CHINA'S ADVANCE IN LATIN AMERICA

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GEOSTRATEGIC IMPLICATIONS FOR EUROPE, THE US, AND THE REGION ITSELF

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- China is rapidly growing its presence in Latin America. While the Chinese activities are predominantly economic, they have long-standing strategic consequences for Europe, the US and the region itself.

- China's massive infrastructure projects help connect the different regions of South America, which may unleash stronger regional integration. At the same time, this redirects the commercial flows of South America towards the Pacific, increases Brazil's strategic interest in its neighbouring countries, and gives the region the opportunity to pursue greater autonomy from the US and Western institutions.

- Having been slow to react to China's geoeconomics, Europe and the US not only risk being displaced economically in South America, but also risk losing important political influence. They now need to devise their own geoeconomic strategies in order to revive their engagement with the region.

- Recently, the regional political situation has become more favourable for Europe and the US, with a changing of the guard towards more pro-Western political leadership. They should now seize the moment and engage with Latin America on a more equal footing by offering actual multilateralism, in contrast to China's more bilateral approach.

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Introduction

The pace of China's expanding presence and influence in Latin America has been astonishing in recent years. Much attention focuses on whether it provides an opportunity or threat to Latin American socioeconomic development. There has been far less discussion about the geostrategic dynamics of China's evolving role. In Europe and the US, the prevailing view has been that as long as the Chinese activities are predominantly economic, not military, they pose little threat to Western strategic interests in Latin America. By offering new trade opportunities, finance and investments, China is helping to raise the economic potential of the region, which also provides opportunities for Western companies.

This 'liberal' view overlooks how such economic activities may have long-standing strategic consequences. In fact, rising powers commonly use economic statecraft when pursuing strategic objectives on the international stage.[1] To this end, strategic aims are often masked under the guise of commercial, seemingly apolitical activities.

Such masking is geoeconomics *par excellence*. The concept of geoeconomics was coined by Edward Luttwak, who emphasised how states in the post-Cold War era increasingly use economic means instead of military ones to pursue relative strategic gains. According to Luttwak, national power in this era of geoeconomics derives from "disposable capital in lieu of firepower, civilian innovation in lieu of military-technical advancement, and market penetration in lieu of garrisons and bases".[2] So, despite the means being 'soft', the aim may still be 'hard' in improving the country's broader geostrategic position in relative competition with other countries.

This paper analyses China's geoeconomics in Latin America, how it is changing the geopolitical environment in the region, and what the strategic implications are for Europe and the US.

1 See Mikael Wigell (2016), "Conceptualizing Regional Powers' Geoeconomic Strategies: Neo-Imperialism, Neo-Mercantilism, Hegemony, and Liberal Institutionalism", *Asia Europe Journal* 14 (2), pp. 135-151.

2 Edward Luttwak (1990), "From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce", *National Interest* 20, p. 18.

China's evolving role in Latin America

Sino-Latin American trade increased twentyfold from 2001 to 2014, making China the first trading partner for countries such as Argentina, Brazil, Chile, Peru, and Uruguay. Since 2010, China has also emerged as a key source of new investments in the region. At the same time, US and European trade with Latin America has declined, and while they are still bigger sources of investment and aid for the region, these have also declined in recent years.[3]

Moreover, Chinese lending to Latin American governments has been rising dramatically, reaching $29 billion in 2015, almost twice as much as the combined total lending by the World Bank and the Inter-American Development Bank. The bulk of this lending has been directed towards four countries: Argentina, Brazil, Ecuador and, particularly, Venezuela (see Table 1). In addition, China has offered an additional $35 billion in new regional funds for infrastructure and industrial cooperation. All in all, China has emerged as Latin America's biggest creditor.[4]

The current economic slowdown in both China and Latin America is not about to alter these trends. Under President Xi Jinping, China has manoeuvred to intensify its relations with Latin America, as demonstrated not only by the accelerating number of summit visits, but also the enhanced institutionalised cooperation. The Cooperation Plan signed at the first meeting of the Forum of China and the Community of Latin American and Caribbean States (China-CELAC) in January 2015 focuses on doubling annual trade and significantly increasing China's investment stock within the next decade.[5] The 'Twin

3 ECLAC, The European Union and Latin America and the Caribbean in the New Economic and Social Context, United Nations, Santiago de Chile, 2015. Also, EPFR Global, www.epfr.com.

