



China's Belt and Road Initiative in Latin America: The Fallout in Governance and Business Competition

By Billy Marlin, Founding Senior Partner, Veritas Assurance Partners
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Emerging markets in Latin American countries have often limited access to financing because of poor governance, corruption and economic policies. In Latin America, China has approached governments and built desperately needed infrastructure projects including electric energy generation plants, roads, railways and ports. China is an attractive investor since most of these projects have been finished at a faster pace than most developing nations are used to and at affordable finance terms.

China's increased economic engagement in the Latin America region, most notably during the last decade, has resulted in major consequences in the local businesses' competitive environment, governance and corruption. China has offered an affordable way to Latin American governments for infrastructure development but in the long term many of these investments have resulted in fostering corruption, non-competitive prices and long-term dependency. This briefing discusses the direct and indirect effects of the growing economic relations with China in Latin America and their consequences in the region.

A Decade of Market Growth

China's involvement in Latin America is the result of the People's Republic of China (PRC) policy known as "Zou Chuqu"¹ (Going Out), which refers to the official encouragement of Chinese enterprises in searching for greater investment opportunities around the world. The notion of "Going Out" applies to a wide range of actors, from

¹ <https://www.diplomaticourier.com/posts/china-s-going-out-strategy>

state-owned enterprises to individual and family entrepreneurs seeking business deals overseas. In addition to promoting business activity abroad, the policy involves foreign aid. China's foreign assistance has been driven mainly by its demand for natural resources, especially energy and diplomatic goals—chiefly, the effort to politically isolate Taiwan, which is diplomatically recognized by a number of nations in Central America and the Caribbean.

Since 2001 Chinese trade with Latin America has increased at a 31% annual rate on average or approximately \$450 billion a year and economists predict that it could exceed \$700 billion² by 2035. China is now South America's largest trading partner and is second only to the United States for trade in all Latin America. China has signed free trade agreements with four countries including Chile, Costa Rica, Peru and in January of 2023 with Ecuador. China is currently South America's top trading partner and the second-largest for Latin America as a whole, after the United States.

China's investment portfolio has also expanded greatly. Chinese enterprises have directly invested the equivalent of some \$17 billion in projects, mostly in South America. With the equivalent of \$137 billion in loans to Latin American governments, the Export-Import Bank of China has vaulted itself into the ranks of the region's leading lenders. Beijing's presence has enabled it to become a voting member of the Inter-American Development Bank and of the Caribbean Development Bank. Twenty Latin American countries have signed onto China's Belt and Road Initiative.

Apart from direct loans to governments, most Chinese investments has concentrated on energy development, petroleum refining and power generation. Currently, Power China has dozens of ongoing projects across multiple Latin American countries. China's Latin American investments have built dams, ports, and railroads. Chinese investment has also flowed to solar and wind projects, including Latin America's largest solar effort in Jujuy, Argentina. Six Latin American countries – Argentina, Brazil, Chile, Ecuador, Peru and Uruguay – have joined the Asian Infrastructure Investment Bank.

Effect on Business Competitive Environment

Undermining of Local Industries

Latin American exports to China are mainly soybeans, copper, petroleum, oil, and other raw materials that the country needs to drive its industrial development. In return

² <https://www.weforum.org/agenda/2021/06/china-trade-latin-america-caribbean/>

China mostly imports higher-value-added manufactured products, a trade some experts say has undercut local industries³ with cheaper Chinese goods in unprotected local markets. Chinese imports destroyed local shoe, textile and toy industries in several Latin American nations and manufacturers are losing out as China prefers to buy raw inputs that its factories and workers transform into steel, concrete, computers, telephones, car parts etc. It then sends these finished and higher value-added products back to Latin American consumers, undercutting local manufacturers.

PRC has free trade agreements in place with Chile, Costa Rica, and Peru, Ecuador⁴ and twenty Latin American countries have so far signed on to China's Belt and Road Initiative⁵ and is pursuing deep water ports in Jamaica⁶, Dominican Republic, El Salvador, Argentina and elsewhere. There is an ever-increasing presence of Chinese companies near the Panama Canal and the Colon Free Trade Zone. These ports are designed to help feed China's appetite for food and raw materials. Most of what it imports from the region consists of soybeans, copper, petroleum, other oils, and uranium. Purchases of lithium for batteries has expanded strikingly, from Mexico and the so-called Lithium Triangle countries. Argentina, Bolivia, and Chile contain more than half the world's known lithium reserves.

