Chinese FDI in Latin America: New Trends with Global Implications

BY ROLANDO AVENDANO, ANGEL MELGUIZO, AND SEAN MINER

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ISBN:
June 2017
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# Table of Contents

- **INTRODUCTION** 01
- **PROFILE OF CHINA’S GLOBAL FDI** 04
- **A SHIFT IN REGIONAL FOCUS** 06
- **CHINESE FDI IN DEPTH: BRAZIL AND KEY INDUSTRIES** 11
- **THE UNITED STATES, LATIN AMERICA, AND CHINA: REBALANCING RELATIONSHIPS** 16
- **CONCLUSIONS** 17
- **ABOUT THE DATA AND METHODOLOGY** 19
- **ENDNOTES** 20
China is an emerging power on the world stage, rapidly expanding its influence beyond Asia. Chinese firms are now zeroing in on Latin America, rebalancing the role of traditional partners in the region. China’s engagement abroad is not new, but the resources directed to this “going out strategy” have risen dramatically, increasing China’s global leadership role. This adds up to a major economic and political rebalancing from the West to the East, a phenomenon also known as “shifting wealth.”

Chinese companies are moving rapidly into Latin America, and have invested over $110 billion since 2003, most of it in the last five years (Figure 1). Once the most favored nation for inflows of global foreign direct investment (FDI), China is now looking to acquire assets abroad. Traditionally, Chinese firms focused their investments in Latin America in the extractive sector. Now, more than half of all investments target the service sector, especially transport, finance, electricity, information and communications technology (ICT), and alternative energy, increasing China’s relevance in the region.

The increasing influence of China is also a result of reduced engagement by the United States, which is focused on other global engagements. Its recent exit from the Trans-Pacific Partnership (TPP) could suggest that the trend will continue.

With the will to play an active part in the global economic order, China is providing economic and financial assistance to the region—also a way to open doors for Chinese firms to expand. By delivering loans, increasing FDI, and building stronger trade ties, China is ensuring its companies maintain market access for its export sector and open new markets for sectors with excess capacity, such as infrastructure.

Maintaining strong economic growth is also important for China’s social and political stability. Part of keeping the economy healthy is securing reasonably priced energy resources and other commodities. State-owned oil firms like China National Petroleum Corp. (CNPC) and Sinopec, China’s first and second largest oil firms, have quickly expanded their activities abroad. These firms are securing the long-term stability of oil exports to China, while also playing a growing role in the financial future of several governments in Latin America.

**Soft Power Effects of FDI**

In theory, the economic benefits of direct investment for the recipient country are clear: more jobs, higher wages, knowledge transfer, increased productivity, and increased trade. But there are strategic benefits for the investing country as well, and they are also significant. The soft power effects of FDI for the investing country can be substantial, and include improving its image abroad, persuading others to side with it in international organizations, and shap-
Chinese firms are increasingly investing in renewable sources of energy production in Latin America, including hydropower, solar, and nuclear.
are slightly more positive for 2017, with an expected growth above 1 percent. With the prospects for Latin American growth turning around, FDI can play an important role in continuing the upward trajectory. Much of the region’s potential hinges on countries emerging from recession (Brazil, Venezuela), and their ability to pull themselves out of economic as well as institutional turmoil.

Latin America is in a prime position to continue receiving a large share of Chinese FDI, due to several external factors. The uncertainty of the relationship between China and the United States could, in theory, force a slowdown of major Chinese deals in the United States with some investments potentially diverted to the region. The United States is also considering reviews of investment from Chinese state-owned enterprises on national security grounds. A similar situation is occurring in Europe, where some in Germany argue that they should have more power to block transactions that may harm their national interests. Rising barriers to Chinese investment elsewhere may be to Latin America’s advantage—although other factors play a role in the surge of Chinese FDI flows.

Over the past ten years, governments in Latin America from across the political spectrum have lowered barriers to foreign investment. According to the Organisation for Economic Co-operation and Development’s (OECD) FDI Restrictiveness Index, several countries rank at or near the level of the United States, including Argentina, Chile, Colombia, and Brazil (Figure 2).

Chinese companies are also racing to get some of their cash out the door. China’s economy has slowed from double-digit growth rates to around 6.6 percent (OECD estimate for 2017), and many large Chinese firms are overly reliant on the domestic market for their revenue streams. In addition, and despite the economy’s impressive performance and unprecedented poverty reduction (nearly 700 million have been lifted out of poverty since 1980), economic imbalances have arisen. At the same time, while China’s growth has long been driven by investment, supported by high savings rates, the growth model has obvious financial risks, as well as excess capacity in heavy industry and real estate.