4 See Rebecca Ray, Kevin Gallagher and Rudy Sarmiento, 'China-Latin America Economic Bulletin 2016 Edition', Discussion Paper 2016-3, Global Economic Governance Initiative, Boston University.

5 'Jointly Writing a New Chapter of the China-CELAC Comprehensive Cooperative Partnership', keynote speech by President Xi Jinping at First Ministerial Meeting of China-CELAC Forum, 8 January 2015, www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1227318.shtml.

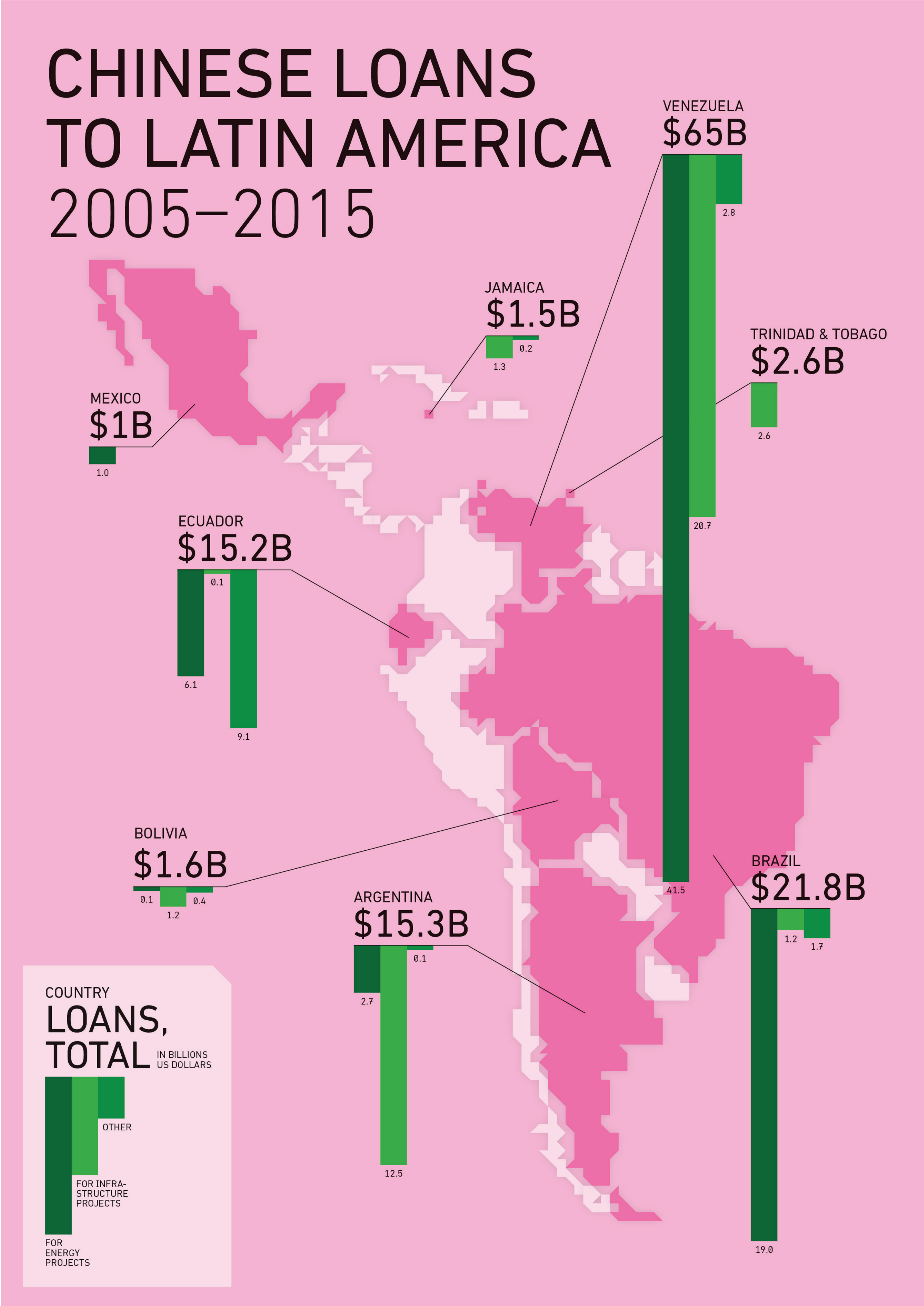

Table 1. Chinese loans to Latin America. Data compiled from: Gallagher, Kevin P. and Margaret Myers (2016), "China-Latin America Finance Database", Washington: Inter-American Dialogue, www.thedialogue.org/map_list. Graph: Tuomas Kortteinen.

Ocean Railroad', agreed during Li Keqiang's visit to the continent in May 2015, is a grand project to build a 4,400-kilometre transcontinental railway linking Brazil's Atlantic coast to Peru's Pacific coast. Prime Minister Keqiang also pledged to aid the construction of the 'Two-Ocean Tunnel' linking Chile's Pacific coast to Argentina's Atlantic coast. In addition, he signed a series of financial deals, including a currency swap arrangement together with an agreement to set up a yuan clearing bank in Chile.

These agreements come on top of a long list of projects in Latin American infrastructure proposed by China in recent years. The Chinese are building or upgrading railways, roads, ports and airports all over the continent. The Nicaragua Canal, a $50 billion trans-oceanic shipping canal, is now under construction and, if completed, will rival the Panama Canal and give China a significant presence in Central America.

What does China want?

China has strong geoeconomic motives for its involvement in Latin America.[6] First, the region provides an important source of the raw materials that China needs to sustain its rapid industrialisation and increasing demand for foodstuffs. This can be seen in the composition of Chinese imports from Latin America and the way it has been evolving over time. Imports are heavily concentrated on primary products and resource-based manufacturing. The importance of securing access to natural resources is also reflected in the financial flows from China to Latin America. Three-fourths of Chinese mergers and acquisitions in region over the last five years were in extractive industries (oil, gas, and mining). Looking at the composition of Chinese investments, two-thirds were in infrastructure and public works, much of which is related to gaining access to raw materials. Most of the remaining third of investments focused directly on agriculture, energy and minerals.[7]

