DOING BUSINESS IN LATIN AMERICA:
POSITIVE TRENDS BUT SERIOUS CHALLENGES

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***** As Prepared for Delivery *****

Good afternoon, Mr. Chairman and members of the Subcommittee. It is a privilege to be with you today. As you know, the Council of the Americas ("Council") is a leading policy voice on Latin America, the Caribbean, and Canada. For almost 50 years, our mandate has been to promote democracy, open markets, and the rule of law throughout the Americas. Thank you for the invitation to appear before you.

The headlines about Latin America routinely focus on threats to democracy along with violence and insecurity. These are certainly pressing issues. But the reality is that Latin America has changed significantly both politically and economically and, while challenges remain, overall trends are positive. On the whole, the region is coming into its own, with sustained economic growth, poverty reduction and an expanding middle class, democratic governance, and more confident engagement in international affairs. In large measure, economies have stabilized and strengthened due to concerted efforts to reform financial systems, manage inflation, reduce debt, and open them to trade and investment.

<u>China's Quest for Commodities is Changing Economic Realities in the Americas</u>

China's rise and its consequent impact on the global commodities trade has been a strong driver of this recent economic growth, particularly in the commodities exporting nations located primarily in South America, and it is here that I want to focus the weight of my comments. These nations were largely able to avoid recession during the global economic crisis which began in 2008 due to China's sustained commodities demand. In fact, China is now the top trade partner of Brazil, Chile, and Peru, and the second trade partner of Argentina. Rather than being a cause of global economic disaster as often happened in the past, Latin America, along with Asia, has proven to be an engine of economic recovery.

This is certainly a positive change. Of course, growth across the region is now slowing as China decelerates, the United States struggles with tepid recovery, and Europe remains embroiled in its own financial crisis. At the same time, not all countries are alike; Mexico and Central America do not have the same commodities export profile as South America does. Nonetheless, those relying on commodities exports have done well, although nations that have become overly reliant on commodities will be negatively impacted by China's slowdown unless they used the recent years of solid growth to diversify into value-added production. Efforts to address the skills gap between students graduating today and the demands of modern labor markets, implement policies designed to create a new climate for innovation, promote labor market flexibility, and encourage small and medium-sized businesses as an engine of job creation, among other initiatives, must be expanded, as the Council of the Americas identified in a report presented to governments at the Cartagena Summit of the Americas in April.

In the meantime, imports of cheaper manufactured products from China have inundated Latin America, and the region is undergoing a process of deindustrialization whereby the percentage of manufactured products compared to primary goods is decreasing. Parts of Latin America with strong links to China are actually moving down the value chain, rather than up. Brazil just signed an accord with China at the Rio+20 meeting which attempts to address the imbalances built in to that important emerging trade relationship. Conversely, the trade relationship that most Latin American nations have with the United States is much more evenly balanced, supporting, rather than potentially undermining, value-added production and broad-based economic development in the region.

China's activities in Latin America on the investment side are also having an impact. In the first instance, much of the promised investment has not yet materialized, leading to unmet expectations. Still, investment is flowing and it is rapidly increasing, particularly in those commodities sectors including energy, mining, and agriculture, where China feels the need to lock in access to the supplies which have sustained its economic takeoff. Of particular interest is energy, where China has been an active participant in Venezuelan, Ecuadorean, and other projects, for example. Chinese investment is accelerating as proven energy reserves expand rapidly and dramatically across the Americas, from the deep water off Brazil to shale gas in Argentina. This is a global phenomenon and China's energy interest in the Americas is not limited to Latin America; just last week, for example, CNOOC announced its biggest overseas energy deal, agreeing to purchase Canada's Nexen energy company for over $15 billion.

This theme will only become more pronounced in coming years. As China's authoritarian rulers seek political legitimacy not from the ballot box but rather from sustained economic growth and an improving quality of life for its 1.4 billion citizens, while maintaining a multi-trillion dollar hard currency war chest, continued access to the raw materials worldwide that fuel production is seen in Beijing as a national security issue. Investments are made accordingly, with implications for doing business in the Americas.

All Investments Are Not Made Equal

The Chinese model of investment differs from others. In the first instance, the initial asset purchase by Chinese entities is frequently underwritten by the Chinese government, thereby allowing Chinese investors to outbid their Western counterparts as a matter of routine. Chinese entities often pay a premium above market value for their purchases, in order to lock in assets. Indeed, the price offered for Nexen is a 60% premium.

Once an investment is confirmed, Western investment values of job creation on the local economy, technology and management transfer, corporate governance, respect for labor rights, environmental protection, anti-corruption, and corporate social responsibility are not necessarily priorities. This can unfairly put U.S. and other companies at a disadvantage by lowering the costs of Chinese production vis-à-vis the competition.

But there are larger implications here, as well. Since the end of the Cold War, Latin America has advanced significantly to promote democratic governance. Progress has been uneven to be sure, but it is unquestionably in the U.S. interest to promote this path. Open market democracies that broadly share values tend to make the best long-term partners of the United States in the promotion of shared interests. China's entry into the Americas has complicated this effort, not just in the conduct of business but also in the conduct of foreign policy.

For example, efforts to promote labor and environmental reforms through sound business practices and formal trade agreements are undermined when nations sign agreements with China that do not include similar provisions, and Chinese businesses are not expected to operate under the same prevailing conditions. Multilateral lending agencies like the World Bank, IMF, and Inter-American Development Bank that promote financial reforms and good governance become less relevant if borrowing nations can receive funds from China without conditionality. China's huge purchases of commodities and the provision of credits on favorable terms allows regional leaders the flexibility to postpone necessary economic and policy reforms consistent with open market, democratic governance, or to take actions that harm the investment climate.

A Competitive Commercial Environment Calls for a More Strategic Approach

China's interest in the Americas will only grow. This means that the United States must do a better job contending for the region. We need a more strategic approach.

In the first instance, the United States would do well to deepen further our economic relations with Canada and Mexico, nations that engage in common business practices with the United States and Europe, as partners in the promotion of a common agenda that share common values. Mexico, for example, is resisting the protectionist temptation to which others in the region are succumbing, and has been a clear voice for open markets even in the face of market turbulence.

More broadly, we need to re-activate an ambitious economic and trade partnership agenda for the hemisphere. The Trans-Pacific Partnership is a meaningful start, but needs to be re-envisioned as a strategic initiative for the Americas, not just Asia. It should be expanded right away to include Colombia and Panama at a minimum, and, over time, explore the possibility of including like-minded non-Pacific coast nations in Latin America. Other initiatives to improve the regional business climate would include stronger emphasis on energy partnership in the Americas, and efforts to promote regional financial markets integration as well as the rule of law. From a bilateral perspective, a dual tax treaty with Brazil would be one of the most effective things we could do to promote trade and investment with Latin America's largest market.

The battle for the soul of Latin America continues, and the United States must engage in a positive, pro-active manner to offer the region a vision for cooperation consistent with our values. China's entrance into the Americas has changed the game. A re-energized approach to the region is required.

Mr. Chairman, thank you again for the opportunity to testify before you this afternoon. I look forward to your questions.