Capital left the country at high rates in 2016, putting pressure on China’s currency, the renminbi, to devalue. Investors and even ordinary Chinese families looked to diversify their assets into other currencies, mainly the US dollar. Authorities enacted strict capital controls to stem the outflow. This had a noticeable impact on outward FDI flows, but these restrictions largely targeted financial market investors and consumers, and had less of an effect on large Chinese multinationals. Chinese firms are more likely to be targeted when they invest outside of their core competency, such as when an insurance firm enters the real estate sector. Investments from China’s firms in industries such as extractive, electricity, alternative energy, and automotive are unlikely to be significantly affected, which bodes well for future Chinese investment in Latin America. In 2017, there were already signs that outflow controls had subsided.
China’s economy has grown at double digits over the past thirty years, increasing the urgency for energy security and access to cheap natural resources, since any disruption could have consequences for their development model. The country’s institutional stability also rests on its extraordinary economic record, so China is encouraging companies to invest abroad as an essential component of securing the necessary resources and diversifying the revenue streams that facilitate strong economic growth.

In the early 2000s, the Chinese government expressed its desire for Chinese companies to internationalize by declaring a “going out strategy.” This strategy gained importance in the years following the global financial crisis as Chinese policymakers saw undervalued assets, especially in natural and energy resources. Now, China invests more abroad than it receives—a major milestone—and its companies have expanded their overseas portfolios.

China’s outward foreign direct investment achieved new heights in 2016, surpassing $200 billion, surprising markets and policymakers. Chinese companies accounted for more than 10 percent of global foreign direct investment flows that year, a remarkable achievement for a country that a decade ago accounted for less than 2 percent. In fact, mergers and acquisitions by Chinese firms in 2016 reached $140 billion in completed transactions—second only to those of US firms.\(^{15}\)

The past two years have seen a transformation in the strategy of Chinese outbound investment. Traditional Chinese investments were mostly in fossil fuels, metals, agriculture, and other natural resources. Recent investment activity is often driven by these same objectives, but also by China’s efforts to fundamentally transform its economy. Deals in real estate, information technology, entertainment, finance, and transport were targets of major acquisitions.\(^{16}\)

The largest M&A deal in history came in 2016, when ChemChina announced the purchase of Syngenta, the Swiss seed and pesticide company. China’s HNA Group also announced a $6 billion stake in Hilton hotels, and a Chinese company agreed to purchase an important robotics firm based in Germany for nearly $5 billion. Chinese firms are clearly targeting higher value companies with technological know-how, brand value, and strategic assets, such as semiconductor and other advanced manufacturers.
The quality of China’s investment in the region has also drawn attention, as environmental regulations, local labor laws, and other investment standards are being discussed with Chinese companies. Environmental impact has been a matter of recent contention with Latin American governments, because the region’s exports to China are still concentrated in environmentally sensitive sectors. Investment in these exporting sectors creates relatively fewer jobs and generates a greater environmental impact than average Latin American and Caribbean exports. Indeed, “Between 2009 and 2012, the region’s exports to China generated between forty-four and forty-seven direct jobs per $1 million in export value, whereas the same value of exports to the world at large created between fifty-four and fifty-six direct jobs in that period.” Moreover, sales to China generate larger greenhouse gas emissions and consume more water per dollar than the region’s exports worldwide,” according to the Global Economic Governance Initiative at Boston University.

Chinese firms are clearly targeting higher value companies with technological know-how, brand value, and strategic assets, such as semiconductor and other advanced manufacturers.
The origins of Chinese FDI in Latin America lie in Chinese state-owned enterprises (SOEs) investing in the extractive industries (oil, gas, copper, iron ore), a strategy to shore up natural resources to fuel China’s booming economy. Investment in commodities persists, even after a significant drop in commodity prices in 2015 when other foreign firms began to pull back on larger investments in extraction in Latin America.

But now Chinese firms are shifting their focus toward the service sector, in line with the shift in China’s domestic economy, where services now comprise more than 50 percent of GDP. This increased attention on services—everything from electricity generation and transmission to information technology and communication, finance, and transportation—represents rising confidence in selling products to middle class consumers in Latin America.

China’s government has helped facilitate this change as well. Ten years ago, Chinese direct investment in Latin America was close to minuscule, on par with China’s distant relationship with the region. The landscape has certainly changed, as the Chinese government released its first strategy (white) paper of engagement in Latin America in 2007, and a second paper in late 2016. Both reference Chinese companies’ growing investment in Latin America, with the second saying Chinese enterprises will align with the countries’ needs for independent development.

