China Economy Lecture featuring Stephen Kaplan – Globalizing Patient Capital: The Political Economy of Chinese Finance in the Americas, December 1, 2021

– All right, good afternoon. I see that people are still trickling in and we welcome you. My name is Professor Meg Rithmire. I'm an associate professor at Harvard Business School, and I am the convener of this seminar series on the Chinese Economy at the Fairbank Center for Chinese Studies at Harvard. Today, we are fortunate to have the co-sponsorship of the DRCLAS Center for Latin American Studies. The David Rockefeller Center for Latin American Studies. It's called the DRCLAS in Harvard parlance. For a special session on Chinese finance in Latin America with Professor Stephen Kaplan. Before I let Professor Kaplan talk about his new book, let me introduce him very briefly. He's associate professor of political science and international affairs at the George Washington University Elliott School of International Affairs. His teaching E interest and research interests focus on the frontiers of international and comparative political economy where he specializes in the political economy of global finance and development, including the rise of China in the Western hemisphere and Latin American politics. His first book was called "Globalization and Austerity Politics in Latin America." And the book itself and the dissertation on which it was based, won a number of awards from the American Political Science Association and beyond. And for the last several years, he's been working on this project on Chinese finance in Latin America. The book which I have here is called "The Rise of Patient Capital: The Political Economy of Chinese Finance in Latin America" from Cambridge University Press. And I suppose I shouldn't say this 'cause it's bad for book sales, but it is available for free online to read on HOLLIS Library. So if you don't wanna buy a copy of the book, you can always access Harvard's libraries to download the individual chapters and read them. It's a special opportunity to hear from Professor Kaplan because this localized knowledge of both Latin America and Chinese finance is exceedingly rare. We do have some colleagues across the river including Kevin Gallagher and others who focused on this, who give blurbs on the back of the book, but we're lucky to have you here. In addition to Professor Kaplan, we have a colleague of mine, Professor Laura Alfaro to discuss and I will introduce her to give some discussing comments. She's exceedingly qualified to do so after Stephen gives us a talk on the book. So with that, I will mute myself and welcome Stephen, but just a couple of housekeeping notes. We are live streaming to YouTube so you can watch this later if somehow you need to go. And after Professor Alfaro's comments and Stephen's response, we will open it up to Q&A. So I encourage you to use the Q&A box at any time to insert your question at any point, and I will be fielding them at the end of the summary exchange. Thanks so much for joining us, Professor Kaplan. We're excited to hear about it.

– Thank you very much for having me. I am gonna share my screen now.

So thank you very much for having me. I'm very excited to be here today and thank you very much to both the Fairbank Center for Chinese Studies, as well as the David Rockefeller Center for Latin American Studies for hosting me today along with Meg and Laura as well. So what I'm gonna do is basically kind of set up China's emergence as a global creditor and then look at how that has impacted Latin America specifically and what we can learn from the Latin American experience as a debtor. So to begin with, if we look at this graph beginning with the global financial crisis, we see that China increased its global bank lending quite dramatically. Whereas prior to the global financial crisis, it was a global creditor that was fairly similar, if you look at the graph to sort of what Brazil had been doing internationally. But you see as sort of Western financing begins to withdraw following that global financial crisis, China takes the opportunity to increase its own cross-border banking activity. And today, is one of the top five bank creditors in the world. At the same time that that's happened, we've seen recently that China and particularly, President Xi, has made some bold proclamations. Including making China leading world power by 2050, blazing a new trail for other developing countries to achieve modernization. And that China offers a new option for other countries who wanna speed up their development while preserving their independence. So we wanna look at what is the role of China's global banking activity in trying to achieve some of these long-run objectives. Here, we can look at the geographic breakdown of China's policy banks. So China has both the China Development Bank and Export Import Bank of China that does a lot of this global financing. And effectively, we can see that much of their cross-border activity is oriented towards the age of Pacific. But we do see that both Sub-Saharan and Africa and the Americas account for a large portion of this financing as well. Americas has accounted for about 16 to 17% of this financing. And what we wanna be able to do here is look at what we can learn from China's experience as a creditor in the Americas, and not only look at the variation in Latin America based upon China's financing, but also sort of what the implications of that are. So to begin with, in terms of a theoretical framework, I'm looking at the history of mobile capital right throughout the globe. And if we look at the history in the political science literature of mobile capital, we see that it focuses on rooms for states to maneuver. How much policy flexibility that states tend to have under financial globalization. An important part of this framework is the Mundell-Fleming Trilemma historically. Which suggests that in a world of global capital mobility, national governance tend to face a trade off between macroeconomic policy autonomy and exchange rate stability. Now, a key assumption historically is that capital is private. And with us exit countries when faced with financial stability and currency depreciation, that erodes profits. So ultimate capital's exit threat can compel governments to raise interest rates, constrain fiscal expenditures in order to try to re-attract investment. However, I argue, when you look at China's capital, it's a patient form of capital. And this changes the basis of the Trilemma because it tends