Second, access to the Latin American markets allows China to diversify and expand its export base. Chinese policymakers have been concerned about the country's overdependence on markets in the US and Europe, leaving it vulnerable to risks such as rising protectionism and economic slumps in those markets. The region also provides a convenient market for Chinese efforts to export industrial capacity and expand its manufacturing base. To this end, China is pursuing a dynamic mercantilism through which it is buying raw materials from the region, adding value to them through domestic production, and then re-exporting this value-added production to Latin America. Part of this mercantilism also involves promoting the internationalisation of Chinese corporations through diplomatic and financial assistance. Chinese engineering companies, in particular, are looking for new markets as domestic growth is slowing, and these efforts are effectively sustained through export credits and government-to-government loans. In general terms, the aim is the extension of national state capitalism as part of China's 'go-out' policy, which was launched at the turn of the century and functions as a high-level endorsement for the expansion of Chinese enterprises abroad.

Third, engaging in Latin America is viewed by Chinese policymakers as an avenue for bolstering the role of the Chinese currency in international markets. The yuan has garnered increasing regional importance, with Argentina, Brazil and Chile already having significant bilateral currency swap arrangements. The Cooperation Plan of the China-CELAC Forum envisages increasing currency swaps in bilateral trade. Worried about the dominant position of the US dollar in global financial markets, which is seen as a potential threat to China's economic security and preventing it from becoming a global financial player, the Chinese government has been pushing for the internationalisation of the yuan in global trade and investment.

6 See Lei Yu (2015), "China's Strategic Partnership with Latin America: A Fulcrum in China's Rise", *International Affairs* 91 (5), pp. 1047-1068. Also, R. Evan Ellis (2013), "The Strategic Dimension of Chinese Engagement with Latin America", Perry Paper Series, No. 1, William J. Perry Center for Hemispheric Defense Studies, Washington, D.C.

