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IS CHINA THE NEW NORTH?
ASSESSING THE IMPACT OF CHINESE TRADE WITH LATIN AMERICA

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P R O C E E D I N G S

MR. FARNSWORTH: I feel like I'm at church. Good morning, everyone.

SPEAKERS: Good morning.

MR. FARNSWORTH: There we go. Much better. Thank you.

Welcome to our program this morning on China in the Americas. It's a particularly auspicious day I think to be hosting this program because those of you who have been following the news know that our own Vice President Biden just got off the plane in Beijing today for a five day visit. So much of the world's attention is on China and the U.S. today. We want to focus a little bit of that spotlight on China and the broader Western Hemisphere, specifically Latin America today.

My name is Eric Farnsworth and I head the Washington office of the America Society and the Council of the Americas. And it's a real honor for me personally and for also for my institution to be able to partner with Brookings this morning on what promises to be a very important and relevant and timely discussion.

I want to thank the Brookings Institution for their willingness to host this program. In particular I want to thank Mauricio Cardenas, who leads the Latin America Initiative and, of course, is one of our presenters today. And I also want to take note of Diana Negroponte, who is a senior fellow with the Initiative and who has a certain connection to the Council of the Americas because our chairman is Ambassador John Negroponte. And the Latin America Initiative, together with the John Thornton China Center, is engaged in important cutting-edge work, some of which we're going to hear about this morning, attempting to understand Latin America's links with Asia and more importantly the implications of these linkages.

It's a multidisciplinary approach that is strongly encouraged by Brookings president Strobe Talbott, whom I first met in 1995 when he was the deputy secretary of state and we traveled together as part of the U.S. delegation to the inauguration of

Argentina's newly re-elected president, Carlos Menem. As part of that trip we also traveled to Brazil and Chile and we came back to Washington describing to the president and secretary of state the quiet revolution that was then underway in the region, a revolution underpinned by a new commitment to democracy and economic liberalization.

Emerging from the Cold War and beginning -- and building on the vision agreed by acclimation -- I repeat, by acclimation -- at the just concluded Summit of the Americas in Miami, it was a time when many believed the region had arrived at its own end of history. The time was ripe for Washington to solidify a partnership from a foreign and trade policy perspective. The United States faced no meaningful competition either commercially or in the promotion of its values, either from outside the region or from within the region itself.

But at the same time another revolution was underway halfway around the world, a revolution that would become more pronounced as the years went on. That was, of course, China's race for growth. And by now the outlines of the story are well known. China's 9.8 percent annual growth rate from 1979 to 2009, including an 8.7 percent growth rate in 2009, when much of the rest of the world faced economic collapse. Growth that has been fueled quite literally by inputs and raw materials for much of the developing world, including the commodities-exporting nations of South America. Trade and investment have grown exponentially. China is now Brazil's top trading partner as it is Chile's.

In my view, this in and of itself is no cause for concern. Trade with China has had positive short-term consequences for the commodities exporters of the region as their own macroeconomic growth has been bolstered. And nations such as Brazil, for example, are booming. And any of you who might have been to Brazil recently can attest to that fact as well. Nonetheless, there are a number of questions that call out for additional study and understanding. For example, what are the longer term implications

for the region of China's engagement? What are the patterns of trade and investment? Who is winning and who is losing? Is trade with China leading to development, innovation, and value-added production? Or primarily just short-term and perhaps unsustainable profits for some sectors. What are the impacts on macro level indicators, such as interest and exchange rates and the ability to manage effectively in a turbulent global economy?

More broadly, and here is where even more interesting questions arise, what are the values being promoted in Latin America through Chinese engagement with the region? Are they compatible with Western style democracy, including a media free from government intrusion; open markets, including transparency and freedom from unfair competition; social inclusion, including labor rights; and the rule of law, including anti-corruption? Or to put it as succinctly as possible, does China's growth revolution support Latin America's uneven but generally positive political and economic transformation toward healthy, open market democracy?

Increasingly, the picture is mixed, I believe. It's time to move beyond the honeymoon period in China's relations with Latin America and to try to discern what is really going on. In so doing we have the best chance to develop our own policies toward the region consistent with new realities while working toward an agenda that promotes mutual interests within the framework of the inter-American democratic charter whose 10-year anniversary we celebrate barely 1 month from today.

And to help us do that we have a stellar lineup of speakers this morning presenting new research that may well in time prove to be definitive. You have their biographic information in front of you so I won't go into that, and if I did we'd be here all morning because their backgrounds are very impressive.

We're going to begin with Mauricio Cardenas and then turn to Erica Downs for their initial presentations. And that's going to be followed by Mauricio

Mesquita Moreira, who will offer comments on their presentations. After a bit then we'll have the opportunity to bring in all of you for a discussion with the audience. This is an outstanding lineup, as I said, and I, for one, am looking forward to hearing what they have to say. So let's get it going.

Ladies and gentlemen, would you please join me in welcoming the head of the Latin America initiative here at the Brookings Institution, Dr. Mauricio Cardenas. (Applause)

MR. CARDENAS: Thank you very much, Eric. Good morning to all of you.

I'll be talking mostly during the next 10 minutes about the economic issues. And I hope we can engage in the discussion on these political questions that Eric just mentioned.

The points I'll be making today are all in a paper that is on the Brookings website on China and Latin America which basically conveys the following message: trade between China and Latin America has been booming since around the year 2000, and it has brought a significant amount of foreign exchange to Latin America. It's been a great opportunity for Latin America, especially in the commodity intensive sectors. But it's also had some side effects. And I want to emphasize some of those side effects.

Let me start with a few facts on the trade issues. In the year 2000, total exports from Latin America to China were $5 billion. Last year there was $91 billion. That is an 18-fold increase, which is -- at an analyzed rate is about 34 percent growth per year, which is more than 3 times the growth rate of China. So there's something special about these trade relationships after the year 2000. Before the year 2000, the growth rates were much smaller. You could say that growth in the trade figures between China and other regions of the world have also been quite high, but not as high as the case of Latin America, which means that something happened around the year 2000 which

triggered this fast growth. And I'll come back to what the possible causes are of that increasing growth in trade.

This means that in the year 2000 trade with China for most of the larger economies of Latin America was less than 5 percent of total trade, which is a small share. Today, as Eric mentioned, trade with China represents 25 percent of exports for Chile, 13 percent of exports for Brazil, and 15 percent of exports for Peru. That means that there has been a significant increase in the trade shares for the majority of these countries.

Another remarkable factor is that it's not only exports to China that have increased; it's also imports from China that have increased. And in the case of imports from China, Brazil now buys $25 billion per year from China; Chile, $8 billion; Mexico, $18 billion. So this is bilateral trade increasing.

Another remarkable factor about these trade figures is that in the case of exports from Latin American countries to China they are heavily concentrated in one or two products per country, whereas imports from China are much more diversified across a wide range of goods. So this pattern of concentration repeats from country to country. For example, in the case of Argentina, the largest export is vegetable products. In the case of Brazil, mineral products. By an order of magnitude larger than the second item in the export list. In the case of Chile, as we all know, it's copper. But it's essentially one commodity per country and this is quite remarkable.

So these are the facts on trade. Fast growth since the year 2000. More than with any other region of the world. High concentration in the case of exports from Latin America, and also high growth in imports from China in a wide range of products.

What have been the consequences of this for the region? The aspect that I want to highlight today are the consequences on the economic structure in Latin America. And essentially the main fact here is the rapid decline in the share of manufacturing in total output across countries in Latin America. Just to give you a few

figures, since the mid-2000s until last year the decline in the share of manufacturing output in total GDP in Brazil was 3 percentage points, from 16 percent to 13 percent. In the case of Colombia and in many other countries in the region it was around 2 percentage points, from 14 to 12 percent.