Cumulative flows of Chinese FDI in Latin America have reached over $110 billion, with $60 billion to Brazil alone. Europe is still the region’s largest source of FDI, but China is catching up. Annual FDI flows from China have been more than $10 billion in four of the past five years. In 2014 and 2015, China accounted for an average of 10 percent of global FDI flows into Latin America, a striking turnaround from the low levels of investment even a few years earlier.

As mentioned earlier, the data shows a major shift toward new industries (Figure 3). Investments in the extractive industries accounted for more than 60 percent of total Chinese FDI in the region from 2003 to 2012, but dropped to 37 percent in the following four years (2013 to 2016). Investments in the service sector jumped from 21 percent of Chinese FDI from 2003 to 2012 to more than 50 percent the following four years (with alternative energy included).

Electricity generation and distribution have seen key investments, including the state-owned...
Three Gorges’ purchase of hydroelectric plants in Brazil from Duke Energy. Information technology, finance, and transportation make up the vast majority of industries in the jump in service sector investment. Chinese firms such as Huawei, ZTE, Hainan Airlines (HNA Group), and Bank of Communications have all made major investments in Latin America in the past few years. This also reflects changes in China’s domestic economy, as it shifts toward services such as health care, culture, and commercial services, and relies relatively less on manufacturing.

Brazil, by far, is the preferred destination for these investment flows (Figure 4). Even though global FDI to Brazil was smaller in 2016 compared to 2014 as firms worried about political and economic uncertainty, Chinese firms doubled down, accounting for their largest annual FDI ever to the country—more than $11 billion. The increasing financial flow from China to Brazil is also reflected by large government loans to the country in 2016, with nearly $15 billion coming from China Development Bank, mainly to finance energy projects.

Beyond Brazil, a number of countries have received large sums of investment from China recently. Mexico has seen more than forty deals valued at over $4 billion in the span of three years (2014 to 2016) from China—a remarkable amount considering no previous year had seen more than five deals. Many of these deals are in the automotive, IT, and alternative energy industries. Argentina, too, has seen around $5 billion in cumulative FDI from China, including investments by Chongqing Grain Group, ICBC, Chery Auto, and Sany. Bolivia has received $3.5 billion from two deals, a $3 billion joint venture by Shengli International Drilling Co and Bolivia’s state-owned oil firm YPFB and a $450 million investment in the mining and metals industry by Sinosteel.

Peru, due to favorable political relations with China and abundant natural resources, has received special attention from China’s


<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>AMOUNT (US$ BILLIONS)</th>
<th># OF DEALS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>61</td>
<td>180</td>
</tr>
<tr>
<td>Peru</td>
<td>18</td>
<td>65</td>
</tr>
<tr>
<td>Mexico</td>
<td>6</td>
<td>27</td>
</tr>
<tr>
<td>Argentina</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>Bolivia</td>
<td>3</td>
<td>36</td>
</tr>
<tr>
<td>Chile</td>
<td>2</td>
<td>27</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Antigua</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Jamaica</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Guyana</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Cuba</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Colombia</td>
<td>1</td>
<td>8</td>
</tr>
<tr>
<td>Ecuador</td>
<td>0.8</td>
<td>21</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>0.7</td>
<td>12</td>
</tr>
<tr>
<td>Panama</td>
<td>0.6</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Bureau van Dijk, fDi Markets
Note: Includes M&A and greenfield investment.
A SHIFT IN REGIONAL FOCUS

state-owned mining firms. In 2014 alone, it saw four major deals in mining and metals worth over $13 billion (Figure 5). In the largest, a $7 billion deal in 2014, a group led by China Minmetals (MMG) purchased a copper mine from Glencore Xstrata. CNPC purchased Petrobras Energia Peru for $3 billion that same year. Chinalco, a Chinese aluminum company, originally invested $2 billion in 2008, and has more than doubled that amount since.

Chinese firms are planning $10 billion more in investment in 2017 and 2018, mainly in the extraction of copper and iron ore. China needs cheap copper to continue its fast-paced growth in the construction sector, and iron ore because China is the largest producer of steel in the world. China’s steel industry is now dealing with the serious issue of overcapacity; this has global consequences, as Chinese firms are pushing out other global producers of steel, and countries worldwide are starting to erect high barriers for steel imports, including the United States and the European Union.

To be clear, the extractive industries of oil and gas and mining and metals still loom large in Chinese FDI in the region, accounting for more than $50 billion in cumulative investments (Figure 6). But they are shrinking in terms of percentage of annual investment.

Manufacturing and the services sector have seen an acceleration in number of deals, as Chinese firms rush to get into other parts of the Latin American economy. Firms such as Huawei, ZTE, Beijing Automotive, and BYD have all targeted the region in the past few years. Chinese state-owned banks have also opened a number of offices to increase their presence. In electricity generation and distribution, China’s state-owned State Grid alone has invested more than $7 billion in Brazil, through a combination of greenfield investments and M&A activities.

