China wants to do more business with Latin American and Caribbean countries

In early 2015 China and the Community of Latin American and Caribbean States (CELAC, for the Spanish acronym) signed an agreement in Beijing aimed at increasing the economic cooperation among the parties, with the purpose of creating great opportunities for the development of Latin American and Caribbean nations. China has already become the second largest economy in the world in terms of GDP and has become a very significant commercial counterpart with many countries in the LAC Region. Most analysts concur that its importance will continue to grow in coming years. As part of the 2015 Agreement the Chinese government has pledged US $ 250.000 million over the next 10 years for investment in the Region.

The 2015 Agreement specifies -in general terms- the areas of economic and financial interest that would be covered over the next decade. A China-CELAC Cooperation Plan (2015-2019) adopted as part of that Agreement establishes 13 thematic areas of work, 8 of which are in economic topics: Trade, Investment and Finance (III), Infrastructure and Transportation (IV), Energy and Natural Resources (V), Agriculture (VI), Industry, Science and Technology, Aviation and Aerospace (VII), Education and Human Resources Training (VIII), Tourism (XI) and Environmental Protection, Disaster Risk Management and Reduction, Poverty Eradication and Health (XII). In addition, there are other areas of cooperation that include policy and security, international relations, sports, arts, etc.

In the last decade China has provided large and increasing amounts of Foreign Direct Investment (FDI) to countries in Southeast Asia, Africa and Latin America and the Caribbean (LAC). According to the United Nations Economic Commission for LAC (ECLAC), during the 20-years period 1990-2009 the amount of FDI in LAC was $7,3 billion while just in the 4-years period 2010-2013 it was $42.7 billion. And, according to the 2015 Agreement, it is expected that during the next decade the flow of direct investment would be in the order of $25 billion per year. These figures show the dimensions of the importance that the Region is to China.

Notwithstanding the size of the expected flow of Chinese investment in the next decade, it still is smaller than the amount that the Region receives in the form of loans through multilateral financial institutions. In the eight-year period 2009-2016 the multilateral development banks serving the Region (World Bank, Interamerican Development Bank and Development Bank for Latin America) provided together an average of more than $30 billion per year, as shown in the following table.

Institution	2009	2010	2011	2012	2013	2014	2015	2016	Avg
World Bank	14,031	13,907	9,629	6,629	5,204	5,068	6,024	8,183	8,584
IDB	15,507	12,464	10,671	11,179	13,811	13,629	11,074	11,325	12,458
CAF (*)	9,171	10,533	10,116	9,125	12,540	11,721	12,000	10,000	10,651
Total	**38,709**	**36,904**	**30,416**	**26,933**	**31,555**	**30,418**	**29,098**	**29,508**	**31,693**
(*) Year 2016, preliminary data for CAF									

Sources: IBRD, IADB and CAF news and data

The Chinese commitment is also, on average, lower than the annual flows of remittances in recent years of Latin American residents in developed countries to their families, which are mostly directed to consumer spending and investment.

But the Chinese model of economic and financial activities in foreign countries is different to what is normal practice of Western companies. For many years LAC countries have utilized their own government procurement legislation and organizational settings, in many cases following the rules promoted by the multilateral financial institutions that provided a large proportion of financing. In China, on the other hand, the heavy presence of State companies in the economy opens the door to deals and projects with Chinese manufactured imports and direct capital investment and financing. In most cases, investment on infrastructure or on production of natural resources facilities projects (e.g., gas, mining) awarded to Chinese companies are "packaged" to include the full provision of imported equipment and other goods and services by Chinese suppliers as well as the financing from Chinese banks and frequently the deals are turnkey projects with very little room for integration of other providers different from Chinese firms. By the very nature of state-to-state arrangements, which come out from the 2015 Agreements, the awarding process is not according to the rules of marketplace competition, but instead is the result of diplomatic and political agreements. This method also has the potential risk of being non-transparent and, at times, even follow corrupt schemes.

Countries in Latin America and the Caribbean must achieve common positions for better results, especially in terms of commercial and financial practices, legal frameworks, or new regulatory requirements arising from the new agreements. Elements for the new phase of relations with China may include:

1. Recipient countries should develop their institutional capacity for formulation of investment initiatives, and to perform analysis, selection, prioritization and implementation of projects. In particular, they must have trained human resources; technical tools to analyze data, explore alternatives, design final projects, and evaluate expected costs, benefits and risks. This would not only encompass economic and financial considerations, but also environmental and labor issues and aspects pertinent to relevant stakeholders.
2. There is limited information about the characteristics of the new Chinese loans, but official reports suggest that credits are intended for Chinese companies that sell goods and services or that build infrastructure in the CELAC countries, a modality technically known as "supplier credit". Specific companies have even been mentioned as possible participants for the funding to take place. This type of procurement procedure typically produces less efficient results than competition between potential suppliers. In addition, it encourages influence peddling and indifference with regard to social implications about the terms of debt and how the construction and acquisitions will be made.
3. Just as countries must strive for increased capabilities to analyze projects, they must also develop tools and information technology platforms to analyze procurement processes. Lastly, national legislation on procurement is key element in each country to help ensure transparency, due process, and careful consideration of benefits and preferences occur in a standardized legal regime.

In summary, to implement the new financial opportunities coming from the Agreement with China, LAC countries should prepare their institutions and legal framework to employ funds from China, or from any other source, according to the fundamentals of investment analysis, not just availability of financing.

Based on the professional experience of our associates, Sigma Capital Advisors LLC can contribute to the work required to improve the institutional capacity, human resources and methodologies to prepare countries in the LAC region to absorb and benefit from those additional financial flows. Similarly to the services we offer in other financial areas, Sigma Capital Advisors LLC guarantees freedom of conflicts of interest and professional independence. We can assist private and government institutions, multilateral financial organizations and other market participants to efficiently and cost-effectively evaluate their investment solutions.

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