So this is a significant change in terms of the structure of production. Which sectors have expanded in Latin America? I think the most remarkable change is the rapid expansion in the services sectors. The shares of output in the services sector have increased in every single country but it's more remarkable the increase in the share of employment in the services sector, which for countries like Argentina, Brazil, and Chile has been on the double digits. Just to give you an example, the share of employment in Argentina has increased by 13 percentage points between the year 19990 and 2005.

Well, these changes in the structure of the economy could mean anything and they could be positive changes if the increase in production and unemployment in the services sector implied greater productivity. But it's just the opposite. Productivity or output per worker in the services sector has declined and it's much lower than in the manufacturing sector and in the mining sector. So the decline in output per worker in the services sector has affected overall aggregate productivity in Latin America and this is an unintended side effect of the primary station or commodity station of Latin America.

Now, what about the future? What about the prospects of trade between Latin America and China? I think there is one key question to answer here and it is what's going to happen with the demand for commodities from China? And in answering that question we have to consider two elements. One is the income elasticity of the demand for commodities. How much additional demand for commodities is generated by each additional unit of output in China? And the second question is the overall growth rate of China in the future.

In terms of the income elasticity or the intensity in the use of commodities, history provides some lessons. Countries that have gone through similar phases of development have experienced declines in terms of the intensity in the use of commodities and this changes from commodity to commodity. For example, one key element of the demand for commodities from China is associated with the rates of urbanization. And this, of course, is related to the migration from the rural sector to the fast growing cities of China.

Based on historical evidence one can argue that once China reaches per capita income of around $13,000 per year in purchasing power parity terms, the demand for new housing will tend to stabilize. Historical evidence -- and this could happen in China, by the way, in the year 2015. The demand for base metals, essential iron ore, tends to stabilize at the per capita income levels of $15,000 per year, which in China could happen in the year 2020.

Other examples abound. For example, the case of soybean oil which tends to stabilize at a per capital rate of 45 kilograms per year, which is something that China can achieve within the next decade. So that means that at that time soybean oil will be replaced with other vegetable oils, like sunflower or olive oil. This is what happened, for example, in the case of Korea. And there are other considerations which are supply considerations. At the same time that the demand will tend to stabilize or the intensity in the use of commodities will tend to stabilize, supply will continue to increase because as we're going to hear from Erica, the Chinese have been very active in engaging and investing in the production of these commodities. And of course, the high commodity prices have also triggered greater investment in these sectors, especially in Latin America and Africa. So this means that we'll also have to factor in the fact that supply will increase.

And lastly, there is also the issue of overall economic growth in China.

It's not just the elasticity. It's not just the intensity in the use of commodities. It's the overall growth rate in China. And it is natural to expect that as the level of income increases, also the rate of growth will decelerate. And this is essentially what the Chinese authorities have also told us in their Five-Year Plan when they now have a 7.5 growth rate projected for the next 5 years.

And in the case of China, the overall deceleration in growth could be even faster essentially because China is a society where as a result of the one child policy will have very high dependency rates very soon. And those high dependency rates mean lower savings. And also China is an economy that has a very large share of employment in manufacturing which is high productivity, and as incomes grow services will also expand and services as we know have lower productivity. So this could factor an additional limit to the deceleration growth in China.

And one extra point that has been emphasized by Nouriel Roubini, whom you know predicted the global recession, is that China's high investment rates in the past few years have resulted in idle capacity in many sectors of the economy and those high investment rates cannot be sustained for too long.

So the message is Latin America cannot count on fast growth in terms of demand for commodities from China forever. And this, of course, means that there are some policy challenges that Latin America has to face and I think it's about right to begin thinking about these questions now as these fast growth in commodity exports and the high commodity prices may not last forever. And Latin America has to begin thinking about ways to generate growth that are more indigenous, that rely more on its own forces essentially with the expansion of the middle classes and the demand for manufacturing and services.

So these are the questions that we deal with in the policy section of the paper. How can Latin America prepare for these new phases? And one way of

preparing is investing the current boom in activities that will generate enough human capital and physical capital to make sure that there will be an expansion in sectors that can take the lead in terms of economic growth once the current boom in commodities recedes. And these are, of course, activities that are related to more engagement in terms of research and development and the expansion of sectors that can rely, as I said, on the demand that will come from the larger middle classes -- the larger size in the middle class in Latin America.

How has Latin America done in terms of investing this recent boom in those activities? What we show in the paper is that the record is mixed. Some countries have been able to use these resources to expand investment, which is positive, but still too many countries in the region invest too little in research and development. And in the generation of new sectors that can replace the expansion of commodities.

So I'll just end by saying that although this has been a great decade in terms of opportunity, the tailwinds from China have certainly had a major impact in Latin America in terms of economic expansion. These tailwinds are not going to last forever. Some people argue that India can take the lead in terms of the demand for commodities but we all know that India's growth strategy depends much more heavily on sectors like the technology sectors and IT which rely much less in commodities than China's growth in the past few years. China's reliance on heavy industries has been a critical element for the expansion in the demand for commodities.

So these are some policy issues that are a challenge for Latin America to prepare for this new phase where alternatives to commodities have to be found and where the recent decline in manufacturing output, the recent decline in export of manufacturing goods that do not rely on commodities or are not resource-based is not a good signal because in the future Latin America will have to reverse that trend and expand again its exports of manufacturing.

This means that contrary to many views in the region, China will not provide all the answers for the development of Latin America. Some of these answers rely on hemispheric trade and the possibility of greater economic engagement between the United States and Latin America but also on greater intraregional trade within Latin America. Those will be necessary elements in a more comprehensive development strategy for Latin America. Putting all the bets on trade with China will probably not result in very favorable outcomes. And this is essentially the message that we want to convene in these papers. So I'll end with this. (Applause)

MS. DOWNS: Good morning. I'm going to focus on another aspect of the growing economic engagement between China and Latin America, and that is the emergence of China Development Bank or CDB as an important source of capital for governments and companies in Latin America.

My remarks today are going to be based on my recent study, Inside China, Inc., which like Mauricio's paper is available on the Brookings website. And the study examines most of the $79 billion worth of energy export revenue-backed loans that China Development Bank extended to governments and companies in Brazil, Ecuador, Russia, Turkmenistan, and Venezuela since 2008.

Now, this is a story about how the Chinese government and Chinese firms interact to execute cross-border deals. However, it's also a story about China and Latin America because more than half of those energy-backed loans have gone to borrowers in the region. For example, the government of Venezuela has borrowed more than $32 billion from China Development Bank since 2008.

So what I'd like to do in my remarks today is to briefly address four questions. The first one is who is China Development Bank? The second one is how are China Development Bank's energy export revenue-backed loans structured and implemented? The third one is what do these deals tell us about how the Chinese

government and Chinese companies interact in the execution of cross border deals? And finally, the fourth question is what are some of the implications of China Development Bank's activities in Latin America for the United States?

So to start, who is China Development Bank? The short answer is that China Development Bank is a wholly state-owned bank that aims to profitably support China's national interests, including supporting the international expansion of Chinese firms and securing energy and natural resources. CDB was one of three policy banks established in 1994 to free China's Big Four state banks to lend on a commercial basis. And although CDB began its life as a piggybank for the government's pet projects, such as the Three Gorges Dam, it has evolved into a much more commercial and international institution under the leadership of Chen Yuan, who has run the bank since 1998.