**FIGURE 5. Chinese Mining Investments in Peru**

<table>
<thead>
<tr>
<th>YEAR (INITIAL INVESTMENT)</th>
<th>PROJECT</th>
<th>CHINESE FIRM</th>
<th>OWNERSHIP</th>
<th>VALUE (US $MILLIONS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>Las Bambas</td>
<td>Chinese Consortium</td>
<td>SOE</td>
<td>7,000</td>
</tr>
<tr>
<td>2014</td>
<td>Las Bambas</td>
<td>China Minmetals Group</td>
<td>SOE</td>
<td>3,000</td>
</tr>
<tr>
<td>2008</td>
<td>Toromocho Mine</td>
<td>Aluminium Corporation of China (Chinalco)</td>
<td>SOE</td>
<td>1,500</td>
</tr>
<tr>
<td>2008</td>
<td>Galeno</td>
<td>Jiangxi Copper</td>
<td>Private</td>
<td>1,840</td>
</tr>
<tr>
<td>2007</td>
<td>Marcona Mine</td>
<td>Shougang</td>
<td>SOE</td>
<td>2,500</td>
</tr>
<tr>
<td>2009</td>
<td>Greenfield</td>
<td>China Minmetals Group</td>
<td>Private</td>
<td>600</td>
</tr>
<tr>
<td>2009</td>
<td>Greenfield</td>
<td>Aluminium Corporation of China (Chinalco)</td>
<td>SOE</td>
<td>1,500</td>
</tr>
</tbody>
</table>

Source: Bureau van Dijk, fDi Markets

Greenfield Investment

Chinese firms are also starting up many new companies in Latin America, which are known as greenfield investments. These are typically smaller investments and are spread across industries. The rise in greenfield investments could suggest that Chinese investment will have a greater economic impact on asset values. Greenfield investments imply that Chinese firms are having greater control in several areas, including hiring, capital investment, and strategy. These investments also make more fi-
A SHIFT IN REGIONAL FOCUS

financial resources available for domestic capital formation and expedite the transfer of more efficient technologies. One resulting implication is that industry diversification of China’s FDI in the region could come through greenfield investments.

The two leading categories for greenfield investment in Latin America are metals and mining and the automotive industry. In fact, there have been more than seventy deals announced in automotive, worth over $10 billion, with the focus on Mexico and Brazil. However trade barriers that restrict the import of vehicles are a large reason behind some of the Brazilian deals. Accessing the market means setting up a domestic assembly plant.

Many Chinese firms are beginning to recognize the value of investing in Mexico. A strong manufacturing country, Mexico is well integrated in the production supply chain, creating efficiencies for factories located there. This is partly due to the North America Free Trade Agreement (NAFTA) opening up the US and Canadian markets and maintaining a supply of intermediate goods. Mexico also has competitive wages for factory workers—by some measures cheaper than in China. For these reasons, assembling automobiles in Mexico is gainful for both parties.

Mergers & Acquisitions
Before 2010, mergers and acquisitions involving Chinese firms were negligible in Latin America, but since then, Chinese firms have awoken and have averaged over $6 billion of M&A activity per year (Figure 7). By dollar amount, the deals are heavy in oil and gas, mining and metals, and finance. Looking at the number of deals, though, we see deals across industries, including agriculture, chemicals, automotive, IT, and consumer products and electronics.

Brazil is again the leader, attracting fifty-seven deals from Chinese firms since 2003. Firms in Chile, Argentina, and Mexico are also common targets of Chinese investors. By number of deals, Chinese investors, many new to the region, spread out M&A activity among a diverse range

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<table>
<thead>
<tr>
<th>INDUSTRY</th>
<th>AMOUNT (US$ BILLIONS)</th>
<th># OF DEALS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil &amp; Gas</td>
<td>25</td>
<td>27</td>
</tr>
<tr>
<td>Mining &amp; Metals</td>
<td>27</td>
<td>48</td>
</tr>
<tr>
<td>Transport</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>Automotive</td>
<td>11</td>
<td>79</td>
</tr>
<tr>
<td>Finance</td>
<td>7</td>
<td>28</td>
</tr>
<tr>
<td>Electricity/Utilities</td>
<td>9</td>
<td>16</td>
</tr>
<tr>
<td>Alternative Energy</td>
<td>4</td>
<td>14</td>
</tr>
<tr>
<td>Information &amp; Communication Tech</td>
<td>2</td>
<td>52</td>
</tr>
<tr>
<td>Consumer Products/Electronics</td>
<td>4</td>
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<tr>
<td>Agriculture</td>
<td>0.8</td>
<td>15</td>
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<tr>
<td>Machinery &amp; Equipment</td>
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<td>23</td>
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<tr>
<td>Chemicals/Rubber</td>
<td>2</td>
<td>19</td>
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<tr>
<td>Construction &amp; Construction Materials</td>
<td>2</td>
<td>16</td>
</tr>
<tr>
<td>Other Services/Wholesale</td>
<td>7</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: Bureau van Dijk, fDi Markets
Note: Includes M&A and greenfield investment.
A SHIFT IN REGIONAL FOCUS