Loan-Trap Diplomacy

China can manipulate and coerce countries that are unable to repay their loans often using deceptive trade and loan practices. For example, China has used contractual language that allows it to cancel and demand repayment on loans when a country defaults on a separate loan from a "different lender," which is unusual for government loans. These contracts also allow China to cancel the loan if the "debtor country undertakes policy changes adverse" to China's preferences.

Loans from China have penetrated significant sectors of Latin America, including energy and mineral sectors, port infrastructure, and telecommunications. China is also willing to offer cheaper credit even to countries with poor track records of paying off debt, raising the likelihood that Latin American countries choose Chinese loans over competing loans from other countries.

³ <https://www.cfr.org/article/latin-america-shouldnt-be-pawn-us-china-rivalry>

⁴ A free trade agreement between China and Ecuador was finalized in January 2023.

⁵ <https://www.cfr.org/report/chinas-belt-and-road-implications-for-the-united-states/>

⁶ <https://thehill.com/opinion/international/528081-countering-chinas-influence-in-the-caribbean-with-a-second-caribbean/>

Ideological Sway

China is using its financial prowess to raise its diplomatic profile and influence. China has signed strategic partnerships – the highest classification Beijing offers diplomatic allies – with seven countries, Argentina, Brazil, Chile, Ecuador, Mexico, Peru, and Venezuela. Beijing also wants to isolate Taiwan, refusing trade and investments to any country that recognizes the island as anything but a part of China. China's efforts achieved its goal since 20 years ago all Latin America recognized Taiwan's sovereignty and now only eight nations in the region still do. More recently, China has used the promise of loans and infrastructure investments to flip the Dominican Republic and Nicaragua on the question of Taiwan sovereignty.

The PRC geopolitical and economical strategy is not focused on promoting fair partnerships and open, fair-market market competition based on the rule of law and good governance. It seeks to create dependencies through deepening economic ties and coercive influence. China is seeking for key support from regional partners on U.N. votes and backing for Chinese appointees to multinational institutions. The ultimate goal is to create a global system in which authoritarian regimes are viewed as legitimate forms of governance.

China is more comfortable dealing with authoritarian regimes like its own. PRC's behavior in Venezuela is a good example. It's not uncommon that Chinese companies provide gifts and kickbacks to facilitate doing business with the Maduro regime. These ties have raised some concerns, particularly among regional governments. While Chinese loans often have fewer conditions attached, dependence on them can push economically unstable countries such as Venezuela into what critics call "debt-traps"⁷ that could result in default. Critics also say that Chinese companies bring lower environmental and labor standards, and they warn that China's growing control over critical infrastructure such as energy grids poses national security risks⁸. There are also fears of economic dependency in countries such as Chile, which sent nearly 39 percent of its total exports to China in 2020.

China has also found a ready market for Chinese military equipment and training in the region. Troops and bases are not yet in evidence, but between 2009 and 2019, the most recent year for which data are available, China sold the equivalent of \$165 million in military equipment to Venezuela, Bolivia, and Ecuador, including aircraft, air defense radar, and small arms.

⁷ <https://www.bloomberg.com/news/articles/2022-02-22/china-faces-creditor-trap-in-lending-to-latin-america-g-a>

⁸ <https://dialogochino.net/en/trade-investment/42453-opinion-chinas-firms-gain-a-foothold-in-south-america-as-energy-providers/>

China has also sold equipment to police forces throughout the region. If troops are not present, several port visits have called attention to China's growing military prominence. Then there's the People's Liberation Army's interest across the region, in education, space, cyber, security cooperation and naval ports. The PRC might be setting the stage for future military expansion and presence.

Corruption: The Strategic Catalyst

There is a dark side of "*Zou Chuqu*" (*Going Out*) linked to informal practices and involving illicit or opaque transactions. This dark side is manifest in various dimensions of Chinese engagement in Latin America, from large-scale infrastructure projects related to public-sector contracts, to small-scale trade (such as textile, consumer goods and electronics smuggling) and criminal networks are engaged in human trafficking or other illegal activities..

Transparency International Bribe Payers Index ranks countries according to the likelihood that their companies will engage in bribery when conducting business abroad (countries with the greatest likelihood score the lowest). According to thousands of businesspeople interviewed for the survey, companies prone to paying bribes tend to come from countries whose governments are perceived as having little regard for the rule of law. China, along with Russia, ranks at the bottom of a list of 28 economies from the developed and developing world.

PRC state-owned and private businesses often exploit pervasive corruption in the region to undermine fair contracting practices and circumvent environmental compliance. A common tactic used is to provide kickbacks to local officials in exchange for favorable deals.

