumption trends, including the role of technology in enabling the experience of Chinese tourists. Strengthen tourism promotional efforts to raise market awareness and develop brand recognition, including at the cross-country and subregional level. Invest in identifying new areas of opportunity for services trade, e.g., business-process outsourcing to support expansion of Chinese firms in the region, to inform new strategies.	Improve air connectivity, leveraging the potential of Chinese airlines. Collaborate with Latin America countries to raise market awareness and support Chinese outbound tourism, including through sharing best practices from other regions.
To tap into advanced technologies, digital platforms and venture capital to foster e-commerce and support start-ups	Contribute to the development of a framework to underpin e-commerce and reduce trade frictions in the WTO context. At the bilateral level, prioritize the design of rules to govern and facilitate digital trade. Maximize domestic initiatives to facilitate e-commerce, including through an improved regulatory framework for e-payments and continued improvements on trade facilitation and logistics. Pilot programs, such as expedited customs-clearance programs or bilateral logistics hubs, could be explored. Develop specialized China-bound e-commerce export-promotion strategies, including joint plans with Chinese firms to bring Latin American firms to market. Invest in better understanding potential drivers of Chinese venture capital investment in Latin America to inform country and regional strategies to accelerate equity funding and maximize impact.	Contribute to the development of a framework to underpin e-commerce and reduce trade frictions in the WTO context. At the bilateral level, prioritize the design of rules to govern and fa cilitate e-commerce. Share with Latin America successful experiences in fostering e-commerce, e.g., through new e-payment technologies, logistics hubs, and others. Develop a concerted effort with Latin American firms to bring Latin American firms to market.

Closing Thoughts:
A Strengthened Multilateral Trading System to Underpin Bilateral Partnerships

Current trade disputes have put a strain on the multilateral trading system. The main challenge is how to de-escalate and manage tensions in a way that avoids fragmentation, helps to improve the functioning and effectiveness of the global trading system, and leads to improved conditions to expand global trade flows and investment-policy cooperation.[122] Reforms to strengthen the WTO as a forum for trade cooperation and conflict resolution are merited. [123] While the United States and China—as the world's two largest economies—bear a special responsibility for calming tensions, Latin American countries also have a role to play to preserve and improve the multilateral trading system.

To tackle the main issues underlying current trade frictions, a rebalancing of certain rules is inevitable. These issues include: clarifying what level of state intervention is compatible with a level playing field for trade; what new rules are needed to govern issues associated with the digital economy and technological innovation; and, what role different countries have in contributing to the renewed global trading system.

Unfortunately, continued trade frictions are likely to continue in the short term, and alternative scenarios look rather gloomy at this stage. Even if bilateral "patches" are found, broader talks will take time. The opportunity and need thus arises to look for renewed possibilities; in this case, for Latin American and Caribbean countries to upgrade and deepen their partnerships with China. While taking action at the bilateral level is important, it can only complement, and not replace, the multilateral trading system. A number of critical issues—most notably in agricultural trade or subsidy reforms—can only be meaningfully tackled at the global level; likewise, the multilateral system remains the best option for protecting against the perils of power-based conflict resolution.

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A glance at the Forbidden City in Beijing, China. Trade in services, including tourism, is an increasingly important component of the China-Latin America relationship

ACKNOWLEDGMENTS

I would like to thank the Atlantic Council for making this publication possible, in particular Jason Marczak and María Fernanda Pérez Argüello for excellent suggestions and editorial comments, and Sean Miner for his initial contact. Special thanks also goes to Lourdes Casanova, Francisco Chacón, Hubert Escaith, Barbara Kotschwar, Mauricio Mesquita-Moreira, José Carlos Quirce, Jose Guilherme Reis, José Pablo Rodríguez, Michele Ruta, André Soares, Kati Suominen, and Mikael Wigell for their extremely valuable comments and ideas. I would also like to thank Domingo Sadurní for his excellent research support, and Jeff Fleischer, for editorial assistance.

A NOTE FROM THE ATLANTIC COUNCIL

We would like to thank Anabel Gonzalez for working with us on this incredibly timely report. Her commitment and numerous hours spent on research and writing are evident at the turn of every page.

The Adrienne Arsht Latin America Center wraps up 2018 with a truly relevant and forward-looking report on China-Latin America trade amid increasing uncertainty in the global economy. The implications of the US-China trade dispute on the multilateral trading system—and, by extension, Latin America— have the potential to affect decades of economic growth and prosperity.

We would also like to thank HSBC for supporting our China-Latin America work, as we try to shine a light on China's activities in the region and the geopolitical implications for the United States. We strive to look beyond the current trade dispute between the world's largest economies and engage in future-oriented strategies, recognizing Latin America as a key, innovative player in the global stage. As China increases its role as a major partner for many countries in the region, it is more important than ever to understand these new developments.

We hope this report will help answer questions on the current state of China-Latin America trade and investment, but we are also optimistic that its recommendations will help the China-Latin America commercial relationship become beneficial for the region as we move forward.

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