of industries. Mining and metals leads the way with twenty-five deals, but oil and gas, finance, electricity, consumer products and electronics, and chemicals and rubber all have significant numbers of deals.

Since 2010, there have been more than twenty investments by Chinese banks and financial firms in Latin America. Acquisitions range from Brazilian financial firms such as BTG Pactual, Banco BBM, and BicBanco, to Argentina’s Standard Bank. Many others, such as Bank of Communications and ICBC, are opening new retail locations and expanding their reach.

State-Owned Enterprises
From mining, oil and gas, and infrastructure, to hydroelectric plants, Chinese state-owned enterprises dominate investments in Latin America (Figure 8). Some come to fill overcapacity, others to secure China’s long-term energy needs. China’s state-owned Three Gorges Corp., for example, after constructing many dams in China, turned to other parts of the world that needed renewable energy. Others, like Sinopec, are buying up assets and exploring new areas for oil extraction to ship back to China. Financial investments are through state-owned banks like Bank of China and ICBC. This contrasts with Chinese FDI in the United States and Europe, where private companies have been out-investing SOEs in recent years.

Why are China’s SOEs predominant? SOEs have been the main destination of the government’s large-scale stimulus during the financial crisis, and they are dominant in competitive industries, including construction, retail and wholesale trade, and hotels and restaurants. In addition, China restricts private investment in dynamic sectors, including services such as finance, logistics, and telecoms. Their favorable position at home, thanks to the control of a spectrum of industries, has allowed more Chinese SOEs to venture overseas.
Brazil plays a major role in attracting Chinese FDI in Latin America, which started to take off in 2010. Total cumulative investment has reached over $60 billion (Figure 9). Towering over other industries is nearly $14 billion invested in the oil and gas sector—although many industries have received more than $5 billion each, including mining and metals, transport, automotive, finance, and electricity and utilities.

Brazil has attracted more than half of all Chinese FDI in Latin America, and that could increase. The head of the Brazil-China Chamber of Commerce and Industry, Charles Tang, stated that 2017 could see more than $20 billion in M&A activity from China, as more Chinese firms turn their attention to Brazilian assets that are underpriced as a result of economic and political crises.

The world’s largest power company, the state-owned China State Grid Corp., has bet the house on the Brazilian electricity market. The firm has invested more than $7 billion in Brazil since 2012, in a mix of acquisitions, joint ventures, and greenfield investments. Having struck deals for electricity grids in Australia, Italy, the Philippines, and elsewhere, State Grid had annual sales of $330 billion in 2015, leaving it with deep enough pockets to outbid almost anyone. The firm’s CEO envisions a global electricity grid where power lines don’t just cross national borders, but continents as well. It is also building transmission lines that will help electricity generated from the


<table>
<thead>
<tr>
<th>Industry</th>
<th>Amount (US$ billions)</th>
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</thead>
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<tr>
<td>Oil &amp; Gas</td>
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<td>Electricity/Utilities</td>
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<td>Consumer Products/Electronics</td>
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<tr>
<td>Agriculture</td>
<td>1</td>
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<tr>
<td>Machinery &amp; Equipment</td>
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<tr>
<td>Construction &amp; Construction Materials</td>
<td>0.1</td>
</tr>
<tr>
<td>Other Services/Wholesale</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Bureau van Dijk, fDi Markets
Chinese investment in electricity generation and transmission in Latin America is transforming the industry, contributing to increased productivity and competitiveness in the region.

Belo Monte Dam to reach the more populated cities in the south. State Grid, and therefore China, is betting a big stake on Brazil’s future success.

With gloomy growth levels in 2016 (-3.6 percent according to OECD) and a slow expected recovery (0.7 percent expected growth for 2017 and 1.6 percent for 2018), China’s investments in Brazil are welcome, especially when the country is experiencing serious external imbalances and a large trade deficit. China’s focus on electricity, mining, automotive, and transport suggests a more long-term strategy, at a moment when external resources for the country are increasingly scarce. Besides the short-term stability this kind of investment can bring, the prospects for China’s FDI could be significant at both the national and the subnational levels. Chinese lending to regional and municipal governments (a particularity of Brazil when it comes to Chinese loans) could extend to FDI investments in infrastructure development (notably in electricity and transport).