And today, CDB is the bank in China with the lowest nonperforming loan ratio, and it's also the Chinese bank with the largest portfolio of outstanding foreign currency loans. In 2010, CDB's outstanding foreign currency loans totaled $134.6 billion and that exceeded the total amount of outstanding loans of the World Bank.

Since the global financial crisis struck, CDB has substantially increased its global business portfolio primarily through its efforts to leverage its considerable financial resources to secure energy and minerals.

And this brings me to the second question I'd like to answer, which is how CDB's energy-backed loans are structured and implemented. All of these loans are secured by revenues earned from the deliveries of oil at market prices to Chinese national oil companies with the exception of the loans to Turkmenistan, which are secured with deliveries -- with revenue earned from deliveries of natural gas at undisclosed prices. And I'll use the case of CDB's loan to Petrobras to illustrate how this works.

As some of you may know, in 2009, CDB agreed to lend Petrobras, the

Brazilian national oil company, $10 billion. Petrobras is securing this loan with revenue it earns from delivering 200,000 barrels per day of oil to a Chinese oil company, Sinopec. And when Sinopec takes delivery of this oil it deposits the money it owes Petrobras for that oil into an account that Petrobras holds at China Development Bank and every month CDB withdraws the interest, principal, and other fees it is owed from Petrobras' account.

In addition to this loan, other energy backed loans made by CDB to borrowers in Latin America include two loans totaling $3 billion to the government of Ecuador and four loans totaling $32.6 billion to the government of Venezuela.

So this brings me to my third question. What do these deals tell us about how the Chinese government and Chinese companies interact to execute cross border deals. Now, much of the media reporting on these loans portrayed them as the work of China, Inc., as China Development Bank, the Chinese government, and China's national oil companies working closely together in a highly coordinated global pursuit of energy. This, however, is only part of the story. And the main argument that I make in my study is that CDB's energy-backed loans are the product of coordination between the bank, the oil companies, and the government but that this conclusion is subject to two important caveats. The first caveat is that each of the actors involved had their own interests to pursue, including profitability. And I'll run through these quickly.

For CDB, the interests include making money, expanding its global business portfolio, and maintaining its privileged position in the banking system. For the Chinese government their interests include energy supply security, foreign exchange diversification, and export diversification. And on this last point what I mean by that is that if you look at the $20.6 billion loan that the bank extended to Venezuela last year, half of that is denominated in Chinese currency so that locks the borrower, the Venezuelan government, into spending $10 billion on goods and services from China and

so that creates export opportunities for firms in China.

Similarly, if we look at the $10 billion loan to Petrobras, although that is wholly denominated in U.S. dollars, reports indicate that $3 billion of that was earmarked for the purchase of oil equipment from China. So again, export opportunity for Chinese companies.

And finally, for China's national oil companies, the big prize, of course, is upstream assets. If you look at the countries that have borrowed from CDB, they control some of the most important sources of future oil and natural gas supply growth in the world and having the opportunity to help develop these resources if they were to arise is attractive to the national oil companies.

And the second caveat to my conclusion that this is highly coordinated activity is that coordination is not synonymous with top down decision-making. And again, CDB's loan to Petrobras illustrates this point nicely, that this loan was actually the product of CDB's efforts to get business in Brazil starting in the mid-2000s. And it started out as a deal just involving CDB and Petrobras. However, according to Chen Yuan, the man who heads CDB, once China's leader has learned about the deal and decided that it would make a good diplomatic deliverable for then-President Lula's visit to Beijing in May 2009, then the government lent support and it became what Chen Yuan calls a national project.

In contrast, CDB's loans to Caracas all appear to have originated and developed within a government-to-government framework. And I suspect that CDB is probably very happy to have Beijing involved for risk management purposes given the large size of the loans it's made to Venezuela.

And so finally, this brings me to the last question that I'd like to answer which is what are some of the implications of CDB's activities in Latin America for the United States? And here there are three that I'd like to discuss.

The first one is that CDB's loans to Venezuela in particular indicate that the bank is concerned about economic policymaking in recipient countries. And I bring this up because for those of you who followed Chinese lending practices, you'll know that sometimes they differ from those of more established multilateral and bilateral donors in that a lot of Chinese lenders have not emphasized things such as combating corruption, fostering transparency, or raising environmental standards to the extent that some of these other donors do. And moreover, many Chinese loans are tied to hiring from China or buying from China. However, CDB's loans to Venezuela indicate that the bank, like some of the more established multilateral and bilateral donors does aim to promote good economic decision-making in borrowing countries. And one piece of information that supports that is that after the framework agreement -- so not the final agreement but the framework agreement for the $20.6 billion loan was signed last spring. A 30-person Chinese delegation consisting of government and industry officials traveled to Venezuela and they spent 18 days there. And part of that trip -- well, part of the purpose of that trip was to assess Venezuela's resource base and just to confirm that the country did indeed have sufficient resources to secure the loan. I suspect it was also about looking for projects that Chinese companies could do to help implement that loan.

But another thing that happened on that trip is that the Chinese delegation drafted 10 plans for the Venezuelans aimed at helping them to reform and grow their economy. And these plans covered things such as price stability and improving the environment for foreign investment. And when the delegation got back to China, one of the co-heads did an interview in which he said, you know, if the Venezuelans implement these plans, you know, they'll be able to grow at more than 8 percent a year just like China. Now, I don't know whether that's true but I think that this anecdote does indicate that the bank is taking steps to ensure that its loans are repaid.

The second implication I'd like to discuss is that these loans are

supporting regimes in Latin America that are not terribly friendly towards the United States. In particular, the loans are both during the administrations of Hugo Chavez in Venezuela and Rafael Correa in Ecuador. I don't see empowering these regimes as CDB's objective. Nonetheless, the bank is supporting them by serving as a lender of last resort to their governments, whose difficulties accessing international financial markets because of risk perception and their reluctance to deal with the International Monetary Fund have left them with few alternatives to Chinese banks for external sources of capital. And it's also worth noting that both administrations are using the money that they receive from CDB to address key political vulnerabilities. For example, in Venezuela, the money is being used to finance housing projects and power plants and so on and so forth.

And finally, the third implication that I'd like to discuss is that the increase in Venezuela oil deliveries to China to secure these loans is unlikely to undermine the security of American oil supplies. First, the oil market is global. If the U.S. imports less form Venezuela, it can simply import more from other countries, including nearby ones like Brazil and Canada. It's also unlikely that Venezuela will quickly ramp up oil exports to China because of transportation and refining issues. The United States is a lot closer to Venezuela than China is, and the U.S. has substantially greater capacity to handle Venezuelan crudes.

In support of that it's interesting to see what the Chinese oil companies are doing with the oil they get from Venezuela. And specifically, there's a big gap between the amount of oil that PDVSA delivers to China oil to secure these loans and the amount of Venezuela crude that actually flows into China. And I suspect that China oil is taking a substantial amount of the oil that it receives from PDVSA and storing or selling that in the Americas.

And I'll stop there. Thank you. (Applause)

MR. MOREIRA: Good morning. Thank you very much for the invitation. It's a pleasure to be here. I'm about to have an anxiety attack because I have 10 minutes to comment on a paper and a book. So I'll try to, you know, go quickly through those two pieces of work.

Let me begin with Mauricio. I am an economist so I'm probably going to weigh more heavily on Mauricio's paper than on Erica's. But I'll try as best as I can to balance the comments.

So let me start with Mauricio. I very much enjoyed reading the paper, seeing him touch on several of the trillion-dollar questions which policymakers in the region are facing these days. And let me quickly summarize his arguments.