to be state-led financing. And I'm gonna argue that eliminates this capital exit threat to some degree and allows for greater policy maneuverability. Why? Well, China has capital controls that limits its overseas private investment and restricts the ability of residents to invest in financial assets overseas. So there's a minimum of short run financial connections between China and the rest of the world. And we tend to get more financing that's long term infrastructure-oriented financing as a result. So why would we consider China's patient capital to be different from Western capital to some extent? If it's different from Western capital, in what way would it be different? So within the book, I make the following arguments for why China's capital may be different from market-based capital. One, it has a longer maturity structure often. Which can be similar to other bilateral lenders, but the scale is rather unique. China has, particularly starting with the global financial crisis, increased its cross border lending, as you saw earlier dramatically and the scale of state to state lending was rather large compared to what other bilateral lenders would do. The average maturity of Chinese loans is 17 years compared to about five years for private creditors. And this reflects the infrastructure-oriented nature of its global financing. I also argue that has a higher risk tolerance. Policy bank investors are more likely to stay with their investment through both good and bad times. Why? There's a longer term strategy of China in terms of using this finance as a way to internationalize its firms. By using and employing infrastructure financing, it can also sort of unleash opportunities to gain cheap assets, market shares, improve key logistical skills of its firms, including marketing, distribution, local engineering capabilities as well. And so compared to, if we think of even multilateral financing or Western bank financing, often, it's very much oriented towards individual bankable projects. Comparatively, what we often see with Chinese financing is it's oriented towards creating strategic credit spaces. To create economic activity in risky environments. Now, of course, risk appetite is not limitless, but policy banks are willing to kind of emerge in the space between traditional commercial banks and development banks in order to try to provide financing and capture market share internationally. So in the book, I make the argument that rather than just being about individual profit maximization, often, China's trying to use its financing to have market maximization instead to help capture markets overseas. A good example of even how China's financing might compare to traditional Western financing is oftentimes during downturns, Western financing tends to exit. Comparatively Chinese financing, because it's coming in to try to take advantage of buying cheap assets, oftentimes, what we've seen over the course of the last decade is when there's an economic downturn, such as the global financial crisis, or in this case, you're looking at FDI into Brazil during Brazil's economic crisis, or even during its recent corruption scandals, we see that China's financing will come in and take advantage of these opportunities to buy cheap assets. So oftentimes, where comparatively, we see Western financing being pretty atomized,

where you have portfolio flows, FDI flows, aid flows, and it's all separate, generally, Chinese financing tends to be more package-oriented. Where you may have infrastructure financing, leading activity, but it's meant to generate trade, foreign direct investment activity. And it's meant through this generation of economic activity to ultimately expand the size of market share of Chinese companies over time. So compared to Western financing, another key feature. So far, it's longer term oriented, more risk tolerant historically, but also this lack of policy conditionality. So we tend not to get the same onerous policy conditions that we get through sort of Western multilaterals or oftentimes are reinforced through market mechanisms. Rather, there tends to be a doctrine of non-intervention in domestic affairs based upon the five principles of peaceful coexistence in China. And so ultimately, you get financing that tends not to necessarily focus as much as Western financing on policy conditionality. A good example of this is the policy banks have research arms and these research arms ultimately oftentimes, will make recommendations. Even recommendations that may involve macroeconomic policies, stabilization policy, things along these lines, but there's no sort of conditionality. So oftentimes, even when I've met with researchers at policy banks, they sometimes have even communicated, frustrations at times. That they could make and communicate recommendations, but there's not necessarily that teeth to those recommendations. So then this question is if you have a lack of policy conditionality, well, how do you reinforce or how do you hedge investment risk? So in the book, I make an argument that with Chinese financing, you have commercial conditionality instead. So effectively, financing is secured with loans that are collateralized by future commodity deliveries. So one key feature that we see in many countries, such as Venezuela and in Ecuador is that effectively, you'll have loans to the government, but the same time, you'll have a separate contract with sales of exports of a commodity from a state-owned enterprise to Chinese importers. With the proceeds of those sales, they will be in bank accounts that are dedicated to repaying Chinese debt. So this is one way to hedge risk, even though you don't necessarily have policy conditionality. Traditionally policy conditionality would say, if you have balanced budgets, and you build up government savings and will have more of an ability to repay its debt, instead, Chinese creditors are trying to secure their financing with commodities essentially. Also sometimes with this commercial conditionality, you have guaranteed contracts are oftentimes with Chinese firms, contractors and suppliers. So part of this is commercial conditionality is hedging risk, another part of it is creating opportunities for Chinese firms abroad. So if China invests in a hydroelectric plant in Argentina, there are commitments to buy Chinese machinery, Chinese turbines. So it's a form of export promotion, very similar to tied aid historically. Now, a key trade off, as we'll see during this talk as well, will be oftentimes with this commercial conditionality, there's not always contract transparency. So we see generally oftentimes, Latin American publics

gets very concerned about what's in the fine print. Particularly in terms of such things as environmental sustainability, indigenous rights, indigenous opportunities, things along these lines. So in this graph, you can see overall external financing. And generally within Latin America, oftentimes, governments may not have sufficient financing or sufficient revenues coming into government to pay down all of their expenditures. So they will look abroad in order to help finance their expenditures. And they can finance this in a variety of different ways. Historically, it's been through global bonds, multilateral loans, etc. What you see happen throughout the 2000s is governments tend to turn to bonds less so in order to finance their expenditures, as well as multilateral loans, as they start to pay down more of their debt. But comparatively, Chinese policy bank loans, particularly since the global financial crisis accounts for a larger share of that financing internationally. So part of what I wanna look at is to the extent to which Chinese policy bank loans are responsible for financing and increasing share of government expenditures, what kind of impact does that have? And do we get more policy flexibility as I suggested we would anticipate based upon now that global financing being state-led, more long term, risk tolerant, and without policy conditionality compared to other flows. Now what's important, and we'll see throughout this talk too, is there's a trade-off. So oftentimes in the newspaper, Chinese loans are characterized as primarily state-to-state loans. But we see in Latin Americas that they can also be market-oriented. They could, in other words, help finance projects and the money would go directly to corporate enterprises to help finance those projects rather than necessarily directly to the government. So in this graph, you could see that even though state-to-state loans represent a large share of Chinese policy banks financing in the region, there are some of these loans that are more market-oriented. So we can take advantage of that variation to see, does it make a difference if the loans are more market-oriented versus state-to-state. Now, why might this be important? Let's turn to Argentina. And I'll give an example of these two channels in Argentina. We have the state-to-state channel when China helped finance hydro power stations in Santa Cruz, Argentina. In this case, there was direct contracting with Chinese banks, which was allowed for, under Argentine law, if it was concessional. So there's an advantage of getting this cheaper financing for Argentina. And at the same time, there's still sort of increase in state indebtedness here because Argentina provides a state guarantee of the loan. So effectively, you have a state back loan direct contracting. But when we look at the terms of the commercial side of the project, you see that there's a large portion of that project that's oriented towards civil works. And more than 75% of that ends up thus being, giving Argentina some spending discretion. Where about a quarter of it is oriented towards paying for Chinese machinery, equipment and turbines. So you get this advantage of having some fungibility, some discretion along with cheaper financing, but as mentioned before, issues surrounding transparency, specifically with this project, the Argentine Supreme Court suspends the advancement of