**Energy**

Chinese investment in Latin America is rooted in the traditional energy sector, mainly in pursuit of its own energy security. The largest investments have been acquisitions and joint ventures of oil assets all over the continent by state-owned firms Sinopec and CNPC. China’s other large state-owned oil firm, CNOOC, won two of ten deepwater blocks auctioned by the Mexican government in December 2016, worth an estimated several billion dollars each. Peru, Bolivia, Colombia, and Venezuela all have seen major investments from these firms as well. The acquisition of seven power plants in Brazil and
the Brazil Iberdrola subsidiary acquisition in 2010 and the development of hydroelectric facilities by firms like State Grid and Sinhydro in the countries already mentioned suggest China will be a major player in the electricity sector.

Latin America’s partnering with China in the electricity sector could certainly bring advantages. Growing capabilities and scale is one clear advantage, with Chinese generating stations increasing from twenty in 2000 to 529 in 2013. Experience is a second advantage, particularly in introducing technological advances (high-voltage, long-distance power transmission) and the electrification of rural areas. Regarding pricing, several Chinese electricity firms are facing high debt burdens (and expanding beyond their domestic market), so they should remain competitive. But there are some risks, too, particularly in the compatibility and maintenance of Chinese equipment. Reinforcing quality standards will also be an increasingly urgent issue.

Alternative energy is beginning to play a bigger part as well. Latin America is already a world leader in renewable energy projects. Brazil, Mexico, and Chile are putting great emphasis on solar and wind projects. China is building out large investments in hydropower generation, solar, and even nuclear. Firms like China’s Three Gorges are involved in many such projects.

**Manufacturing**

Transport services are increasingly important for the competitiveness of the manufacturing sector in Latin America. As China’s logistical and distribution companies penetrate Latin American markets (the two largest investments, Nova and Shenzhen Investment Limited, are focused on shipping), their success will become critical for the region’s overall performance.

A significant portion of China’s manufacturing investment in countries like Brazil and Argentina can be attributed to import barriers for products such as automobiles and electronics. Both countries have increased tariffs and nontariff protection measures to incentivize foreign companies to set up factories locally.

Other forms of investment have performed less well. Argentina’s experiment, the tax-free zone of Tierra del Fuego, has been less successful than expected. The government forced foreign firms to set up joint ventures to produce products locally instead of importing them. This has increased prices for items like mobile phones and is deterring consumers, while realizing little technology transfer. The products made there have high production costs, leaving them uncompetitive in the global markets.

**Automotive Industry**

Chinese firms are rushing into the automotive industry in Latin America, with more than seventy-five deals worth over $10 billion. Half of these have landed in Brazil, with Mexico, Argentina, and Venezuela also in the mix. Almost all are greenfield investments, with few acquisitions or joint ventures. Firms like Chery Auto, JAC, Great Wall Motors, and Geely (which in 2010 bought Volvo from Ford) all have or are building factories to assemble vehicles in Latin America.

China seems to see the automotive industry as a strategic sector, and the government encourages Chinese firms to expand their...
operations abroad. China’s domestic industrial policy limits foreign firms’ ownership of any auto manufacturing company set up in China to 49 percent. Further, China slaps at least a 25 percent tariff on car imports, and some cars face much higher taxes. These two measures—heavy tariffs and ownership control in joint ventures for local Chinese firms—partly explain why foreign-made cars represent just 5 percent of the Chinese market.

Brazil, with one of the largest auto markets in the world, also has very high import taxes, although it does not have the same limits on foreign ownership. Brazil, once facing increasing auto imports, especially from Japan and Korea, implemented quotas in 2013, heavily taxing any cars above the limit. Still foreign firms can set up factories with little restrictions or pressure to hand over technological know-how. This, together with targeted programs for strengthening global value chains and incentives for innovation, are behind the significant increase in investment in the auto sector in Brazil over the past several years. In the end, protectionist policies like these often can do more harm than good, as Brazilian consumers end up paying more for their cars, and Brazilian-owned auto firms see little innovation shared from the growing number of foreign companies in the market.

Other countries, like Mexico, have seen policies for attracting FDI (through ProMexico Fund, PRODIAT, and other programs) to the automotive sector pay off. Today, Mexico’s main export destinations, apart from the US market, include China, Brazil, and India. However, the sector is facing challenges to adapt its practices to new demands coming from the Chinese market. As a host to original equipment manufacturers (OEMs), the know-how on light vehicle models will be handy to expand in Chinese markets. Increasing domestic content will present a challenge to scale up investments in the automotive sector in the future.