First, this idea that China's emergence is leading to a reversal on LAC's structural transformation as shown by a decline in the share of manufacturing in GDP. Second, the decline in manufacturing share is leading to a negative productivity shock in the sense that money, resource, employment is flowing to low productivity sectors. The third argument is that China's demand for natural resources is likely to fizzle out in 10 to 15 years as shown by the experience of other countries, particularly from other Asian countries like Japan and Korea. And finally, LAC needs -- Latin America, LAC for short -- needs, you know, industrial policies to reverse this structural shift. So let me comment on each of those arguments hopefully briefly.

Falling share of manufacturing. Falling share of manufacturing GDP. I think when we look at those figures we have to take into account that manufacturing overshooting in Latin America during the import substitution years and if you look at the end of the '80s, early '90s, there was much more manufacturing in the region than was supposed to be. I mean, Brazil, my country, is a clear example. The share of imports in total domestic consumption in the early '90s was 5 percent which is close to the Soviet levels. I mean, it was as if people didn't know that, you know, didn't read Smith or

Ricardo. There was this idea that you need to produce everything. So it was inevitable and desirable that we would see a decline in the share of manufacturing in most countries in the region, particularly in the largest countries where, you know, industrialization went further like Brazil and Mexico. We also have to take into account that there's this so-called Engel's Law and as incomes grow people demand more services, productivity and services lower so they need more people to do the job. So you're bound to see an increase in the services sector.

So there are many factors behind this decline that we need to take into account. But I don't dispute the fact that China has been playing a part. I'm not sure we can pin down exactly, you know, the contribution of China but I do think that what I usually call the scissor effect, I mean, the fact that China is raising commodity prices and lowering manufacturing prices at the same time, is clearly hurting manufacturing in the region.

The second point, productivity -- negative productivity shock. I'm definitely not comfortable with this idea because the implicit assumption is that we have this wonderful manufacturing sector, you know, in the early '90s before opening up the economy and then when we open up, for some reason manufacturing shrunk and then, you know, resources flowed to lower productivity sectors. If we measured productivity in manufacturing on those days, on those closed economy days, probably productivity would be negative. I mean, if that's possible because people usually measure those productivities. They take into account local prices which were, you know, jacked up by 100 percent, 200 percent tariffs. If you measure productivity at those days at international prices, you would probably see that many of those sectors weren't adding any value at all.

So the idea that after you open up, you know, there was a negative productivity, shock for me, I mean, it doesn't make much sense. Quite the contrary. You

saw after opening up, thanks to more competition including later on Chinese competition, was a productivity gain. You got rid of all those sectors. The car sector was clear to give you a concrete example. To produce a car that cost twice the price, twice the international price, you're not adding, you know, much value in international terms, which is the way you should be measuring opportunity cost. So I think the idea of a negative shock really troubles me.

Third point, Chinese -- the China demand. The China demand is going to fizzle out. I mean, I'm the one -- one of those that believe that China cannot continue to grow at current rates. I mean, even before Roubini was saying, I mean, for me it was always hard to understand how a country can for more than two decades invest more than 50 percent of GDP. I mean, there's clearly not enough projects -- profitable projects to sustain this rate. So it's going to slow down inevitably, sooner or later, particularly in an environment like, you know, the world economy these days with the U.S. and Europe stagnating. So I agree that there's going to be a slowdown. What I don't agree is this idea that, you know, this would lead to a decline in the relative price of commodities.

Now, I agree also that there's going to be income and technological effects. I mean, China is going to reduce its intensity, you know, of metals and things like that, but I don't think that looking at the past, looking at countries like Japan and Korea that have less than 10 percent of Chinese population, you can learn much from that. I mean, either China or India, we are talking about a billion-plus economies sitting in small pool of land and water. So I mean there's no precedent. There's no leading economy in either the U.S. or the U.K. or whatever that can tell us when exactly this, you know, demand, this demand intenseness, intenseness for natural resources is going to come down.

My hunch, this is, you know, you can't say much more than an educated hunch is that this is going to take much longer to stabilize. So we are bound to see, you

know, a trend. I'm one of those that believe in the super cycle and the increase in commodity price since the early 2000s. This is -- I believe this is going to be a long-term trend. You're going to be declining in manufacturing prices and increasing -- of course we've a lot of volatility but I believe this is going to be a new trend. I don't dismiss India at all. I mean, it's true that India has, you know, has been growing in part because of services, IT services. But the IT services are 1 percent of their employment. You know, if they want to reduce their 40 percent rate of poverty they have to go into manufacturing. They're going to go into manufacturing or else. So they're going to be doing -- and they are in an even worse situation than China in terms of resources. I mean, they literally don't have land. They don't have water. So even if they don't demand metals, they're going to be demanding a lot of food from Latin America.

Finally, the industrial policy thing. And here let me try to be polemical and blunt. I don't think that China -- with China, India, and the rest of Asia in the game, the region stands any chance of becoming a major exporter of manufacturing goods. I think this window is closed with a very few exceptions. I mean, Mexico, some countries in South America for, you know, transporting intensive goods, time sensitive goods. I think there's clearly an opportunity there but to think that the region can reproduce what happened in Asia in terms of being a major exporter, having manufacturing exporters as a driver of growth, I think this is not in the charts anymore.

And the comparative advantages of Asia, competitive advantages are overwhelming. So in this context, I mean, it doesn't make sense to lean against the wind and insist with industrial policy particularly because we don't have a good record. I mean, the Asians do those things very well but, I mean, what has been done in the past hasn't been much successful. We have wasted a lot of money on these kinds of initiatives.

So now turning to Erica, hopefully not using too much of my time. Just a

little bit. So I found Erica's book fascinating and a little bit scary. Erica was more concerned with the implications for the U.S., but you can also see, you know, in her work the risks that the region faced with its relationship with China.

Now, Erica suggested the motivation behind China's investment is a mix of commercial and strategic interests, and I see risks on both counts. I think, of course, the region has to balance the benefits of adding fresh resources to expand its supply of natural resources but, you know, of course there are risks of selling its assets to its main clients. I mean, you're going to open up the possibility of practice such as transfer pricing which can very quickly whisk away the rents that those countries could be enjoying.

And on the strategic side, you know, again, if you have -- if you keep accepting a lot of financial favors from China on the count that, you know, strategic interests of the Chinese government, of course you're going to pay a price in terms of, you know, the freedom you're going to have in terms of defining your own foreign policy of pursuing your own strategic interests. So this clearly has to be on the table, at least on the balance.

And on a broader note, with that I conclude, this is something that always comes to my mind. This very aggressive stance of the Chinese state in terms of pursuing commercial and strategic interests raises a lot of questions on how the region should respond to that, particularly in terms of competition and manufacturing, something that worries Mauricio a lot.

So what are the options? I mean, to try to do the same thing. I mean, increase the size of states, start subsidizing a lot of those interest-peaking national champions, nurturing your own state companies, sort of a tit-for-tat kind of strategy, you know, again, my country seems to be pursuing lately. Or perhaps they should be taking a more aggressive foreign policy against state intervention or international trade. I have no doubt that the region has a lot to lose in terms of pursuing the first strategy. Again,

the point I made before, I mean, our experience with big government industrial policy has been no short of, you know, very problematic and, you know, you -- even if you could have a very efficient industrial policy you cannot match the resources of the Chinese government.

