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Photo caption: Chinese President Xi Jinping attends the first joint China and Community of Latin American and Caribbean States (CELAC) meeting in January 2015. Photo credit: New York Times.

Latin America, China, and the COVID-19 economic crisis

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In addition to causing healthcare systems everywhere to become overwhelmed, COVID-19 is on track to cause a severe economic contraction all over the globe. Recently, the IMF revised its economic forecast for 2020 from a projected growth of around three percent to a projected contraction of almost six percent worldwide.[1] This economic downturn will affect Latin America and will leave many countries in the region scrambling for resources, which creates opportunities for competitors to gain ground on a region that is vital to U.S. national security. Specifically, the economic downturn precipitated by the pandemic could create an opportunity for China to make further inroads in the region by issuing debt to cash-strapped governments or seeking ownership of strategic assets. China has already achieved full-ownership of ports in other regions. An economic crisis might give it the opportunity to gain ownership in this hemisphere.

[1] "World Economic Outlook, April 2020: The Great Lockdown." *IMF*, 1 Apr. 2020, www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020.

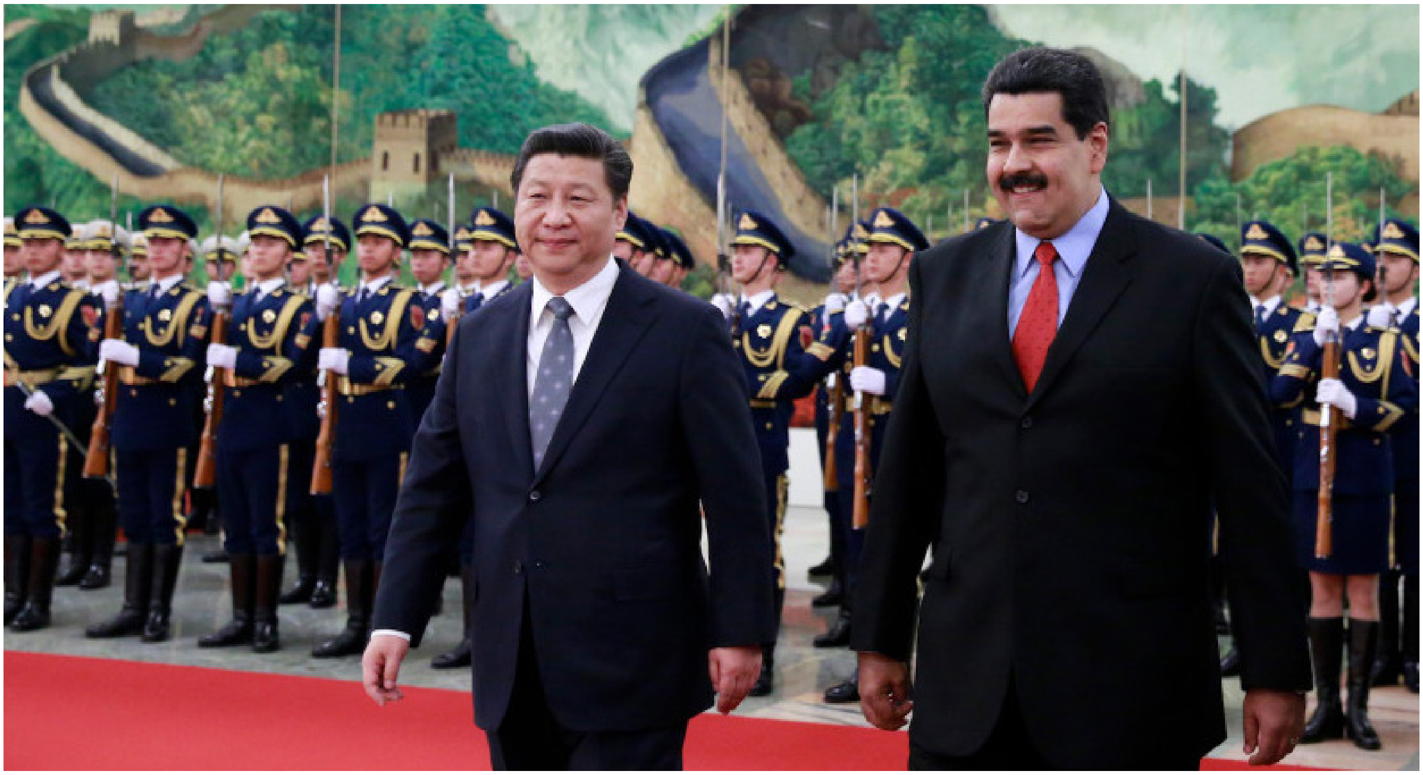


Photo caption: Venezuelan President Nicolás Maduro walks with Chinese President Xi Jinping in the Great Hall of the People in Beijing on Jan. 7, 2015. **Photo credit:** Andy Wong/Getty Images.

Economic situation in Latin America

Before the pandemic, the Economic Commission on Latin America and the Caribbean (ECLAC) projected that the region would grow by a maximum of 1.3 percent in 2020.[2] This forecast has since been revised, with GDP now predicted to fall by at least 1.8 percent.[3] The decline in economic activity in the region is driven by a few factors, principally the worsened economic situation of their trading partners and the accompanying downturn in commodity prices. For most Latin American countries, the top two trading partners are the United States and China. This year, the U.S. economy is expected to contract 5.9 percent while the Chinese economy is expected to grow only 1.2 percent.