

China, Chile and free trade agreements

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On November 19, at the 21-nation APEC (Asia-Pacific Economic Cooperation) Summit held in Pusan, South Korea, Presidents Hu Jintao of China and Ricardo Lagos of Chile signed a Free Trade Agreement (FTA). With immediate effect, 92% of Chile's current exports to China will enter that country duty-free. The same goes for 50 per cent of China's current exports to Chile. The significance of this FTA, however, goes way beyond technicalities. This is not only the first any such agreement between China and a Latin American nation; it is the first signed by China with a single country, as opposed to a regional grouping anywhere.

Given that this was originally mooted by China in June 2002, the five FTA Negotiation Rounds took place in a record ten months, from January to October of this year, it raises a question. Why would China, an emerging global superpower, be interested in a trade agreement with a medium-sized Latin American country, half way across the world, whose GDP is one sixteenth (US\$ 100 billion) of that of its own (US\$ 1.6 trillion)?

Partly, because of booming bilateral trade. In the past five years, Chile's exports to China have more than tripled, from US\$ 958 million in 2000, to US\$ 3.34 billion in 2004, and Chinese exports to Chile almost doubled, from US\$ 1 billion to US\$ 1.9 billion. With a total trade of US\$ 5.2 billion, China is now Chile's second largest trading partner, after the United States, and its third largest export market after the U.S. and Japan. China's enormous appetite for raw materials and commodities –which Chile, and South America more generally help satisfy– accounts for this. Minerals represent almost 80 per cent of Chile's exports to China. The latter has become the world's largest consumer of copper, and close to half of the copper it consumes comes from Chile.

Industrial products make up for some US\$ 626 million of Chile's exports, and agricultural products, some US\$ 43 million. Minmetals, a Chinese company, has entered into a deal with CODELCO, Chile's state owned copper company and the world's largest, to secure its long-term supply of "red gold": Chinese consumption, which averaged one million tonnes a year in the 1990s, is projected to reach 4.4 million tonnes by 2010.

Far from being an isolated event, almost a fluke, in the broader scheme of international economic affairs, this FTA between Asia's and Latin America's most vigorous economies is the result of a carefully calibrated international trade strategy followed by both countries. It has paid high dividends to both.

China has for long realized that to sustain its emerging status as «the world's factory» it needs ever –larger amounts of raw materials and inputs– be it oil, copper, iron, wood and paper, soy beans. Much of which can be sourced in South America, perhaps the world's richest region in mining and agro-forestry products. Latin America's 33 countries and 530 million people, on the other hand, are an attractive market for Chinese manufactured products, which are doing very well there. In 2003, Chinese-Latin American trade reached US\$ 30 billion, ten times the trade between India and Latin America.

China has therefore actively pursued greater trade and investment links with Latin America. After the 2004 APEC Summit (held in Santiago, Chile last November), President Hu Jintao visited Argentina, Venezuela and Cuba, in a whirlwind tour that put China firmly on the region's diplomatic radar screens. Brazil, of course,

is China's main Latin American trading partner, and Brazil is now planning to build special dams in the heart of the Amazon region to cater to the energy needs of Chinese investment projects.

For Chile, on the other hand, this is only the latest of 42 FTAs it has signed with most of the leading economies around the world, including the United States, the European Union, Canada, South Korea and Mexico. No other country has signed more, and it has been announced that negotiations for an FTA with Japan will be launched soon, and others with Malaysia and Thailand are in the offing. A Preferential Trade Agreement (PTA) with India is being negotiated.

Many economists have been wary of these FTAs, which they consider only create a "spaghetti-like" net of unwieldy bilateral deals, difficult to monitor, and a suboptimal solution, at best, compared to an overall, global trade liberalization and lowering of tariffs. Yet, the obstacles faced within the Doha Round, to be addressed in the WTO Ministerial meeting to be held in Hong Kong in December, attest to the difficulties in making fast progress on such a topic, when more than 100 nations are involved. To push for continuous trade liberalization, the best alternative would seem to be to do so simultaneously on all fronts—multilateral and bilateral.

This is exactly what Chile has done. While participating actively in the Doha Round (as a member of the G-20+, led by Brazil and India), it has persisted in its bilateral efforts, especially in Asia.

For Chile—as for much of Latin America—its traditional export markets had been in the United States and Europe, and until the late 1980s most trade and investment promotion efforts were targeted there. Yet, in the early 1990s, it realized the world's economic axis was shifting towards Asia, and that unless it became a partner in the process of growth and change sweeping across the Asia Pacific region, it would be left behind.

Chile thus joined APEC in 1994, the second Latin American country to do so, and over the past decade, Asia has become the region with which Chile trades the most. 27% of Chile's foreign trade is with Asia, as opposed to 25% with Latin America, 22% with Europe and 16% with the United States and Canada. More than a third (34.9%) of Chile's exports, in fact, went to Asia in 2004. Of Chile's four largest export markets in 2004, three were in Asia—Japan, with US\$ 3.7 billion, China, with US\$ 3.2 billion and South Korea, with US\$ 1.8 billion.

Chile's success, based on an export-led, policy-driven strategy which relies on an open economy, sound macroeconomic management and strong institutions, is at least partly related to this diversification of its export markets, in which Asia has played a key role. The Chile-South Korea FTA, the first between an Asian and a Latin American country, in effect since April 1, 2004, is the best proof that these treaties do have a positive effect on bilateral trade. In 2004, it increased by US\$ 1 billion in relation to 2003, reaching US\$ 2.5 billion. In the first ten months of 2005, it has increased by 25 per cent in relation to same period in 2004.

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Yet, much as Chile followed a "Look East Asia" policy in the early 1990s, and is now reaping the benefits of it, it is now looking at South Asia, and especially at India, as "the next frontier" in its international trade and investment strategy. Bilateral trade has grown considerably over the past few years reaching US\$ 525 million in 2004. It should touch new, record levels by the end of this year, and, although the trade balance is largely favourable to Chile, India's export basket to Chile is much more diversified, including cars, pharmaceutical products, chemicals, garments, textiles and electrical machinery.

Still, these figures are way below those of some of Chile's East Asian trading partners. With 90% growth in the value of Chilean exports to India in 2004, India jumped from number 21 to number 17 among Chile's foreign markets –tangible progress, but still far removed from East Asian levels.

Given India's infrastructure needs and the dynamism of its industry, its demand for raw materials and commodities should not lag far behind that of its East Asian neighbours in the near future. Indian companies are coming to realize that they have been missing out on much of the action in Latin America, and are finally targeting the region.

Essar has recently announced a US\$ 1.2 billion project, a greenfield steel mill in Trinidad & Tobago, Reliance has had long-standing business with Venezuela and Brazil, among other countries, and other Indian oil companies have been looking at off-

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shore fields in Cuba, Ecuador, and Venezuela. In Chile, the recent takeover by Tata Consultancy Services of Cromicrom, a business process outsourcing company that has 70% of the bank checking business in Chile, in a US\$ 23 million deal, may be the prelude for a strong business offensive by India's largest IT company in the region. Wockhardt recently landed the contract for supplying all of the insulin to Chile in 2006. The time is right for a major breakthrough in Indo-Latin American trade and investment.