this project because of environmental concerns. Effectively, the contract details were not well-known. Lots of people fretted about the environmental sustainability of the projects, They end up being renegotiated. And the number of turbines is reduced as well as a generating capacity. Now, comparatively, what happens when it goes to the private procurement channel?/ Here, a good example would be Cauchari Solar Park in Argentina. Here, you have a privately-managed auction system called RenovAr. And when Shanghai Electric Power Construction wins the bid, the loan flows directly to corporate enterprises with the winning bid as well. So it's not the same state discretion, policy discretion, policy maneuverability. You still get from China's Eximbank, a preferential export buyer's credit that allows for the purchase of Chinese machinery equipment. So you still have kind of this tied loan element, but you don't get the policy flexibility. You don't get that policy discretion that you do when it flows directly towards the government. Also, it tends to be more transparent. In this case, there had to be local community consent. There was local members of the community, could even receive training to work in the plant construction and operations, ultimately even got rights to participate in the profits of the project. So there's a lot more transparency compared to when it flows through the state channel. So we're gonna be looking at this trade off effectively of, more degree of maneuverability and the lack of policy conditionality versus commercial conditionality. That's a trade off, ultimately that many Latin American countries can face with Chinese financing. So you see here, one element of it, this is a just descriptive statistics effectively as China's bilateral credit expands as share of total external financing. We see that on average primary budget balances also expand as well. So this is suggestive of the idea that governments may get more room to maneuver. We also see this right in some statistics here as well and comparative statistics when we look at China's state-to-state financing as a share of debt or GDP as compared to some more traditional measures, including bonds and multilateral loans. As you can see with Chinese financing, the sign here, even though it's statistically significant, is negative. Meaning fiscal deficits tend to be associated with larger Chinese financing. By comparison, when countries finance themselves with global bonds, multilateral loans, there tends to be a positive relationship here. Meaning, the more bonds or multilateral loans, the more likely you are to have narrower fiscal deficits or even surplus. So ultimately, whether fiscal deficits are good or bad will reflect the kind of investments that governments make, so it's unclear whether this policy discretion that may come from Chinese loans is sort of a good, a net good, or a net bad. However, it puts the onus, rather than through policy conditionality, which is sort of a check for creditors to ensure that governments are saving enough to repay their debt. Comparatively, China puts the onus on countries to manage that macroeconomic stability. And so, depending upon the governance situation locally, you could have really good investments or you could have investments that go awry. Here, you also see that relationship

between this negative association between Chinese financing and negative primary budget balances as well across a range of models. Descriptively, we can also see it in the case of Argentina, Ecuador, and Venezuela here from 2000 to 2018. If you look at this graph prior to the global financial crisis, even in these nations that were governed by the left, tended to have budgetary surplus right up until the global financial crisis. Now not surprisingly during an economic downturn, we see countercyclical because of these government savings, governments are able to spend counter-cyclically. But the argument I make is that these blue lines would represent Chinese financing. And as you can see, as Chinese financing comes in, makes up a larger share of external financing, even though you had a countercyclical reaction to the crisis, these budget deficits tend to stay over time. I would make the argument that this would be the result of not necessarily having policy conditionality. So government's not necessarily having to have the same kind of checks in terms of budget discipline when they're borrowing from Chinese sources. Now we see some variation here. For example, Brazil has constitutionally mandated public procurement. What does that mean? That means that effectively, Brazil can't finance itself through direct contracts with China. So effectively, it flows directly to corporate enterprises in Brazil. So as a result, much of Brazil's financing is still very market-oriented. And you could see as a result, even during a time where there's economic downturns and you get sort of initially some countercyclical reaction, you also get the implementation of a constitutional spending cap. In order to ensure in a country that has expanding government liabilities over time, this constitutional spending cap is implemented in order to ensure budgetary balance in the long run. I would make the argument that the market forces and Brazil's share of market financing helps keep this budgetary constraint relative to a country like Venezuela, where there was no constraint that came with Chinese financing. So now I wanna switch over to commercial conditionality, So to date, we've made an argument essentially that as Chinese financing flows to national governments through direct contracting state-to-state lending, the public balance sheet is often expanding. We've seen sort of this relationship, a correlation. Now on the flip side as mentioned, even though there's no policy conditionality, we get commercial conditionality. And there's two types of commercial conditionality that tend to flow with Chinese financing. One is, it's oriented towards promoting Chinese commerce. So not hedging risk as much as promoting Chinese commerce. So that's bilateral tied aid that's seeking to expand Chinese foreign content. Good example of this would be something like the preferential buyer's credit from the Export Import Bank of China. In the case of Argentina, Argentina is one of the countries in Latin America with the most nuclear power reactors. Has three of Latin America's seven nuclear power reactors. So effectively, China looks at its global share of nuclear energy. It's around nine, 10%. Compared to a country like Russia, where it's at about 45% of the global market. It can use this concession preferential buyer's credit in order to aid in the construction of a