[4] For comparison, consider that China's gross domestic product (GDP) had grown above five percent annually for the past three decades.[5] Most Latin American countries are also resource-dependent (some excessively so). The region rents somewhere between three to seven percent of GDP on average in non-renewable natural resources (oil, gas, and minerals). account for somewhere between three to seven percent of GDP on average.[6] A downturn in the price of these commodities will have a significant negative impact in the economic situation of countries in the region. The current decline, from a predicted $57/barrel to the current $25/barrel will be felt directly in the oil-exporting countries of Latin America.[7] The effect is likely to be similar for

[2] *The 2014-2020 Period Will Mark the Lowest Growth in the Last Seven Decades for Latin American and Caribbean Economies: ECLAC*, Economic Commission for Latin America and the Caribbean, 12 Dec. 2019, www.cepal.org/en/pressreleases/2014-2020-period-will-mark-lowest-growth-last-seven-decades-latin-american-and.

[3] *COVID-19 Pandemic Will Lead to the Biggest Contraction in Economic Activity in the Region's History: A -5.3% Drop in 2020*, Economic Commission on Latin America and the Caribbean, 21 Apr. 2020, www.cepal.org/en/pressreleases/covid-19-pandemic-will-lead-biggest-contraction-economic-activity-regions-history-53.

[4] "World Economic Outlook, April 2020: The Great Lockdown." *IMF*, 1 Apr. 2020, www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020.

[5] "China" World Bank. 2020. https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN

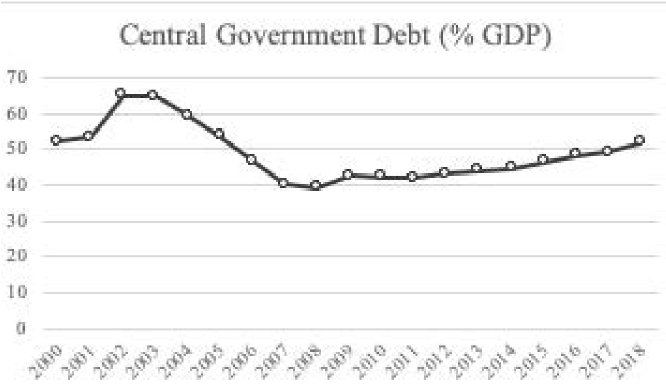
[6] "GDP Growth (Annual %) - China." *Data*, data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN.

[7] *Short-Term Energy Outlook*. Energy Information Administration, Oct. 2019, www.eia.gov/outlooks/steo/archives/oct19.pdf.

the exporters of other commodities. The combination of slowed trade, a decrease in commodity prices, and an existing debtor-creditor relationship with China might encourage some countries in the region to again turn to debt, including debt from China, for relief.