So there's a very old saying. I think it's a Brazilian saying that the little guys like the police, you know, the little guys like regulation. So I think we are much better off if you have an environment, international trade environment where those kinds of practice of state intervention, subsidies is not just from China, from a lot of places as well, you know, it will be much more productive and beneficial for the region than trying to go for a tit-for-tat strategy. Thank you very much. (Applause)

MR. FARNSWORTH: As we're waiting for our colleagues to get mic'ed up I have to tell you after those presentations I had about 15 questions for you, Mauricio. And then after Erica spoke I changed those questions to different questions. And now after the other Mauricio spoke now I -- there are so many things on the table here that I think we could pursue and I know all of you want to pursue as well. We don't have unlimited time, unfortunately, but we do want to jump right into it.

You know, Mauricio Cardenas, you spoke very eloquently I think about some of the changes going on internally in economics, particularly in the commodities-exporting nations of South America. And I should emphasize that you weren't talking about countries, for example, like Mexico maybe or the Central American countries but rather the commodities exported primarily to China.

Let me broaden this out just a little bit and talk about global trade negotiations because Latin America, specifically Brazil, specifically some other countries of South America, have taken very strong positions in the WTO context about what they want to see advanced in those discussion and what they're not willing perhaps to really come to agreement on at this point. But based on your analysis of how some of these

economies are changing from manufacturing to services perhaps, are there implications there in terms of the global trade negotiations, the Doha round? Would you anticipate more emphasis, for example, on services as a negotiation platform, for example, for the Brazilians or somebody else? And you've been a trade negotiator with Colombia. So how do you see that? Put on your trade negotiation hat for us.

MR. CARDENAS: Well, I think the question of deindustrialization, the fact that the manufacturing sector has been declining in terms of its share in total output and employment is a major concern. It's something that politicians talk about. It's something that worries people because the main point here is that there are not enough good paying employment opportunities in Latin America. You see we talk a lot about how Latin America weathered the crisis so well and Latin America is growing relatively fast these days. But if you look at the employment figures, they still show problems. There's high unemployment, in countries like Colombia, 10 percent. A country that is praised by everything else, everything else in the economy looks good but the unemployment rate is 10 percent. And the reason for this is that these commodity intensive sectors, especially in the minerals and oil, are not generating enough jobs.

So politicians need to respond to that. And one possible response is policies that will expand the manufacturing sector, the services sector, to generate more jobs. And of course, trade in those areas is so important. That's why, for example, countries like Colombia or Panama put so much emphasis on the need of a free trade agreement with the United States. But that's just one part of the trade agenda. There is also the multilateral trade agenda in which these countries promote the idea of expanding markets as essentially reusing subsidies. And I would say that the one sector that is the target of these negotiations is the agricultural sector where it's important for countries in South America to be able to access the markets of Europe, the market of the United States, with products such as ethanol, for example. But not just in that particular case.

So this is why the trade agenda is so important.

I think at the end of the day the key concerns here are more employment opportunities and also more diversified trade, not just in terms of the number of products that are exported but also in terms of the number of countries that these countries in South America engage with in terms of trading opportunities.

MR. FARNSWORTH: So taking some of that and bringing the spotlight now domestically to some of these countries, Latin America traditionally has done a relatively decent job of creating jobs but many of them have been in the informal economy, not the formal economy. So you see a lot of service jobs, but you don't see them with the protections of the state, social security, health care, any of that. Do you see implications here, based on your analysis, for changes in, for example, labor codes, in some cases, which have been around for decades if not centuries? Or government policies domestically that this new external actor is encouraging changes domestically in South America?

MR. CARDENAS: Yeah. Well, it's not a coincidence that with the expansion of the primary sectors and essentially the exports to China there has been this rapid increase in the services sector. And if you look at the services sector, some of it is the modern sector -- the financial services for example -- but the majority of the expansion in services is in areas where you see things like personal services or retail where informality is a big issue. So that's one element of the side effect of the expansion of the commodity-intensive sectors which is that a big share of the employment is in informal services. So you essentially have economies, and this is the picture I want to portray. You have economies with very modern facilities to produce the minerals or the one or two agricultural exports or oil. Those resources are recycling to the entire economy and end up generating employment in sectors with very low value added. Many of those jobs are informal. So this is not a balanced economic structure. And I

think this is the issue that needs to be resolved.

MR. FARNSWORTH: No, thank you. And I'd love to explore that in greater detail. Perhaps we can do that with some of the members of the audience.

Erica, I want to turn to you and ask a very blue sky type question. You presented an analysis of coordination, maybe not perfect coordination but coordination nonetheless and strategic thinking of the Chinese approach into the hemisphere. Obviously the optic there is China is doing what China perceives to be in China's interest, but there are implications, as we've heard from both Mauricios for the region itself. But let me ask you, does China take note of some of the things that are occurring as a result of its engagement in the region? And more to the point, does it care? It's a bit of a loaded question, no doubt. No doubt. But what does China see as happening based on its own engagement? And do you see that changing based on the political question of the Chinese saying, well, there are implications here and we need to take note of them.

MS. DOWNS: Okay. Well, I have to start by saying I feel a bit deceived because you had promised me easy questions before we got on stage. To answer your question I'm going to take the case of, again, of Venezuela. And one thing that struck me there and that made CDB's activities in Venezuela among the most interesting that I studied is that the bank is very -- as I mentioned in my remarks -- is very concerned about getting paid back. And I think that 20 point -- even though the bank's loans now total, you know, $32.6 billion, the biggest loan was the $20.6 billion loan that was extended last summer. And it seems to me that the bank was -- the China Development Bank, you know, was sort of very careful in thinking about how that loan was going to be dispersed and what types of projects that the loan was going to be spent on. And I think this had to deal with the fact that the bank was aware that this loan has a 10-year term and that Hugo Chavez, you know, may not be -- there's a possibility that he may not be in office when -- he may leave office before the loan is repaid. And so I think there was a

big effort on the part of the bank to make sure that the projects that the loan is supporting are ones that are perceived as helping the country as a whole and not just the administration of Hugo Chavez.

And so there is an effort, I think, to make sure that projects were chosen that could be seen as benefitting the country as a whole, such as building power plants to help combat some of the blackouts that have been plaguing the country, to build housing. There's a big housing crisis of affordable housing around Caracas. I ask my colleagues who know more about the country to correct me if I'm wrong. And I think that there is a recognition that they, you know, by virtue of making these big loans, you know, some of which have relatively long terms, that they're in there for the long haul.

And so I think that there's an effort -- there's more attention being paid to how those loans are sort of being perceived in the country and what can they do to make sure they're being, you know, perceived in a way that if there is a change in administration, a change in government before the term is up that whoever succeeds Chavez will be just as willing as he is to repay the loan. And I should add that so far there haven't been any repayment problems with payments from Caracas on the loans that CDB has extended.

MR. FARNSWORTH: And based on that and based on the analysis that you gave in your presentation about -- it was really interesting to me. You said that it was a coordinated approach but each of the actors does have their own interest. And to this point, those interests have largely coincided. Do you see over time that those interests might diverge, for example, the bank with perhaps some of its private sector clients internally? And if so, what might be some of the implications for that? This is another easy question, I know. I'm asking Erica to speculate and maybe that's not fair but this is tremendously interesting to me because as a student of Latin America and the Western Hemisphere and U.S. policy there it's difficult sometimes to ascertain or to view a

strategic approach to this region. But the Chinese are certainly changing that model a little bit. And do you see that as sustainable over time?