**Service Sector**

The services sector has grown markedly in prominence, fueled by capital flowing into finance, transport, information technology, electricity, and construction. The service sector received more than half of all Chinese investment from 2013 to 2016, nearly double that of the previous ten years.

China will have a large role in connecting the next generation of middle class consumers to the Internet, with more than fifty deals related to ICT. Huawei, the Chinese telecom giant, has made more than a dozen investments across Latin America, followed by its peers, such as China Unicom, ZTE, and TP-Link. From communication lines to routers, Chinese firms are on the frontier of the next generation of digital data.

**Lending vs. FDI: Differences Between Financial Flows**

Chinese FDI to the region is accompanied by lending from China’s policy banks (established to take over the government-directed spending functions of the four state-owned commercial banks), which has surpassed the $140 billion mark since 2005. Most of this financing has gone to four countries: Argentina, Brazil, Ecuador, and Venezuela. Rather than substituting for other lenders, these loans are complementary, and are focused on countries where access
to capital markets is more expensive and where international financial institutions are limited or do not have active portfolios.

As of 2016, Inter-American Dialogue data show that most loans from China to the region continue to be concentrated in infrastructure, energy, and mining. In contrast, international financial institutions, including CAF Development Bank of Latin America, Inter-American Development Bank (IDB), and the World Bank, seem to be expanding to other areas, with 60 percent of their portfolios focused in education, health, environment, and public administration—basically the modernization of the state, rule of law, and justice.

China’s loans to the region are different than other international financing sources in several respects. Nearly 15 percent of Chinese loans to Latin America today have a commodity-backed clause, such as loans-for-oil and purchase requirements. Unlike with the World Bank or IDB, loans from China’s policy banks don’t come with conditions for economic or political reforms. However, they can come with mandates that the infrastructure or other construction projects funded use Chinese services or parts—a common practice today when Chinese policy banks provide financial assistance. In terms of costs or lending conditions, China’s loans are similar to the ones provided by multilaterals. However, the stabilizing role Chinese loans have played in recipient economies over the past two years, particularly in Ecuador and Brazil, should not be underestimated.

Unlike China, the Inter-America Development Bank, which China joined as a donor member in 2008, attaches conditions to its loans.
President Mauricio Macri of Argentina, on a state visit to Beijing in May of 2017, called China a “strategic partner,” while announcing over $17 billion in deals in multiple areas, from nuclear power plants to transportation. China’s emerging status is on display in Latin America. China’s economic relationship with the region was previously based on importing raw materials; now it includes skyrocketing FDI and infrastructure investment.

Meanwhile, the United States has pulled out of the TPP, which includes three countries in Latin America (Chile, Peru, Mexico), and aims to renegotiate NAFTA. In this uncertain context, it would not be surprising to see Mexico shift some of its attention to China. A closer relationship with the Asian giant could give Mexico some leverage in future NAFTA negotiations.

Further economic integration of Latin America with China could re-define linkages between the three blocs in the future. Increased FDI from China, especially if the shift to services continues, will play a constructive role in economic development. Chinese participation in Latin America’s infrastructure upgrades has been and could continue to be positive. But perils remain. As one study notes, China’s imports from Latin America are still comprised mainly of natural resources and resource-based manufactured goods. And Chinese FDI in Latin America still has a disproportionate amount of investment in the extractive sector, compared to other foreign investors. Have these factors slowed some Latin American countries’ transitions from the extractive sector to services and manufacturing?

Moreover, given China’s growing relationship with Latin America, what will be the political effects? China’s 2016 policy paper guiding its relationship with the region favored support for different groups, including the Community of Latin American and Caribbean States (CELAC), the Union of South America Nations (UNASUR), and ALBA.

As China’s influence in the region extends beyond the economic arena, the region needs to prepare and negotiate with China. Increasingly intertwined economic ties with China should not affect countries’ independence and autonomy in the international arena, as this could affect relations with the US and other allies. To maintain their autonomy, the use of regional platforms should strengthen the region’s bargaining power in coming negotiations with China.
Chinese firms will continue to invest heavily over the next decade, and President Xi Jinping’s goal of $250 billion by 2025 is certainly attainable. This can be a very positive development for Latin America if investments benefit the whole of regional economies. To get the most out of it, China and countries in Latin America should create a strong foundation for future crossborder flows. The following recommendations should help achieve this goal.

For China:
- Continue efforts for investing sustainably, and focus on long-term projects that provide benefits to the communities invested in, through employment creation and linkages with local firms.
- Ensure investments are transparent, so there is little doubt as to the motivation behind the investment.
- Encourage Chinese firms to engage in more corporate social responsibility, finding new ways to give back to communities. The Chinese government could provide best practices guidelines for its companies operating abroad, especially for more sensitive sectors such as energy and services, or more effectively share existing guidelines.38
- Open more industries to foreign investment, especially in sectors where Latin American firms can have similar opportunities to access the Chinese market.