7 Rebecca Ray and Kevin Gallagher (2015), "China-Latin America Economic Bulletin 2015 Edition", Discussion Paper 2015-9, Global Economic Governance Initiative, Boston University.

Fourth, Latin America represents a major arena for China in its efforts to diplomatically isolate Taiwan. Half of the 24 countries in the world that recognise the government of Taiwan are in Latin America and the Caribbean. This diplomatic contest has influenced China's economic engagement with the region. China has been using economic incentives, selectively as sticks and carrots, to bid for diplomatic recognition. On the one hand, countries that recognise Taiwan have found their access to the Chinese market restricted. On the other hand, Costa Rica's shift in allegiance from Taiwan to China in 2007 was followed by a major aid package for public works, the Chinese purchase of $300 million Costa Rican government bonds, a billion dollar joint venture to upgrade the country's oil refinery, and better access for Costa Rican products to the Chinese markets. It served as a powerful reminder to the other countries in the region of the benefits to be reaped in severing their relations with Taiwan and switching them to China.

Finally, Latin America has broader strategic significance for China by way of securing political alliances in support of its rise as an emerging superpower and as a counterweight against US attempts to contain it. Chinese policymakers largely see the US 'Pivot to Asia' as a containment strategy targeted against China and, as argued by Lei Yu, by deepening economic interdependence and integration between itself and Latin America, China wishes to "create a 'sphere of influence' in the traditional 'backyard' of the United States…in retaliation for the US containment and encirclement of China, and as a fulcrum in its rise as a global power capable of challenging US dominance and reshaping the current world system in a fashion more to its liking".[8] Careful not to be seen as openly challenging the US, China thus applies geoeconomics as a more subtle strategy of balancing against the US and cementing its relationship with Latin American countries. Such "soft balancing", while being conducted by economic means, is calibrated to avoid the sort of counter-reaction that more traditional geopolitics would trigger.[9] Yet, despite the means being "soft", the motivation is still also geostrategic – broadening and deepening the sphere of political influence.

South America's shifting landscape

Latin America's growing economic ties with China are having a major impact on the region. First, the strategic geography of the continent is being altered. Particularly in South America, and to a lesser extent in Central America, China is helping to build the infrastructure needed to overcome the natural geographical barriers to regional integration. The Andes mountain range, the Amazon basin with its dense, almost impenetrable rainforest, as well as the sheer connecting distance of South America, have constituted major barriers to intra-regional trade and the development of regional production chains. As a result, the sort of natural economic ties that would exert pressure for deeper integration have simply not been there. The new infrastructure projects, many of which focus on building bi-oceanic corridors, will now help connect the different regions of South America and, by extension, may unleash stronger regional policies and commitment. This will also radically redirect the commercial flows of South America towards the Pacific.

At the same time, it will increase Brazil's strategic interest in its neighbouring countries. Brazil has traditionally not been very engaged in the region. Brazil's core population zones and economic activity are located on the Atlantic coast with poor continental links not only to neighbouring countries, but also to the Brazilian hinterland itself. Intracontinental trade only accounts for 1.9 per cent of Brazil's GDP. In comparison, Africa, Europe and North America are within easier reach by maritime transport, and links to those regions have often been more intense.[10] Given that the transregional transport infrastructure envisaged by the Chinese will actually be built, the prospect is now for Brazil to be tied much closer to the region.

8 Lei Yu, p. 1048.

9 On the strategic differences between traditional geopolitics and geoeconomics, see Mikael Wigell and Antto Vihma (2016), "Geopolitics versus Geoeconomics: The Case of Russia's Geostrategy and Its Effects on the EU", *International Affairs* 92 (3), pp. 605-627.

10 Scholvin, S.; Malamud, A. (2014), "Is There a Geoeconomic Node in South America?: Geography, Politics and Brazil's Role in Regional Economic Integration", ICS Working Paper, No. 2/2014, Lisbon.