MS. DOWNS: I think in terms -- I think the question of will interests diverge is an interesting one. So often if you look in the background of some of these deals, even though there are a lot of interests that overlap, sometimes there are ones that are not. It seems to me, you know, if there -- if any of these deals -- if there is a repayment problem, do you see interests diverging? And one example of that -- I'm actually going to go outside the region to make this point -- as I mentioned in the introduction remarks, one of the case studies that I looked at in my volume were loans to Russia. In 2009, right around the time that the bank made its loans to Brazil and one of its loans to Venezuela, it loaned $25 billion to two Russian energy companies. And I think the big prize, certainly from the Chinese government's perspective of these loans, is that they are finally going to get this cross-border oil pipeline that they had spent 15 years negotiating.

But what we see, you know, if we fast-forward to today what's been going on is that the Chinese oil company that's involved in the loans for oil deal with Russia which is China National Petroleum Corporation, they've been involved in a multi-month squabble with Rosneft, the Russian oil company, over the transportation coefficient in the oil pricing formula for the supply contract that underpins the loans. And basically the Chinese are no longer happy with the transportation coefficient that they agreed to back in 2009. And so they're unilaterally taking action to, you know, pay the Russians less. And this is making the Russians unhappy. So here's a case where, yes, you know, the government might be happy in that they have their pipeline but, you know, the oil company itself is unhappy because, you know, once again they're in a battle with Rosneft over an oil pricing formula. So there are things like that.

There's also, I mean, the other thing that I think is interesting about the

loans with Venezuela and Ecuador is because these did not go to a national oil company, because these went to foreign governments, my suspicion is that these are loans where you had the state council, where you had sort of senior Chinese leaders involved in brokering the deal. And I suspect that these might have been loans where the government told CDB you're going to do this and CDB was sort of left to, you know, make the best of the hand of cards it was dealt. And so far, at least in the case of Venezuela, these loans have been paid back. But if there are, you know, repayment problems, you know, then what happens? I mean, I think that's probably why CDB is happy to have these deals occur within a government-to-government framework because there's probably expectation that any of these administrations will sort of think twice about stiffing Beijing, but you never know.

MR. FARNSWORTH: I think that's actually probably true.

It was, again, your analysis I thought was really interesting and the whole idea that China was structuring the loans almost the way a New York bank would structure them. They're worried about repayment. They're worried about obviously access to natural resources. There's an agenda there. There's no question about that but they want to get repaid. And this isn't charity. And it's different perhaps from the model one would have seen with other countries during the Cold War where it was politics first, economics second. Here you almost have -- correct me if you disagree but it's almost a reverse of that. It's almost economics and access to natural resources first and politics is nice and we want to maintain relationships with the Venezuelas and Ecuadors but also Brazils, also Canada and the United States, certainly. Is that an accurate summation?

MS. DOWNS: I think it's accurate. One thing that's worth noting about all of these deals is that these were not deals that were sort of structured on the back of an envelope that, you know, China Development Bank, you know, had hired top-tier

international law firms to advise it on all of these transactions. And, you know, but they've been -- the deals also included -- I think in the case of Venezuela and Ecuador and I think Russia that there's sort of binding third-party arbitrations so that, you know, if something goes awry it's, you know, it's the courts in the U.K. that will help settle the dispute. That it won't be Venezuela law or Chinese law; it'll be U.K. law.

So it looks like a lot was done, you know, from my perspective that China Development Bank did sort of do as much as it could to mitigate the risks involved in these deals in a number of ways, both in terms of who they hired to advise them, in terms of how the loans are structured. And finally, just in -- certainly in the case of Venezuela, and it looks like they're doing this in Ecuador now, too, with the most recent loan, and sort of being very careful in trying to make sure the loans are spent or at least the discussion of how these loans are spent is one, you know, that sort of indicates that they're there for the benefit of the people as a whole and not to support any one particular government.

MR. FARNSWORTH: Very good.

Well, Mauricio, you have commented on both analysts' presentations and I want to draw you out a little bit in terms of some of the comments you made as well. There -- one of the panelists -- forgive me, I can't remember exactly who it was; I think it may have been you -- mentioned that the resources that are coming into the countries are being spent on current needs. For example, housing and some of the things.

SPEAKER: Mauricio.

MR. FARNSWORTH: Mauricio. Okay, thank you. Supporting perhaps a political agenda of the recipient countries. And I guess my question would be we've talked a lot about sustainability. You've talked about sustainability and commodities prices and this and that. The question would be if you want to use these resources for their coming in from China, the ones that are not perhaps already locked into purchases

of Chinese products for export, that sort of thing, how could those resources be used in the domestic Latin America context to get to the next stage of development? For example, you have a pile of money for your natural resources from China. What could those governments usefully be doing to ensure that they are developing innovation, research and development? Getting to the next stage of development? You have just said perhaps that manufacturing is not the direction to go. So where should they be investing those resources usefully?

MR. MOREIRA: That's a good question. I mean, I definitely believe that there are a lot of risks. You know, this discussion about natural resource curse, I think it's not a myth. You just have to walk around the region to see that it's not a myth. So there are a lot of challenges there ensuring that, you know, these types of rents of resources don't corrupt the system, the institutions. So it's, you know, a precondition. If you can have a working democratic society government accountable with transparent, you're going to have a lot of problems, you know, with all this money coming in.

But then if you don't have that, I mean, you're not going to have any economic development anyway. I mean, it's, you know. But my concern is, and let me clarify. My time was short. I'm not saying that manufacturing is going to disappear in the region. I mean, it's going to remain I think as an important sector in most of those economies because the regional market's big enough. You have natural protection, you know, transport costs and things like proximity to the United States. So it's going to remain important.

What I'm saying is that this is not -- this is not going to be Asia II or Asia III. You know, the resources are not there. I mean, you can't compete with wages that are one tenth, one eighth of your wages. I mean, if you look at India it's even more. So, it's fine to lean against the wind but lean against the hurricane is sort of, you know, I mean, it doesn't make any sense. To use those resources, this money that is coming in

to try to subsidize the manufacturing sector, you know, exports of manufacturing goods and things like that, for me it's a waste of money. And this can lead to a lot of corruption as well. You know, which sectors you're going to, you know, it's easy to do that in a totalitarian regime but in a democracy, you know, you try to be selective. You start with two sectors. A week later you have five sectors. One month later you have, you know, you are subsidizing the whole economy.

So I think the best thing that they could do and, you know, Chile clearly is seen as an example of that, you know, is to try to channel those resources to, you know, one of the biggest weaknesses of the region which is education, science, technology. Because then, you know, you're going to be able to, you know, not just be stuck in basic commodity exports but to add value to those exports. I mean, I think that's the clear opportunity we have. I keep thinking, you know, not trying to challenge any U.S. interests right now but I'm saying if with the wealth of resources the region has, why can't they have companies like Mosant. You know, you look at the natural resources but you add technology sophistication to it, I think that's the most sensible way of investing this money. Otherwise, we're just going to be wasting this one more time.

MR. FARNSWORTH: Very good. No, that was very well said. Thank you very much.

We don't have a lot of time but I do want to go to the audience and bring you in. Why don't we take a round of three questions. We'll get as many of these as we can. Please keep statements to a minimum. In other words, no statements; let's go right to the questions. Right? Identify yourself by name and organization, please. If the question is directed to a specific panelist, feel free to direct it to them. Otherwise, we'll assume it's for the panel.

We'll go here to this first gentleman as well.

MR. SHULE: Yes, thanks. My name is Matt Shule. I'm from *Inside U.S.*

Trade. This is a question, two-part question for the panel, kind of alluded to in this Mauricio's remarks.