new nuclear power plant in Argentina. But then, there's stipulations that the nuclear reactor will be built by China, the foreign content and the purchases of machinery will all be related to China. So that can expand China's commercial presence in nuclear energy, not only in Argentina, but also globally. So there's this element of expanding rather than focused on individual profitability. It's focused on market maximization and expanding the share of Chinese business strategically and internationally. You often tend to have commercial interest rates. So sometimes we get an orientation where it's called development finance, but oftentimes, there can be commercial interest rates and Chinese policy banks have the flexibility based upon the situation. Sometimes we get lower interest rates in the market, other times, we get rates that are closer to the market. So this isn't necessarily straight for development finance. There also tends to be an element of this that's also oriented towards currency promotion, Renminbi promotion. So to date, much of global commerce global trade within Latin America tends to be oriented towards commodities. So a lot of this is settled in dollars today, but we see China building the apparatus through commercial banks, through its policy banks, through central bank swaps to eventually in the long run, be able to use a renminbi. And so there is an element of this that also is oriented towards internationalization of the renminbi. So we have this kind of set of commercial conditionality that's oriented towards promoting Chinese commerce. But then we also get tools for managing sovereign risk. When meeting with policy bank officials in China, they would highlight essentially that, well, we have a different way of managing risk from the West, and we're very good at it. And so essentially, they would highlight multitude of different things. One being administrative channels. In the case of the hydroelectric plants I mentioned before in Argentina, when there was that environmental stay put forward, China directly communicated with Argentina, sending letters and reminding Argentina about cross default clauses that were contained within the contracts. And if Argentina didn't move forward with those hydroelectric plants, China would pull its financing elsewhere. So there's this use of administrative channels in the contract to kind of enforce agreements. And even though you saw, there was a negotiation and turbines were reduced and generating capacity was reduced. Nonetheless, the project kept moving forward. You also get commodity guarantees as mentioned earlier, commodity-backed loans. This was very popular in places like Ecuador and Venezuela, where governments got more discretion through direct lending, but then the state on enterprise would sell exports to Chinese importers, take the proceeds, put it in a bank account. That's dedicated to repaying that debt. And finally, you have state-backed commercial insurance that would help support and mitigate this risk through state state companies, such as sign offshore. So when looking at cross-default clauses, this is an example of the kind of cross-default clause that we'd see in contracts. This is from Argentina's contracts. And this highlights the cross-default clause that existed between the Belgrano Cargo Railway and the hydroelectric plants I mentioned earlier.

Interestingly enough, the hydroelectric plants had very relatively low Chinese content, only 30% compared to a traditional deal. So at the time, China was actually inserting this cross-default clause in order to ensure that the Cargo Railway was built because they had 100% of the content in that contract relatively. So ironically, even though they use a cross-default clause to ensure that the hydroelectric plants move forward, it was contained because they were very concerned about the cargo railway moving forward. So here we can see, again, a set of descriptive statistics where the first kind of commercial conditionality that's oriented towards expanding Chinese commerce is one here. That's gonna firms, contracts to buy from Chinese firms, machinery, things along these lines. And we can see the black is if it goes through corporate financing. The grays if goes through China state-to-state financing. The two highlights these commodity back loans. Securing lending with natural resource commodities sings along these lines. The gray again is your state-to-state relative to China's corporate financing. What we see here is what the state-to-state financing, you tend to get a lot more of these kind of oil for loan deals. Commodity-guaranteed, resource guarantees in order to help secure the loan. So even though you get this policy conditionality or lack of policy conditionality, potentially more degrees of maneuverability for a government the same time, there are these commercial conditions that are guaranteed instead through natural resources and commodities. And you can see this relationship here in general, this association, as China state-to-state financing makes up a greater percentage of total Chinese financing. You tend to have more commercial conditionality over time. So in the remaining time here, what I wanna do is then from the Latin American perspective, talk about these benefits and costs in a little more detail that come from Chinese financing. And then also look at what China's doing in light of some of the risk it's taken on in the region. So some people argue that China has engaged in debt trap diplomacy in the region. In other words, they purposely indebted other countries in order to get cheap assets from those countries. Essentially, what my work right in other people's work. I know Meg has illustrated similar points in her own work as well. Effectively showing that, well, this is much more of a creditor trap in some ways, right? Where China as a new rising creditor has made bets within Latin America that have gone awry. And so the lack of policy conditionality in some ways has left China much more exposed to credit risk. And it tried to mitigate this credit risk through resources and commodities, was ultimate left exposed. So let's look at those trends in a little more detail. First, we have the benefits. So it highlighted that, yo long-term financing in a region, that has struggled in the '90s and the 2000s with austerity and implementing austerity in order to attract capital. What got cut over time? Well, actually education, healthcare, these things actually expanded in the region, even during periods of austerity, oftentimes, in the long run, but where governments had to make the cuts with infrastructure. So we see sort of large infrastructure deficits throughout the region. And the 2000s, we had Latin American investment

at a mere about 0.6% of GDP compared to 3% rates in 1980s. So when China comes in with this long-term infrastructure financing, it's incredibly appealing to Latin American governments that need infrastructure. And they're not getting it sufficient amounts through private sector, etc. Take Ecuador is a great example. They had a hydroelectric power plant project in the works for over a course of a decade or so, but couldn't arrange financing from Argentina and other suitors, but income China with multi-billion dollar financing willing to do that. Right So Ecuador looks at that and that's a great opportunity from Ecuador's perspective. But this financing can come with cost. And this is where the commercial conditionality is really important because loans are tied as mentioned earlier, to Chinese firms, products and machinery. So just like trade negotiations. Again, sometimes, this infrastructure financing has a development rhetoric that's associated with it, but it's very much commercially oriented. And so when it comes down to the commercial side of these contracts, it's oftentimes a negotiation about the local content. A good example of this is an Argentina during the Kirchner administration, when they're very dependent upon Chinese financing coming in, they were not able to, they were negotiated for manual labor for the public works projects, did that very well. Weren't able to necessarily negotiate for certain parts of the project, certain types of local content. For example, Argentina has an industry in railway ties. But they weren't able to secure the components or those railway ties for the cargo railway during the Kirchner administration when these loans were first negotiated. The macro administration comes in, opens up to global markets as more of a diversified financing source is better able to negotiate for this local content. So one is that even though this is infrastructure financing that sometimes sort of has its development rhetoric, has this win-win rhetoric, at the end of the day, Latin America countries need to have a buyer beware attitude, 'cause it ultimately reflects a trade negotiation over local content. There's also lots of concerns about middle income trap. This is concern that China has in its own economic development. But we also see throughout Latin America. The history of Latin America has been one where countries have been very commodity-dependent and wanted to diversify into industry over a very long period of time. And to some extent, if you think of the way these contracts are completed within Latin America, oftentimes, as mentioned before, they're secured with commodities. Oil deliveries, commodity deliveries, but what's happening in exchange for that, all these countries are buying Chinese capital inputs, Chinese machinery. So there are concerns of hollowing out of Latin America's industrial sector. Now of course, China's aware of this. So they also say, listen, we understand you want more value added. We're willing to kind of do more manufacturing, investment things along these lines. But if you look at to date, much of that has gone to Brazil. So only 1/10 of Chinese FDI has been destined for Latin American manufacturing sector. 2/3 of that investment has gone to Brazil. There's also the question of just labor costs. Latin Americans is a region that tends to have higher labor costs. That can