Second, China's economic engagement with the region gives Latin American countries the opportunity to pursue greater autonomy from the US and Western institutions. The most obvious example is the way Chinese investments, loans and export revenues to the countries of the Bolivarian Alliance for the Americas (ALBA) have not only helped them forge a path independent of US efforts to pursue its policy agenda in the region, but also indirectly enabled them to set up regional institutions such as the Union of South American Nations (UNASUR) and the Community of Latin American and Caribbean States (CELAC), which excludes the US. At the same time, as Evan Ellis points out, the varying intensity of the China links have opened up new divisions in Latin America, most prominently between South America and Central America, "with the former increasingly displaying a China-led 'internationalism', while the latter remain bound to the United States in a relationship largely dominated by security and immigration issues".[11]

Yet regional political dynamics could still help reverse these tendencies. In Argentina and Brazil, the two biggest countries in South America, there has been a changing of the guard towards more pro-Western political leadership. With Venezuela in a political and economic meltdown, the anti-Western ALBA project stands without a leader and financial backer. These three countries were also key actors in forming UNASUR, which was deliberately formed to exclude the US from regional affairs. It now appears to be of less relevance, with political leaders seeking to improve relations with the US and Venezuela having lost much of its political influence and economic power to rally minor countries around UNASUR.

China also faces its own difficulties in Latin America. There are growing concerns in the region about possible neo-dependency structures and many countries are involved in trade disputes with China, as they worry over the mercantilist nature of the Chinese trading patterns. China's ambitious infrastructure projects have started to face growing resistance, particularly from environmental groups. In addition, the Chinese have sometimes found it difficult to navigate the bureaucratic systems of Latin American states. In general, there seems to be a growing wariness towards these projects, as initial expectations with regard to their job-generating effect have seldom been met, not least because of workers often having been brought in from China instead of being hired locally. As a result, many projects have been suspended or even cancelled. The political and economic upheavals in many countries in the region also make it difficult for the infrastructure projects to attract the necessary attention and backing from political leaders. A changing of the guard towards more pro-Western leadership in key countries such as Argentina, Brazil, and Peru adds to the growing uncertainty surrounding big infrastructure projects such as the 'Twin-Ocean Railroad' and the 'Two-Ocean Tunnel'.

11 Ellis, p. 21.

Implications for Europe and the US

For Europe and the US, China's increasing economic engagement with Latin America, and the regional dynamics that it fuels, pose a set of geostrategic challenges. Having previously served as a useful counterbalance to the US, Europe can no longer lay claim to such a political role amongst Latin American countries. Unable to match China's offers of loans and investment, Europe also risks being economically marginalised in Latin America. In fact, China's growing economic presence in Latin America to a large extent comes at Europe's expense. China's export activity has started to occupy niches where Europe formerly had a strong advantage, such as in medium-tech and high-tech goods, and European investors are losing out precisely in those areas of greatest interest to them, such as infrastructure, energy, oil and gas, as well as agriculture and finance.

In order to reassert itself, Europe would need to offer new trade deals, visa-free travel and deeper ties across the board. Yet the EU has been dragging its feet in the negotiations for a free trade agreement with Mercosur,[12] the South American regional organisation comprising Argentina, Brazil, Paraguay, Uruguay and Venezuela.[13] An EU-Mercosur agreement would help Europe revive its presence

12 See Mikael Wigell, "Seal the Deal or Lose Brazil: Implications of the EU-Mercosur Negotiations", FIIA Briefing Paper, March 2015.

13 Venezuela is excluded from the negotiations and will thus not be part of a possible agreement.

and influence in South America. In particular, it would help the EU strengthen its strategic partnership with Brazil, a potentially useful ally for the EU in global governance. If the EU fails to act, Mercosur and Brazil will turn elsewhere and hasten Europe's slide into irrelevance in South America. At the same time, the EU also needs to deepen existing free trade agreements with countries such as Mexico and Chile, as well as hasten talks over visa-free travel. The EU-CELAC strategic partnership provides a forum for the EU to reclaim the initiative, if it can muster the political will. As things stand now, the traditional 'Atlantic triangle' (US-Latin America-EU) risks being replaced by a new 'Pacific triangle' (US-Latin America-Asia).