It seems that in the past couple weeks Brazil has come out with its own kind of new industrial policy and I was just wondering if -- well, it seems that this policy is mainly aimed at, you know, supporting these industries that have been really impacted by cheap Chinese imports. And I just wanted to get an assessment from the panel as to, you know, whether you thought that this policy was going to be effective or was a good idea? And the second part would be whether you think that we'll see more kind of policies like this in the countries in Latin America, either aimed at supporting domestic industry or in some senses using trade policy as a way to protect their markets from China? Thanks.

MR. FARNSWORTH: Thanks, Matt. Very good. There's a gentleman here on the aisle. No, the gentleman behind you. Thank you.

MR. MIKALUP: My name is Jordan Mikalup, McHale International.

This question might be hard but I would ask any of the panelists if they could comment on the environmental impact of this Chinese rush for commodities might cause actually in Latin America. I have interest in that.

MR. FARNSWORTH: Thank you very much. And there was a gentleman right in front. So, yeah. There you go. Right here.

MR. VINCENT: Hi. I'm Ken Vincent. I'm here from the Department of Energy. My question is for Dr. Downs.

Given that a lot of these heavy Latin American crude streams are pretty inefficient acquisitions for Chinese refiners, do you see that going forward being a source of tension in terms of the NOC's disposition to this sort of tripartite relationship?

MR. FARNSWORTH: Very good. Let's take those. Let's see how many of these we can get done. So to the panel, if you could also please keep your remarks

obviously substantive and answer the questions but as short as possible. We'll try to get another round of questions.

Let's go first to Mauricio Cardenas. There are some very interesting questions here: industrial policy, environmental implications, and then a question specifically to Erica about Venezuelan crude.

MR. CARDENAS: So let me deal with the industrial policy question. We've talked about industrial policy but when we think about industrial policy we think about the import substitution policies of the 1960s. We've created very inefficient operations and white elephants. Industrial policies have changed. Industrial policies have also learned from the past experiences. I think Brazil is a good example of some successful industrial policies. Think for example of the case of Ambriel in the production of aircraft. The idea behind this is investment in science and technology, research and development, where the government puts funds that can actually generate sectors where there is a competitive edge.

The reason (inaudible) industrial policies that you mentioned that was announced about two weeks ago in response to the competition from China in manufacturers and the employment consequences of that is related to a reduction in taxes for some sectors, especially the labor intensive like, say, the garments and shoes, et cetera. So this is a reaction by lowering taxation in sectors that are facing stiff competition from abroad.

Now, where I would disagree with the recent wave of industrial policies in Brazil is the use of subsidized lending, which is the key element in industrial policies in Brazil. There is the development bank, the BNDES, that lends to the private sector at a rate which is half the rate of the commercial banks. And in choosing which industries benefit from these subsidized loans there can be mistakes in terms of choosing the wrong industries just because of political connections, et cetera, et cetera.

So you have all kinds of industrial policies. Industrial policies are not necessarily bad. There are some good; there are some bad. I think what we have learned is that they are more horizontal in the sense that they're broad, that they're not selected at specific firms or industries but that they benefit the broad range of industrial sectors are the more effective ones. And the environment, I think countries in the region are aware of that. And legislation in terms of environmental regulations are becoming much more strict and there are limitations.

And if I just could mention one example which is the decision by the Brazilian government not to allow the purchase of land in the Amazon from foreign investors, I think that's a message in that direction in the sense that there is a concern and of course the region is very aware of the importance of protecting its environment.

MR. FARNSWORTH: Mauricio, any comments on either of those comments?

MR. MOREIRA: No, I think that Brazil's industrial policy is very much, you know, in the way that concerns me. I don't think that, you know, there are differences but there are a lot of things that are being done that are very much like the things we used to do in the '70s or even in the '80s. You know, it's going to have the same kind of problems. Even the tax reductions are sort of unfunded. Tax reduction, the Treasury is going to have to pay for that. And at the same time I don't see much action on the foreign policy side. So it's very much a decision to go for tit-for-tat, sort of an assumption we are in a world that now states compete so we also need to have our, you know, big states and, at the same time, very soft on criticizing, you know, the state intervention in international trade. And you can't do both. Either you criticize and try to reign in those sort of practices. Otherwise, if you try to intervene at the same time you criticize unfair trade, it doesn't work. So I don't think it's a step in the right direction.

MR. FARNSWORTH: Very good. Erica.

MS. DOWNS: On the question about Venezuela and crude flows to China, as I mentioned earlier, China does not have a lot of refining capacity to handle Venezuela's very heavy crude. And I think that because of that, that's why there's such a gap between what Chinese custom says China is importing from Venezuela in terms of the number of barrels per oil and what PDVSA is delivering to China oil to secure the loans. And so I think what explains the difference is that this oil is being sold or stored in the Americas simply because it can't be processed in China.

That being said, as you may know, China National Petroleum Corporation and PDVSA have signed, you know, an agreement to build a joint venture refinery in Guangdong province in Southeast China to handle Venezuelan crude. It's a 400,000 barrel per day refinery. The project is progressing very slowly.

I think there have been some disputes between the Chinese and the Venezuelans about how much of the oil is going to be upgraded in Venezuela and then how much, you know, for the refining is going to be done in China. But if this project does eventually get off the ground then I suspect we probably will have 400,000 barrels per day of Venezuelan crude going to China because that's a pretty inflexible crude stream. And if they build the refinery, presumably they're going to want to run it. You know, but until that happens I think we're going to continue to see, you know, Chinese companies taking delivery of Venezuelan crudes and selling it or storing it in the region.

I think that same thing is going on with Ecuador as well. That if you look at what Chinese customs data says they're getting from Ecuador and then you look at what Ecuador has -- Petro Ecuador has agreed to sell China to secure its loans, again, there is a big gap. I think it's worth noting that when Petro Ecuador and Petro China sign their loan agreement to support I guess the $1 billion loan, there was a lot of sort of anger in Ecuador because that supply contract reportedly did not include a clause that said Petro China cannot sell the oil it gets from Petro Ecuador in the Americas. And the

concern there was that Petro Ecuador was going to be turning Petro China into a competitor and that now Petro China will be selling Petro Ecuador's crude in the same places that Petro Ecuador wants to sell it.

So I think that until, you know, until that refining capacity is online and China, if that happens, you will continue to see the Chinese oil companies as major sellers and storers of oil in the Americas.

MR. FARNSWORTH: But here's an example if the refinery actually is built in Guangdong that --

MS. DOWNS: If it's built. Yeah.

MR. FARNSWORTH: If it's built this actually would seem to be at least one example of where politics is superseding economics because the economics of that don't seem to work.

MS. DOWNS: Well, the other issue there, I mean, I think one question I have that I don't know the answer to is that any volume of oil, if you ship enough of it it's going to be economic. I don't know what that volume is in the case of Venezuelan crude to China.

And the other thing to keep in mind I think in this case is also what's going on domestically in China and the issue of competition between CNPC and SINOPEC for market share in China, that Guangdong province is where SINOPEC, CNPC's domestic rival is dominant. And so CNPC is very eager to increase its market share there. And so I think building this refinery in Guangdong is one way to do that. So sort of domestic competition for market shares are also coloring what's happening, you know, in this particular case. And it also covers other things that the companies do overseas as well. So that's another part of the JV refinery story.

MR. FARNSWORTH: Very good. I think we've got -- well, I don't know. Do we have time for another round?

SPEAKER: Yeah, (inaudible).

MR. FARNSWORTH: He's the boss. So we'll go here, to the lady here, and then there's one right behind her. That might do it I think. Well, maybe we can sneak in three. All right. Go ahead.

MS. GILBERT: Lauren Gilbert from American University.