be very difficult to then compete with Southeast Asia or other countries in Africa when it comes to these kind of advantages for labor intensive manufacturing. And then finally, there's indebtedness. We'll get to indebtedness in a moment. But first, we can just look at again, these charts showing descriptive statistics over time and you can see as China joins a WTO, this black line is high tech manufacturing inputs from China. Expand dramatically. The dotted line since China joins the UNWTO, which is high tech manufacturing imports from the US, relatively steady over time. But obviously one of the big concerns is here. We have countries like Argentina, we have unicorns, tech companies that are emerging, but to what extent can that be a broader trend within the region? And so some of these patterns are reflective of Latin America's concerns about middle income track and the ability to be able to diversify into higher technology goods. Then we also see sort of in terms of commodity dependency, again, stylized facts, just descriptive statistics here. You see that effectively Latin America's primary commodity exports to China continue to be high over time and Latin Americans and manufacturing good exports to China have even dropped off over time. One from off of a relatively low base, but one from when China joins the WTO, but then also after the global financial crisis. So you see in stylized facts that there tends to be a lack of Latin American opportunities for Chinese market in terms of their own manufacturing goods. So the final cost would be in terms of indebtedness. And in terms of indebtedness, there's concern about the moral hazard problem. If you do not have policy conditionality, it could give governments more degrees of maneuverability. Coming out of an error right of austerity, this can be a very positive thing if governments spend wisely. However, when you do not have that policy conditionality and if governments are not willing to orient themselves to a good macroeconomic policies, macroeconomic stabilization, then you could have sort of expansive government balance sheets without sort of any kind of check. And this is the kind of thing that we see happening in Venezuela, as well as Ecuador too, during these periods of time where effectively, they use government commodities as mentioned before, to help enable this state-to-state lending, both countries expand their state balance sheets, but then, owe China a lot of oil resources over time that are oriented towards help financing. In the case of Ecuador is four years of oil exports. That were used to finance present consumption. And so this tends to be an issue in terms indebtedness for the region. And this also reinforces the point I made earlier about China's creditor trap. As Venezuela enters into a debt moratorium in 2016, effectively, China can not get its interest payments, its oil payments. The proceeds from those oil sales are not sufficient. So China is in a defensive lending posture trying to reschedule and restructure loans in order to get new principal and interest payments. It's quite similar to the kind of stance commercial banks in Latin America faced during the Latin American debt crisis. So from this standpoint, I would make the argument that China is a new creditor globally. And rather than a debt trap, made bets in countries like Venezuela and was not able to

effectively, how did they make the bet? They said, okay, Venezuela's oil production will be sufficient that that will sort of underwrite this lending. That will finance or support this lending, collateralize this lending ultimately. What happens, so we'll see in a moment, Venezuela's oil production falls dramatically. So there's not the proceeds to repay these loans and effectively that's where it's sort of a mispricing creditor risk situation rather than from my standpoint, an intentional desire to make Venezuela indebted over time. So we'll close with these few graphs and before looking at how China as a creditor, are reacting to these trends. And you can see in the case of Venezuela, this is Venezuela as foreign debt over time. You can see it's greatly expanding. And by 2019, it's over 200% of GDP. In the red here is the amount that China accounts for. So oftentimes, this rhetoric of debtor trap is used in countries like Venezuela, but you can even see it's only about 20% of the overall debt that China's accountable for us. So if we're gonna use a debtor trap language, we have to think of Wall Street bankers. To think of everybody that has exposure to Venezuela during the period and was willing to continue to lend. So the problem ultimately is that Chinese policy banks thought, all right, we'll collateralize this lending with oil, but what happens? Oil production falls over time. This is thousands of barrels per day. And you could see from 2006 to 2007, all the way to 2019, you see essentially, that oil production basically falls by about 1/3 or so during that period of time. In the red is what China is promised in terms of oil sales. And you could see that it ends up being a larger and larger share of what's outstanding. What does this mean? State oil companies have pre-commitments then to Russia, to China, to the Caribbean, through PetroCaribe. Sort of foreign aid program. There is less and less available to reinvest in the companies. So you have a situation where essentially, as Venezuela goes through an economic and humanitarian crisis, oil production is faltering, there's not enough proceeds to repay its debt. And we have a situation where Venezuela goes into the debt moratorium, hence, a creditor trap. So in closing, we have about a minute remaining here, China now is taking more of a diversified strategy in the region. Because it had this state-to-state lending. And still, a lot of it's outstanding debt ends up being state to state. But they're also thinking about, okay, how do we diversify our exposure in light of the commodity downturn? And more recently, the COVID pandemic. So we see China increasingly using equity rather than debt financing to diversify its exposure from the state-to-state level. So in other words, we see state-backed equity funds. In other words, capital reserves or money from policy banks that are used in order to directly invest in companies, in manufacturing, logistics, agriculture, across many countries, including Argentina, Brazil, Peru and Jamaica. We see there's 40 billion of funds dedicated to Latin America since the global commodity downturn and 40 billion dedicated to Silk Road fund. But only for this Latin American funds, $2 billion were de were actually implemented or dispersed within Latin America right prior to COVID. That only represented about 5% of Chinese capital that was