Prior to the pandemic, Latin American countries were substantially in debt, compared to industrialized democracies elsewhere and compared to most other developing regions. In 2018, public debt accounted for 42.3 percent of GDP in the region.[8] Rising debt is a concern in Latin America because the region has a difficult history with debt.

Graph 1: Average sovereign debt in Central and South American countries.



Source: International Monetary Fund (2020)

Debt and China

Not all debt is created equal. Debts incurred to China differ significantly from debts incurred to other countries and multilateral institutions. China considers most of its investments a state secret and because of that, it does not report on its international lending. The problem is compounded because on the recipient side debtor countries they often do not collect data on debt owed by state-owned companies, which are the main recipients of Chinese loans.[9] In addition, Chinese debt is overlooked by credit rating agencies (Moody's, S&P) which focus on private creditors. Consistent with its worldview, China is not a member of either of the multilateral institutions (Paris Club and OECD) that collect data on loans issues by countries.

Photo caption: China markets its investments aggressively throughout most Latin American nations including during this trade show in Havana, Cuba.
Photo credit: Brookings Institute.

These loans are free from the conditions attached to other types of lending and certainly don't come with the market reform conditions that were attached to loans issued to the region by multilateral institutions such as the World Bank in the 1990s. Instead, these loans are issued to spur economic growth in the debtor country, which should, in turn, prompt an increase in trade with China. While the conditions of the loan are not clearly spelled out as they were

[8] *Fiscal Panorama of Latin America and the Caribbean*, Economic Commission on Latin America and the Caribbean, Mar. 2019, https://www.cepal.org/en/publications/44517-fiscal-panorama-latin-america-and-caribbean-2019-tax-policies-resource.

[9] Horn, Sebastian, et al. "How Much Money Does the World Owe China?" *Harvard Business Review*, 26 Feb. 2020, hbr.org/2020/02/how-much-money-does-the-world-owe-china.

during the Washington Consensus, these are not altruistic investments.[10]

Table 1: Chinese loans to Latin America

Country	Amount (in billions of U.S. dollars)
Venezuela	$62.20
Brazil	$28.90
Ecuador	$18.40
Argentina	$17.10
Trinidad and Tobago	$2.70
Bolivia	$2.40
Jamaica	$2.10
Mexico	$1
Dominican Republic	$0.60
Suriname	$0.58
Costa Rica	$0.40
Cuba	$0.24
Guyana	$0.17
Barbados	$0.17
Bahamas	$0.09
Peru	$0.05

Source: Inter-American Dialogue China-Latin America Finance Database

About two-thirds of the countries in the region have accrued debts to China. There is significant variation in the level of investment and in the consequences of these loans. Venezuela is the country with the largest amount of Chinese debt. The entirety of this debt was accrued by the governments of Hugo Chavez and Nicolas Maduro. If the country does transition away from this autocracy, a new democratic government would have to meet the country's steep debt obligation to China, which would stretch the financial capacity a new government trying to deliver economic prosperity for its citizens. It could also make the calculus for the U.S. more complicated as funds directed to shore up a new democratic money could indirectly make their way to China to pay debts incurred by one autocratic government in Venezuela from another autocratic government in China.

Outside Venezuela, adding more debt would increase Chinese leverage over Latin American economies. It is also not clear what could happen if a country takes out more than it can repay, as the terms of these loans are often not public. In Sri Lanka, China came to own a port after the government couldn't pay back what it owed.[11] While there have so far been no examples of this transfer of ownership in the western hemisphere, it is possible that the terms of the loans issued to countries here are similar.

