7-18-2011

How Is China Changing Latin America's Energy Sector?

Inter-American Dialogue's Latin American Energy Advisor

INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

Q and A: How Is China Changing Latin America's Energy Sector?

Citation: Inter-American Dialogue's Latin American Energy Advisor July 18-22, 2011; pp. 1, 4, 6. Also online at **www.thedialogue.org**.

China recently announced several loans worth billions of dollars to Ecuador and Venezuela—to be paid back largely in the form of oil—for public works, energy and infrastructure projects. These investments and others have made China the biggest credit source for the two governments, often on terms that other financial institutions would spurn, analysts have pointed out. Are China's big loans going to be good deals for the Latin American countries? Will the money come through, and will it be used effectively for the intended purposes? Is China's increased investment in Ecuador, Venezuela and other countries in the region playing out as expected several years ago? What unexpected or new economic and political twists are on the horizon resulting from evolving China-Latin America relations?

A: Kirk Sherr, member of the Energy Advisor board and president of Regester Larkin Energy:

"China is not just lending to the region in return for oil, it also is leveraging the goodwill synergies of these loans to support large equity investments in oil, gas and electric companies. These loan agreements are important to China and they have a solid track record of meeting their obligations—even when the recipient countries may not meet theirs due to project delays and costs overruns. China has benefited on many fronts from its relationship with the region, exporting more than it imports while also nailing down long-term commodity resources. Energy security is a major issue for Beijing and Latin American sourcing is merely one part of a complex solution. According to the BP Statistical Review, China imported nearly 5 million barrels per day (bpd) of crude from South and Central America in 2010, compared to only 8,000 bpd in 2001. Over this same period, Chinese national oil companies have extended their presence across the Latin America region, gaining valuable operating experience. In Venezuela, especially, China has become a major force with the $16.3 billion joint venture between PDVSA and China National Petroleum Corp. to develop the Junin-4 block of the Orinoco oil belt. A number of twists and turns lie ahead, however, for China's engagement of the region. Already, there is growing regional backlash against Chinese imports in Brazil. Additionally, China faces significant regional risk from implications of possible regime change in its allies, Venezuela and Cuba. On the other hand, if Chinese shale gas addresses more of their energy needs, their interest in the region may wane over time."

A: Roger Tissot, independent energy economist:

"A simplified explanation of the transmission mechanism that has sustained growth in 'ChinAmerica' was China's purchase of U.S. bonds to keep U.S. interest rates low, the U.S. dollar high, the Chinese currency low and, thus, Chinese exports strong. This engine of growth, of course, was not sustainable in the long term. Despite calls for a revaluation of the currency, China is still reluctant to allow rapid revaluations. On the other hand, the weakness of the U.S. economy and the uncertainty regarding its debt and the dollar are sufficient incentives for China to look at diversifying its portfolio. Investing in Wall Street and other western financial markets would only expose China to the risks of financial institutions afflicted with bad debts and highly indebted economies. Investing in natural resources is a more attractive option. China needs oil to fuel its rapid economic growth. Although it has closer and more economic supply sources, investing in these countries offers an attractive alternative, despite the risks. First, it increases the global supply of oil while securing a share of the incremental production and profits to Chinese national oil companies. Second, it hedges against future price spikes. Third, it offers Chinese companies new markets for their products and services. And fourth, it reduces the challenges of direct ownership or flawed joint ventures, which were the preferred strategies by Chinese NOCs in their earlier quest for resources. In this case, pressure is on the host country to realize the investments, particularly since China has increased its oversight of these loans. China is aware that payment of the loans is likely to continue in any post-Chávez administration. Thus, China wants to ensure the loans benefit the entire country and not just the political class in power currently. For the host countries, Chinese financing is often the 'lender of last resort.' It is not a cheap one, but due to the concern the international financial community has over Venezuela and Ecuador, and the large risk premiums they would charge, Chinese lending is an attractive option."

A: Margaret Myers, director of the China and Latin America program at the Inter-American Dialogue:

"China promotes a 'win-win strategy' when dealing with Latin America, promising mutually beneficial bilateral relationships. Upon first glance, its recent agreements with Ecuador and Venezuela appear mutually beneficial. Having spurned other creditors, Ecuador and Venezuela are increasingly reliant upon China for infusions of capital. China uses 'loans-for-oil' and other investment mechanisms to stake claims to the region's natural resources. Its domestic urbanization and industrialization efforts are highly dependent upon resource imports from across the globe. Barring rapid political transition in Ecuador or Venezuela, or a significant economic downturn in China, these loan agreements are likely to materialize, and to be used according to loan stipulations. But the extent to which they will benefit Ecuador and Venezuela is less certain. The vast majority of China's investments in Latin America either directly or indirectly support resource extraction. They are intended to guarantee China's natural resource supply over the next decade. Countries like Chile, through sound macroeconomic policy and effective governance over the extractive sector, have benefited greatly from China's resource-related investment. But in the absence of institutional controls and macroeconomic foresight, oil-tied investments in Ecuador and Venezuela are unlikely to generate long-term, sustainable growth. Chinese funding may also have unexpected political or environmental impacts. Many worry that environmental degradation will accompany China-funded projects. Also, Chinese loans thus far have enabled Correa and Chávez to increase spending on popular social and infrastructure projects, sustaining some degree of domestic political support. At present, few countries in Latin America would deny the immediate benefits of a renminbi infusion. Chinese investment in Latin America continues to promote growth, but long-term success will require strong institutions and responsible policy formulation. As Latin American diplomats in China have noted, recipients of Chinese investment must take measures to ensure that China's 'win-win' arrangements don't just mean China wins twice."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at kuleta@thedialogue.org with comments.*