committed to these funds. So we see that they're trying to diversify bits incrementally. So much of it still remains state-to-state. What else do we see? We see increasing move towards multilateralism. We even see it over president Xi's speeches at the BRI forum from 2017 to 2019, we got an increasing focus on multilateralism. New investment partners, Chinese commercial banks are becoming more active internationally as well. And we see more partnerships with multilateral institutions, including the World Bank and Inter-American Development Bank or to argue this is in part, this move towards multilateralism is reflective of desire to try to mitigate some of this debt burden over time as well, by trying to diversify its finance flows moving forward. We can also see the AIIB is operating with private procurement through international bidding. So China is also increasingly sort of talking about the importance of private procurement international bidding. So given what we've learned from Latin America, where when financing flows to those channels, it tends to be more transparent and Governments tend not to have that same discretion. The money goes right into corporate enterprises and projects. This may be also, even though we think traditionally of China state-to-state lending, if we see more and more taking place through the private sector or through procurement programs, that could be potentially a positive sign in terms of trends such as transparency. So with that, just wanna close with the saying from John Maynard Keynes, essentially, "The old saying holds. Owe your banker 1,000 pounds and you're at his mercy. Owe him 1 million pounds and the position is reversed." Hence one of lessons for China and Latin America has been one where even though they thought they securitized their lending through oil for loan contracts, commodities, natural resources, they have found themselves in a position of defensive lending. Places like Ecuador and Venezuela, having to restructure in order to get access to payment arrears. Thank you very much. I look forward to your comments and questions.

- Great. Thanks, Stephen. I just learned a ton. I have a lot of reactions myself, but that's not my job right now. My job is to introduce our discussant, Professor Laura Alfaro. Laura is the Warren Albert Professor of Business Administration at Harvard Business School. She holds a number of professional positions at the NBER and other places, including the DRCLAS policy Committee. She is an economist whose work relates to the field of international economics. And in particular, international capital flows, foreign direct investment, sovereign debt, trade and emerging markets. So all relevant topics and between 2010 and 2012, she served as the minister of National Planning and Economic Policy in Costa Rica on leave from HBS. So most of us just take sabbatical, but she an economy and knows many of the people featured in your book. Many of the policy makers with whom Chinese investors or lenders are engaged in Latin America. So Laura will now discuss the book for a few minutes and then we'll give Professor Kaplan a chance to respond. And again, I invite the audience members to please leave their questions in the Q&A box, and

I'll be asking them after this exchange. So thank you, Laura for doing this.

- Thanks. Let me share, do you see my slides.

- Yes.

- Yes. Thank you, Meg. She reached out to me last week to comment this book. And I have to say that I did spend a lot of time reading it. I do recommend you to buy the book. So I'm trying to give you back some of the Royalties that Meg took away. If not, your local library always accessible. So this is a fascinating book and as was mentioned, I'm not gonna overview it. It does have two big parts. The big part tells you the story of China as a rising global creditor. The second part looks at this relation through the eyes of Latin America. So it's a rich analysis again, of this capital flows relation. I would say long 'cause I'm an economist. We tend to do little articles. So I did spend some time yesterday burning the midnight oil. But again, I just couldn't stop reading the book. As was mentioned by Meg, full disclosure. My political party was the one that actually negotiated the transition from Taiwan to China. This was a real politic movement for a country like Costa Rica that we do our main source of income that are related to trade, capital flows, tourism. We just could not have relations with China. And so, the overall thesis that one should engage with different players, in particular, capital flows players. I would agree and again, this is what we did. But as my boss would say, and when I say boss, I mean the vice president of the country. When I was an undergrad in Costa Rica, I worked in a small consulting firm. It just so happens that who became later the vice president when I was there was my former boss. So it was an interesting relation 'cause he still saw me as a student and I was happy still to learn from him. He used to own the biggest bank in Costa Rica. And so as he would say, one needs to engage all the possible relations, but one does need to read the contracts. And so what I'm going to do is focus on three topics. I'm actually going to reorganize some of the arguments as costs. The cost of the project is not only the interest rate. Another argument is I actually do see the lack of a transparency as a big problem. Apart from something that Carmen Bing and Christopher Trevor have documented, there is a lot of hidden debts. So a lot of the graphs we need to take with care because they are under perhaps representing some of the burden with China. I do think that budget constraints matter, even if you don't wanna write the budget constraint. If you wanna ignore it, it's still there. And I do think sustainability came back to haunt as was mentioned. And the last one is I think projects should be judged by the social rate of return. An infrastructure project on its own is not necessarily a great project. And so that I do think, it would be nice to engage in the next paper if you want or book. So let me go back to first, the topic of the cost. It is not clear to me per se, these loans are cheap even in an interest rate point of view because we're talking about the era of the

very low interest rate. Here, I quoted the US pet funds rate after the global financial crisis is the time everyone went to low interest rates just to be surprised by the carbon era, whereas even lower interest rates. We have defined the lever over the zero lower bound. The Europeans effectively have a nominal negative rate. But everyone could borrow at low rates. When I was in government, we knew. Our problem was not lack of financing. Our problem was capability of implementing good projects. Every country Latin America was able to spend in bad times. We don't have a problem with that part. When we're Keynesian, we do spend in bad times. Our problems, we cannot save in good times and that is what is required to be . Related to that, this is also the time when Latin America actually managed to borrow local currency. There is this famous concern coined by Eichengreen, Hausmann and then my good friend, Ugo Panizza, that Latin America cannot borrow in local currency. And that is a symptom of many things. There has been redemption to this scene. And Latin America is able to borrow in local currency except from China. And it is true that there are swap lines, but they're still paid in dollars. It's unclear to me, those swap lines are going to ever be used, especially in these volatile time. Related to that, we actually have managed to extend our maturity. The average maturity in 2015 for Latin America is 20 years. And it does include very short-term finance needed for government. Peru, Mexico and Brazil managed to sell 100-year bonds. So private capital is more patient that I would say the book makes it sound to be in many forms of finance. And even Latin America has managed to extend maturity even to a 100-bonds. I would say that the fact that you have to buy the factors from China machinery equipment, labor actually means that the project is more expensive, goes back to the cost. You do mention cases where they didn't have to bring the Chinese labor. Costa Rica did bring the Chinese labor to some of those projects. And overall, apart from the cost, if you do not have your workers, that means that you lose the spillovers, the learning, the know how's. So this is worse in many levels, but it also increases the cost related to sometimes, you're stuck with worse quality inputs. There are many explicit and implicit guarantees. When you read a lot of these contracts, there are rate of returns, demand. And as I said, exchange rate Latin America is varying the exchange with risk. Many of the contracts that look like FDI equity that are not. You go and read them, they're full of contingencies. They become non-contingent contracts. Even the private contracts have implicit government guarantees. I can guarantee you that if a big hydro goes belly up, the government has to intervene, but many do have explicit in terms of a lot of these clauses. Collateral, I actually see it the other way. Being able to borrow more against collateral has never been a puzzle. The puzzle in serving debts is that you manage to borrow without collateral and without an international institution to deal with bankruptcies. So if they pledge collateral, they borrow, that's fine. Of course, as we have found out, they have more and more to refinancing because a lot of these collateral is very hard to repossess. And a lot of this restructuring is not very transparent.