For Latin America:
- Seek to further open the market for FDI, including tax agreements (avoiding double taxation) and creating more protection for investors. Countries like Brazil and Argentina, which are looking to negotiate bilateral investment treaties with China, can also leverage regional platforms (Pacific Alliance, Mercosur) to gain a stronger position in negotiations.
- Keep high standards for investment. The OECD’s guiding principles for global investment provide comprehensive steps toward this goal. These principles aim to improve the transparency, neutrality, and impact of global investments.
- Make public and private investors accountable for compliance with local environmental guidelines. Strong regulatory frameworks

Latin America should implement domestic policies that favor skills development, technological adaptation, knowledge transfer, and innovative product development to materialize the benefits of China’s investment.
Chinese President Xi Jinping, who has visited Latin America three times since 2014, has zeroed in on Latin America, promising vastly increased trade and investment with the region by 2025.

are particularly important in the environmental domain. Latin America needs to protect lands, communities, livelihoods, and industries where a focus on primary extractive industries (where China and other foreign investments are concentrated) could put environmental sustainability at risk. Regulatory frameworks that should be either created or strengthened include those that reinforce evaluation and monitoring mechanisms, improve ministries’ capacity to enforce standards and laws in extractive projects, and establish a clear consultation processes to address local civil society concerns.

• Guide FDI, from China and elsewhere, to industries that will further integrate national economies into global value chains. One way to do that is to support special economic zones targeting strategic sectors for integration, as long as there is impact evaluation, and revisions if the zones are not working.

• Provide a productive environment for companies to operate in by building and maintaining efficient infrastructure. Quality roads and ports provide a foundation for dynamic economic growth.

• Maximize the potential of Chinese intermediary services for Latin America’s manufacturing sector, particularly in the areas of distribution and logistics, where the Chinese are globally competitive.

• Focus on policies that will boost R&D spending to facilitate greater innovation and productivity.

• Implement domestic policies that favor skills development, technological adaptation, knowledge transfer, and innovative product development to materialize the benefits of China’s investment.
ABOUT THE DATA AND METHODOLOGY

Chinese overseas FDI is notably hard to track. For this report, we used two data sets with firm-level data to get a clear picture of Chinese investments in the region. The data on mergers and acquisitions comes from Bureau Van Dijk, a major publisher of business information specializing in private company data (financial data, legal entity details, and M&A activity) and covering confirmed and assumed confirmed deals (using proprietary methods). Bureau van Dijk/Orbis integrates information from local jurisdictions, regulatory bodies, credit bureaus, tax authorities, central banks, ratings agencies, and reputable niche information providers. This sourcing methodology combines official corporate registry information with Bureau van Dijk’s own research and analysis to provide unrivaled visibility into the interconnectivity of companies and affiliated entities and individuals. Bureau van Dijk’s data services are relied upon by the vast majority of industrialized governments, multigovernmental bodies, regulatory agencies, and international financial institutions.

The greenfield data is from fDi Markets, the most comprehensive online database of crossborder greenfield investments available (including investment projects, capital investments, and job creation), tracking announced deals from a variety of sources (financial news, media sources, project data from industry organizations, and investment agencies). Some data sets that relate to Chinese FDI in Latin America, track only announced deals from news articles. This leaves out many smaller deals.

Note: Differences in reported figures (from IMF, national sources, and others) of China’s FDI to Latin America can be explained by under-reporting of official data collected by the Ministry of Commerce. Three main factors may explain this. First, many Chinese firms make their investments through Hong Kong-China, Macao-China, and other financial centers (such as Cayman Islands and British Virgin Islands). Estimates of the share of China’s investment entering the region through tax havens can reach 78 percent of total investment. Second, not all countries in the region register the country of origin of FDI investments. Third, FDI investments can be made through subsidiaries outside of the country. In addition, many deals have multiple investors and this can skew the data.
ENDNOTES


3 Ibid.


9 OECD Economic Outlook, June 2017.


18 Ibid.


20 Economic Commission for Latin America and the Caribbean (ECLAC) data and authors’ calculations.

22 The distinction between M&A and greenfield investments differs among institutions. In general, M&A transactions refer to the purchase or sale of existing equity, while greenfield investments refer to entirely new investments. See OECD, Benchmark of Foreign Direct Investment (Paris: OECD Publishing, 2008).


26 Interim OECD Economic Outlook 100, March 2017.


35 Bureau van Dijk and fDi Markets.


37 Ibid.

38 See, for example, the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas.

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