As for the US government, its public position has been that it does not see a geostrategic threat emerging from China's rapidly growing economic leverage in Latin America. Yet, intentionally or not, by offering an alternative economic relationship, China has been driving a wedge through Latin America, with the southern part increasingly drifting away from the US sphere of influence. As Eric Farnsworth has noted: "In a post-Cold War world, where global competition is as much economic as military, the inability or unwillingness to contend for markets abroad has strategic implications".[14] US leadership in the region has traditionally been built around its geoeconomic nodality, that is, by being the core of economic networks in the hemisphere. As noted above, intra-regional economic links in Latin America have been weak. Instead, Latin American countries have been linked to the US, with many of the most important transport corridors and trade arrangements favouring economic interaction with the US on a bilateral basis. But as South America's economic geography shifts, with economic links increasingly running in an east-west direction and the region being tied closer together, the basis of this traditional US system of hemispheric leadership is eroding.

To revive its leadership in the region, the US would need to develop a new strategy for binding the region closer to itself. Such a new *binding strategy* cannot just revive the old hub-and-spoke system, but would need to pursue actual multilateralism where all Latin American countries participate as equal partners. Latin American governments have rarely felt like real partners with the US. But with them now being increasingly able to diversify their external relations and steer a course independent of the US, the ability of Washington to pursue its agenda and leadership in the hemisphere, especially in South America, depends to a large extent on partnering up with major countries such as Brazil.

The US also needs to revive its economic ties with other Latin American countries. In Central America, the US has started to engage more robustly, especially by advancing regional energy cooperation and investments. It has also markedly increased its economic aid programme. Importantly, having restored its diplomatic ties to Cuba, it has removed a constant problem in its hemispheric-wide diplomatic relations. However, in South America, the US has offered only meagre competition to Chinese funding and investments. With the political landscape having now turned more pro-American and pro-trade in South America, the US could revive its hemispheric-wide trade agenda. The 'spoilers' of the US initiative for a Free Trade Area of the Americas (FTAA) in 2005 – Argentina, Brazil and Venezuela – are all experiencing political changes, which are likely to lead to a re-examination of anti-free trade and anti-American perspectives. From a US perspective, an FTAA would help tie Latin America to the American-led liberal world order and make any soft balancing strategy against the US increasingly redundant. More than trade, an FTAA would thus serve the US's long-term strategic interests. As such, the US should be careful not to push too hard for its own economic self-interest when negotiating an agreement, but rather judge the merits of an FTAA from a larger strategic perspective in which it can be used to revive its leadership in the region.

Conclusions

By not engaging in geoeconomic competition with China in Latin America, Europe and the US not only risk being displaced economically, especially in South America, but also risk losing important political influence that may have repercussions for the future of the liberal world order. Europe and the US should see these Chinese activities for what they are, not only commercial in nature, but also strategic in

14 Eric Farnsworth, "Memo to Washington: China's Growing Presence in Latin America", *Americas Quarterly*, Winter 2012.

that they help increase Latin America's dependence on China. While China has thus far been careful not to be seen as a political actor in Latin America, its growing geo*economic* presence in the region provides it with the potential to wield considerable geo*political* influence as well. China's economic activities in Latin America have already weakened the EU's and the US's "structural power" in the region, namely their ability to control important regional organisations and power structures. The EU and the US urgently need to devise their own geoeconomic strategies towards Latin America, so as to be able to re-engage more deeply with the countries in the region. This may involve offering economic carrots to Latin American countries, which does not make immediate commercial sense, but which will help build longer-term strategic partnerships and cooperation.

Recently, the regional political situation has turned more in Europe's and the US's favour in this respect with a changing of the guard in key countries towards more pro-Western leadership. Europe and the US should now seize the moment and engage with Latin America on a more equal footing by offering actual multilateralism, in contrast to China's more bilateral approach towards engagement with the countries in the region. If China were so inclined, this bilateralism would allow it to use its preponderant resources to cement a hierarchical relationship in which Latin American states would become more dependent upon it. Inherent in such a bilateral approach is also the tendency to focus on reaping national benefits at the expense of mutual benefits. Instead, using a more multilateral framework, the EU and the US should offer their own economic carrots to the countries in the region and make a new push for inter-regional trade integration, paving the way for more mutually beneficial cooperation and long-term, collective gains. From the perspective of Latin America, this more multilateral approach would help Latin American states band together and base the relationship on reciprocity, instead of being exposed to the severe power asymmetries inherent in the current relationship with China.

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