And again, there are all these problems with non-disclosure clauses. That renegotiation is a mess. You have to go to China for arbitration. Good luck with that one. And as you know, your colleague, Anna Gelpern and co-authors have written a lot about these contracts. The second, as I said, I do think lack of transparency is a big issue. First, it is hand with hand with corruption and this has been terrible for our region. De-legitimized spending and taxation. I have a little paper that I'm presenting at the AAR papers and proceedings, where we compare three scenarios. The world without China, the world with China with incomplete information, but the world with China and complete information. We do many robustness where we look at whether these type of lending are substitutes or compliments, different cases of the default under negotiation, what happens if they can collateralize lending or not. And we do get that when China appears, it does reduce the sustainability and leads to more defaults. Something that and co-authors have documented this complex renegotiations. But the best world is always one where you have transparency, but that doesn't mean that China lose market share. And I do think that what we're seeing is that. They just played that there was no sustainability, there is. We now see a lot of these problems. And what is interesting is that sovereign default has always been a problem of willingness to pay more than capacity to pay. But when a country gets to 200% of GDP, and this is not only Venezuela, but a lot of the little islands and countries in Africa, I would actually say that they have a capacity to pay. And this has never been the issue in sovereign debt. China has put these countries in capacity to pay front. And then again, a project is a project. When you see it, you have to go and read the contract, all the clauses. And here, I'm not that convinced many of this project have social rate of returns. I actually took an undergrad at project evaluation course. Social rates of returns will give you all the externalities, all the linkages. And again, one does need to do the calculations. The lack of environmental assessment is a problem, it's not trivial even if it's by design. Many of these products are actually not finished. So we have a road with China. It's at 40% of where it should be. It's a mess to renegotiate. Like every time, we're trying to do something, it just becomes a complete mess. And so the big question is have these projects benefit the people? And it's interesting that the two cases they use a lot in the case are the sad, famous examples in Latin America of GDP reversals. Argentina was the richest country. It's not anymore and every year, it's less. Venezuela, which by the way, is not a democracy is also the same story. Argentina, nine defaults and counting. Inflation above 50% before crisis. Inflation is one of the most regressive taxes. That means sustainability and budget constraints matter. They were not going around them. They are paying for these projects, taxing the poorest of their people. Venezuela, hyperinflations again, before the pandemic. And you talked about that Trilemma. Both Argentina, Venezuela also have capital controls. I would argue that flexible exchange rate have been very helpful and useful for Latin America. But in the case of Venezuela, there was another part, if you want another

leg that was not thought in the Mundell Trilemma. People leaving. And that's what happened. Venezuela has one of the worst refugee crisis in the region. That's what's solving this equation. And again, many of the projects with China are unfinished. And of course, the big question is whether conditionality would've made it better. It's unclear, but clearly what they got didn't make it better. Ecuador, again, where is it? At the IMF. It's interesting that Correa, after he led government, he went to the chief country of Belgium. And that's where he was staying. And now there is this, just recently, about the corruption probes. Multilaterals are political. That that is a reality. There is a reason why Argentina has nine defaults. Because they managed to come back. If they were not political, Argentina wouldn't have so many defaults, but they do ask you to open the books and that is a good thing. There is no drawback of making a country open the books and find out what is it that they're doing. So to conclude, so I said, I do agree competition of world bankers are beneficial, but I am not as convinced that this lack of transparency has helped us developed. Lack of transparency does not necessarily mean there are no conditions. It just means that we don't know about them. And let me finish with the great words of one of the most wisdom smart people I ever met, my grandma. She would always tell me, "If you cannot tell me what you're doing, it's because you're not doing something good." So let me end there.

- Thank you, Professor Alfaro, for your comments. I'm gonna give Professor Kaplan a minute to respond or a couple minutes, I did a figurative minute, and then I know I have a question, but I'm gonna go to the Q&A first. And so we have quite a while left and so yeah. So Professor Kaplan.

- Terrific. Thank you, Professor Alfaro. I really appreciate it. Thanks for taking so much time with the book. And your fractions are super helpful, including social rate of returns in terms of future projects. I think that's a really good idea, trying to think about social rate return. In terms of some of the different points here, I'll try to highlight them as quickly as possible. One, transparency. It's part of the trade-off here. And I absolutely agree with you. I mean, one of the things, the nice part about doing the field research here and meeting with people in person is you get a lot of people reflecting in government on the potential implicit costs here in terms of the lack of transparency. A lot of people talking about sort of the lack of fine print things along these lines. There's even sometimes like inter-agency differences, I've noticed. When you meet with people where oftentimes, the finance ministry, depending on the country is front and center in negotiating these things, but then oftentimes, planning ministries and other ministries have very different ideas in terms of what should be the key negotiation points as well. So I think that's also really important. One key place that came out is a place like Ecuador, where the people from planning, ministries were saying, "Wow, we should focus so much more on local content and opportunities