Ownership and China

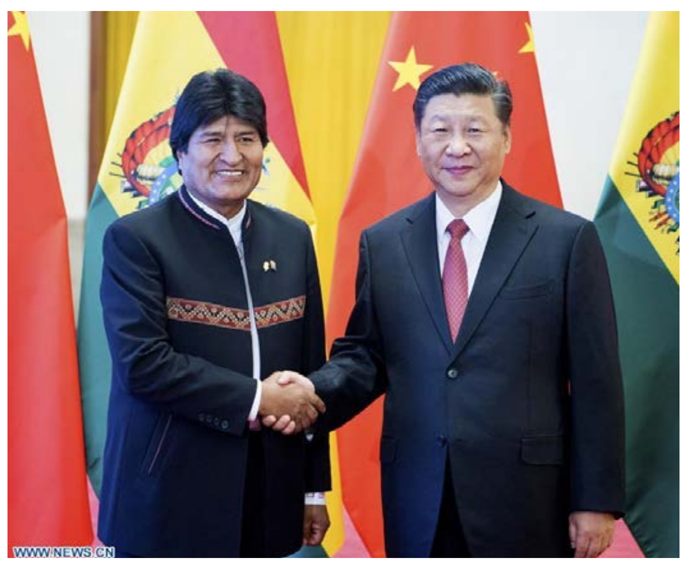


Photo caption: Chinese President Xi Jinping invites former Bolivian President Evo Morales to join him for a signing ceremony in Beijing, China as the two leaders negotiated trade agreements.
Photo credit: Greg Baker of Getty Images; republished from Brink news.

[10] Gallagher, Kevin P. *The China Triangle: Latin America's China boom and the fate of the Washington consensus*. Oxford University Press, 2016.

[11] Abi-habib, Maria. "How China Got Sri Lanka to Cough Up a Port." *The New York Times*, June 25, 2018. https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html.

In addition to taking out additional loans, countries experiencing economic hardship might be amenable to selling critical infrastructure to China. On the other side of the Atlantic, NATO Secretary-General Jens Stoltenberg, speaking after a virtual meeting of defense ministers, noted that the "geopolitical effects of the pandemic could be significant" if economic difficulties made "some allies more vulnerable for situations where critical infrastructure can be sold out."[12] The European Union (EU) expressed a similar sentiment when it encouraged its governments to buy stakes in key companies to prevent a Chinese takeover. Investment by Europe and the U.S., whether public or private, could potentially be an effective way to weaken the economic and political leverage that China has over debtor countries.[13]

There has been no similar call in the western hemisphere. With the exception of the oil and mining sectors in some countries, in Latin America there is no requirement that critical infrastructure be owned by the state, which creates an opportunity for foreign investment in this area. Latin America is not unique in this regard, though its weaker intra-regional defense cooperation leaves it more vulnerable than Europe, for example, which has already called attention to the issue of foreign ownership.[14] China has made inroads in this sector investing heavily in ports and planning an alternative to the Panama Canal, although so far, that plan has not come to fruition. The present situation might present China with an opportunity to expand these investments. Though China's economy is also expected to be impacted by the pandemic, its economy will continue to grow (albeit at a slower pace).[15] Compounding this advantage is China's system of governance which does not require consent from the citizens to take an action that is seen as important to the state, even if it could be detrimental to its own population in the short-term.

Implications

Latin American countries are facing difficult, but not unprecedented, economic challenges. In the face of these challenges, it will be important for each country to apply the lessons learned in previous economic downturns. Chief among these is the recommendation to be cautious about debt and its implications and transfer or ownership. The debt crisis of the 1980's showed the consequences of taking on more debt than the country can afford. A decade later, the privatization efforts of the 1990's showed the effects of relinquishing state control over basic services. Countries in the region would be wise to remember those lessons as they seek economic resources to overcome the current and coming economic downturn.

From a U.S. perspective, an increase in China's economic leverage over Latin America challenges the U.S. role as the partner of choice. To the extent that China's advance in Latin America is a consequence of U.S. disinvestment in the region, the U.S. would be wise to engage with its partners in the hemisphere and to work with them to understand the terms and consequences of Chinese assistance, and to offer an alternative if possible.

[12] Deutsche Welle. "NATO Warns Allies to Block China Buying Spree: DW: 17.04.2020." DW.COM.. https://www.dw.com/en/nato-warns-allies-to-block-china-buying-spree/a-53167064.

[13] "COVID-19, Debt, and Strategic Competition." Daniel K. Inouye Asia-Pacific Center for Security Studies, April 20, 2020. https://apcss.org/covid-19-debt-and-strategic-competition/.

[14] NATO. "Résilience Et Article 3." NATO, July 8, 2016. https://www.nato.int/cps/fr/natohq/topics_132722.htm?selectedLocale=en.

[15] "IMF Data Mapper." IMF. Accessed May 18, 2020. https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD.

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