Informality is notably high in both China and Latin America. Though the two regions have different values and attitudes, both have traditionally lacked transparency in government. They operate according to informal business dealings which, in turn, undermine or further weaken the rule of law and may institutionalize corrupt practices.

Latin America has for decades struggled with corruption and a fragile rule of law, and China's expanding presence may only serve to continue to foster this feature of the Latin American landscape.

Public-sector contracts are most affected by bribery. Usually large and requiring multiple layers of subcontractors, these projects offer opportunities for significant, multiple kickbacks. Corruption of this sort is most common in the mining, oil and gas sectors, as well as in major infrastructure projects.

Many of the investments have come from Chinese state-owned or state-supported companies that have sought participation in megaprojects in various Latin American countries. Multiple media outlets have already exposed examples of bribery, irregularities in bidding processes and overall lack of transparency in awarding contracts.

The Coca Codo Sinclair hydroelectric project in Ecuador is a recent example. Only two companies bid for the project—both Chinese and state-owned. Sinohydro won, negotiated the project at \$1.7 billion and financed it largely by China's Export-Import Bank. Set to be the country's largest hydroelectric power plant, the project has been challenged by subcontractors, opposition leaders and environmentalists. Critics point to deficient feasibility studies, environmental problems and corruption. Experts have raised concerns that the plant would not be able to generate the expected power output, which would make it difficult for Ecuador to repay the loan China's Export-Import Bank extended to secure the project.

In recent years, reports of corruption, lack of transparency and violations of labor and environmental regulations within Chinese mining ventures (Peru), petroleum refineries (Costa Rica), oil deals (Venezuela, Ecuador), and other large-scale investment projects have emerged.

Recent reports have linked Chinese organizations and Latin American public officials with operations to bring undocumented immigrants to Argentina, Bolivia and Peru, and from those countries to Canada and the United States. Earlier this year, Peruvian authorities disbanded the Red Dragon gang, composed mainly of Chinese and Peruvian-Chinese citizens, which was responsible for the illegal smuggling of Chinese nationals. An investigation uncovered links to a corrupt network inside Peru's national registration authority.

China has delivered assistance without following bureaucratic procedures and with an aura of secrecy and has given preference to public works with high visibility. The new San José National Football Stadium in Costa Rica is an example. The \$140 million China invested in building or revamping cricket stadiums in the Caribbean for the 2007 World Cup is another. The official Chinese position is that foreign aid responds to South-South solidarity and follows the principles articulated by Zhou Enlai, China's first premier, in

the 1960s, which established that assistance to other countries should promote mutual benefit, avoid any form of dependence, establish a partnership between equals, and have no strings attached.

Conclusion

The long-term effects of China's increased trade and influence in Latin America will continue to become more evident as some of the infrastructure projects from past administrations are questioned for their cost and effectiveness, quality of workmanship, materials and in achieving their intended purpose. Questionable deals and transactions become increasingly exposed during government changes and economic downturns as debt renegotiations and loan defaults are likely to expose past administrations misdeeds. Unfortunately, the same lack of transparency and accountability and the informal application of the rule of law that facilitated the terms and conditions for these questionable projects will continue to play a significant role and the actors responsible might not be held fully accountable for their deeds.

Of immediate concern is the telecommunications infrastructure where data governance and cybersecurity of the networks may be vulnerable, particularly in Colombia, Mexico, Peru and other nations where Huawei systems are being used. Latin American countries can ask the European Union (E.U.) and the U.S. to provide alternatives for 5G and for financing this and other infrastructure, starting with ramping up loans from the U.S. International Development Finance Corporation and multilateral financial institutions. U.S. and European Union talks are the most comprehensive to date, designed to boost cooperation around international standard-setting, data governance and cybersecurity through a newly announced Technology and Trade Council.

Some meaningful, progressive initiatives toward transparency and accountability have selectively emerged during the last decade in several Latin American countries including some of the countries with the bigger economies in the region. The track record for these efforts in the past has been checkered at best, judging from previous incarnations. The effectiveness of these new initiatives are yet to be measured but these are welcome as a step forward towards better governance and accountability.

Editorial Credits and References

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Billy Marlin and Manny Supervielle are Founding Senior Partners and Chris Marquet is Senior Partner of Veritas Assurance Partners, a boutique international risk mitigation, business intelligence, litigation support and investigative firm, based in Miami, Florida. Together they have more than 100 years of investigative and independent fact-finding experience. They can be contacted at bmarlin@veritasap.com; msupervielle@veritasap.com; and cmarquet@veritasap.com, respectively. For more information go to www.veritasap.com.