My question would, I guess, presumably be mostly to this Mauricio. But fundamentally, assuming if we take your thesis that Latin American trade cannot be based on the East Asian model, that it simply won't compete, then what would you say to other models such as services models like -- services-led models such as India's or perhaps Israel's? They seem to have a little bit more stable or a little bit of a better analogy to the situation of the Latin American countries.

MR. FARNSWORTH: Okay. Very good. There is a question right behind her as well. The gentleman.

MR. ZANG: Thank you. Jack Zang, Eurasia Group. My question is I guess to any panelist who wants to speak on the future of Chinese overseas investment, specifically do we see an expansion of private sector actors investing in Latin America? And to protect its market share in Latin America in terms of exports, do you see Chinese companies perhaps creating factories or buying out Latin American competitors in order to both provide employment but also to maintain market share? Thank you.

MR. FARNSWORTH: Very good. That's an important question.

Let's go here to Barbara and maybe -- right here. Barbara, raise your hand. There we go.

SPEAKER: Thank you. And thanks, Eric, for sneaking me in. Great panel.

Just a quick question. I wonder if you see any implications other than exports for China of the renminbi denominated loans to Latin America? If you have a

greater picture for the international role of the currency.

MR. FARNSWORTH: Well, how much time does everybody have? These are three very important questions. Why don't we start with this Mauricio? Or was it that Mauricio? Anyway, Mauricio, we'll start with the -- what is the model of development for Latin America in 30 seconds or less? And are there models out there like India, Israel, others that might be usefully pursued?

MR. MOREIRA: That's a very good question. Very difficult question.

Let me start -- I mean, there are several Latin Americas and it's very hard to generalize. I mean, there's small countries, big countries. But it's good to be clear that India is not a service-led development at all. I mean, you just have to look at the figures and see that there's a lot of high, you know, it's an important source of foreign exchange for India. It's almost 40 percent of the total exports. But if you tried -- if you look at the GDP (inaudible) compose India's growth in the last 20 years, the contribution itself is pretty small.

So it's hard to, you know, generalize or to label the type of development that India had. And it's a mixture and you're going to see agriculture making a huge contribution, manufacturing making a huge contribution. And the fact of the matter, they had a very repressed economy. So in a sense they're sort of benefitting from the reforms that Latin America did, you know, in the '60s, in the '70s.

So I'm not sure that you can see much in India in the sense that, you know, would be a model for the large countries in Latin America. But for the smaller countries, I mean, if you think of Chile, Bolivia, Central Americas, I think services is an option. Israel could be clearly a good example. There are lessons there to be learned. But for the bigger countries, and there I agree with Mauricio, there's an issue of where are you going to, you know, find, generate employment that people need.

And what I don't agree is that this is possible via manufacturing. We're

going to have to, you know, find other options, try to, you know, reduce informality in services, raise productivity in services, particularly by reducing taxation and encourage formalization of those sectors. You know, and use all those rents perhaps to beef up the social programs. Those cash transfer programs are already in place.

So we're going to have to be creative. I think it would be wonderful if we could have sort of a Chinese-Asian type of -- a much faster way of reducing poverty but, you know, this is not there anymore, I believe.

MR. FARNSWORTH: Thank you. Well, Erica, we talked a lot about trade flows. We haven't talked a whole lot about investment. And again, I know time is very short and this topic deserves its own panel. But would you have any thoughts or comments about what you've observed in terms of how Chinese investment in Latin America is progressing? And do you see that changing perhaps to more of a private sector-led emphasis over time?

MS. DOWNS: Okay. I'll answer that. I'm also going to quickly --

MR. FARNSWORTH: Please, absolutely.

MS. DOWNS: -- take the question on renminbi loans. I think these are a particular project of China Development Bank. I think to the extent that they can persuade their borrowers to accept loans in Chinese currency, you know, they're more than happy to do that, you know, for the reasons I mentioned in my presentation, that if the loan is in renminbi, then it ties the borrower into buying and hiring from China and this helps CDB sort of fulfill its mission to help create business opportunities overseas for Chinese companies. I think that there probably is some resistance in some countries to borrowing -- or some governments or some companies to accepting loans in renminbi. I think that for a lot of the oil companies that CDB has loaned money to, those companies trade oil with reference to the dollar. So they're less interested in having a loan in another currency.

You know, in the course of doing research for this paper I stumbled across an article about negotiations between CDB and the government of Myanmar and CDB kept wanting the Myanmarese to take the loan in renminbi and the Burmese wanted the loan in euros. I don't know how that worked out. I think a lot is going to depend on how much of an upper hand does CDB have. You know, how much does the borrower want the cash? So that's my take on that. I think to the extent that CDB can extend loans in renminbi, they will do so.

On the investment issue, I actually -- most of my work on Chinese overseas investment focuses on the activities of major state owned companies, especially the oil companies, so I'm not really in a position to comment on what Chinese private sector firms are doing in Latin America, although I do think it's a great question. When it comes to what the oil companies have been doing in Latin America, you know, there has certainly been a big uptick in activities, investments in the past years. And I think a lot of that has to do with other companies sort of farming out. That if you look at, for example, the investments that Chinese national oil companies have made in Brazil, you know, that's because Statoil put assets up for sale. Reps Oil put assets for sale and Chinese companies were quick to take those. There are also a lot of investments, a number of investments made by CNUK in Argentina. And I think, again, these investments were made, you know, CNUK used these investments as a way to, you know, help get a foothold in the region.

MR. FARNSWORTH: And when they make those investments, are they making -- are they taking majority stakes or are they comfortable with minority stakes so long as they have guaranteed access to product? Or have you noticed any particular structure there on the investment side?

MS. DOWNS: They're both. I think a lot of it simply depends. I think a lot of what they do is determined by what's available.

MR. FARNSWORTH: Right.

MS. DOWNS: So if someone is farming out a project and it's a 40 percent stake then, you know, at least initially they're going to end up with a 40 percent stake.

MR. FARNSWORTH: Very good. But they don't insist necessarily on majority control, certainly not upfront necessarily? Yeah.

Well, Mauricio, we're going to come to you for the last word. And any of these three questions that are on the table, feel free to comment.

MR. CARDENAS: Just a word on these last points. I think if we were to characterize the relationship, the economic relationship between Latin America and China, it's about trade. I mean, these investment deals have been marginal. Very few examples. Most of them in the oil sector. Smaller investments. So nothing to compare with the trade figures.

We've seen a new element in this landscape which is the financing through China's Development Bank. But still the financing, very concentrated in a few countries and a few deals. Venezuela, Ecuador, Brazil, some Argentina. So if we're going to talk about the whole region, it's trade. And it's trade that really matters.

This has had tremendous positive implications for the region. The fact that the growth rates were high during the global recession is related to the fact that commodity prices were high and this is overall positive news for Latin America. But there is this side effect, which is the economic structure, the expansion of services, informal services, that Latin America needs to address. And for that it's necessary to first adopt the right policies but also to think about increasing interaction with other parts of the world where the economic relationship is more balanced between trade, investment flows, not particularly concentrated in one sector of the economy. So this process of diversification I think is very important and it's something that the U.S. should take note of.

MR. FARNSWORTH: Well, this has been a terrific panel with one primary exception. There's been one failure and that is that the panel actually has gone beyond time. And I apologize for that. That is clearly a failing of your moderator who did not do his job very well. But the panelists were fantastic. And I hope that there is sufficient interest here to come back to continue the conversation because frankly there are many additional avenues we could take this conversation and additional areas for conversation and discussion and research.

So until the next time, which I hope will be soon, thank you all for coming and please join me in thanking the panelists for their outstanding comments today.

(Applause)

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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