and all these things within the negotiation, and we didn't." So I think transparency is definitely an extremely key issue. And as well as the sustainability of the projects. We're seeing in places like Ecuador fissures and some of the walls that were built. The dams and things along these lines. So there's important trade-offs, not only in terms of transparency, but also in terms of sustainability as well. And that's part of the broader trade-offs here. Also your point about inflation, terrific. It actually connects to my previous book. Was all about austerity politics and sort of the regressive tax that inflation is. So undoubtedly, if you have expansive fiscal policies that lead to inflation, countries are gonna pay with that higher cost over the long run as well. So yeah, I think it's sort of not only the social rate of return on infrastructure projects, but expanding the horizon to also consider what happens down the road in terms of inflation as well. Also really good ideas, really good thoughts here. In terms of some of the other factors mentioned, and I'll try to be really quick here as well. Original sin. Undoubtedly, really important. My previous work that looked at bond financing. This is really important. And the fact that many countries were able to issue locally, that helped diversify away from some of this risk. But importantly, China does not do this. So you're still effectively borrowing in dollars. You still have that exchange rate risk. And I think it was exemplified by minister I met with in Brazil who said, "We did this before. We don't need this from China. We did this direct lending. We took on this exchange rate risk. We took on this debt. We don't need to do it again." So I think that's also a very good point as well. And then finally, in terms of one last point in terms of negotiations here that you mentioned in terms of the labor content. This is something we see a lot of variation within the region where countries that had more capacity, like a Brazil to kind of push negotiations, we actually saw that investment was stalled from China. It didn't come right away because Brazil wasn't willing to grant visas for Chinese workers. That kinda slowed the process. Now today, when the Chinese president comes to Brazil, he talks about Brazilian jobs. And so that's a big difference compared to other countries where you see that Chinese labor was permitted to enter without the same constraints. So I think that's another really important thing to consider in terms of these kind of human flows. Obviously, I think your point with the Trilemma is really good to then think about, okay, what do we do in terms of human outflows? When you think of the fall of oil production in a place like Venezuela, one key component is a loss of managerial expertise, and that was a product of the outflow of human capital. So also sort of a very important trend, but thank you very much. These insights were terrific. And I think they've generated some nice ideas for future projects, so I appreciate it.

- Great. So I will thank the audience for their attention and patience and open it up. So the first question that I'll give you is from Professor William Shao from the School of Public Health, an economist. And he asked if, "Loans financed by US policy banks, like the Export

Import Bank have similar bilateral tied trade or purchase US equipment requirements as the Chinese." And I'll give you just two at a time for the sake of efficiency, I guess. And Andrew Quail asked, "To what extent is China using its leverage as a major existing and future lender to support anti-democratic or corrupt regimes. And so for example, Maduro and Venezuela, and increasingly other groups in other countries to obtain support in the UN for votes in favor of China and against the US." So kind of comparative economic question, and then the political question, which I have variation on too. So I'll have my question in a little, but I'll let you respond to things.

- I've been answering questions over Zoom now for a full year and a half, and I still don't hit the mute button when it's time. I start talking without the mute. So in terms of the first set of questions, tied aid, this is not in any way unique to China. So I divided, you know, their commercial conditionality. I would say the oil for loan deals are a more unique thing that their policy banks have implemented compared to tied aid, which is much more common. We've seen that in the US, we've seen many powers used at tied aid. Where they attach commercial conditions or conditions to their aid. That you have to contract with US firms, for example. So, one thing to note is that indeed the oil for loans, there is some precedent for that, even though China has implemented this on the world stage, the precedent comes from Japan. With Japan's economic activity globally and in regions like Latin America, they sort of were some of the first to implement these oil for loan deals. So China's really increased the scale of that, but even there, they're borrowing a bit from the historic playbook with Japan. Then in terms of the question about transparency, anti-democratic forces things, along these lines. I think that, I guess first, in terms of the transparency question, from what I can gather in my interviews, and when I did this research, it was not oriented towards transparency primarily. It's something that would come out on a secondary basis through interviews, through secondary sources, things along these lines. There's nothing overt. I would say like Russia's experience in Venezuela, there's a pretty overt geopolitical game. I think China has a less overt kind of game that it plays. That being said, I wanna share with you a quote from a foreign investment guide that Chinese embassies put out. In this case, it's actually for Costa Rica. It says, "It's a democratic nature, often creates gridlock and massive amount of inefficiencies." So you can see, and this is not just Costa Rica, through many of these foreign investment guides, they're telling their firms when things are too open, too democratic and too transparent to be aware. Now that's direct communication with their firms, but you do see this kind of, and probably the best way to put it is concern about efficiency. And you see it both ways because certainly, in places like Ecuador, when you had a five-year plan and there was a rush to implement a lot of this infrastructure, efficiency was important, but as loud as highlighting, there's a trade-off there. Sometimes with efficiency, also comes lack of transparency. So we see it in that way. Also, I

wanna highlight the difference between Central America and South America. So a lot of my research, particularly primary research is oriented towards South America. But as you heard from Laura's comments earlier on, Professor Alfaro's comments earlier on, is that effectively, China had a type of checkbook diplomacy in the region. In order to get the spigots of Chinese investment in financing, you had to commit to a one China policy. And we see that happening. Costa Rica, Panama, lots of places within Central America and the Caribbean, but this tends to be this political conditionality tended to be a lot more common in central America than necessarily South America.

- Great. So let me insert myself and ask my questions. So the first question I have is sort of thinking about the creditor trap and about China's willingness to renegotiate. And so, I mean, I take Laura's point and I say this all the time, sovereign debt is really never about capacity. It's always about willingness and so it's always political. So it's hard to separate the political and economic. And so taking that as true, it seems interesting to me and especially when we think about what China wants. And so the argument that I get from your book is basically what China wants is increased market share and market access to the countries in which it's either investing or to whom it's lending. And so, but then, they run into trouble. And they run into trouble economically when countries encounter, for example, commodity price stops, pandemics, those kinds of things. And then they run into trouble politically because their investments get politicized. And then you have things like a Supreme Court intervention in Argentina or presidential elections that run on anti-China platforms. And then a lot of the like green hostage stuff. I mean, I'm not denying that many of the problems have actual engineering problems and environmental problems. Significant ones that are surprising everyone. But in any case you get, we're suspending the project based on environmental concerns, and then there's a renegotiation. So I wanna know from your view, if you think the Chinese entities that you've studied, are they more sensitive to the economics of the politics? So basically, does China want friends or does it want money? So you can see a trade off there to a certain extent. Because if they want a return on the investment or if they want the export credits, and I should just mention, in response to Professor Shao's question, most of the Marshall plan was actually export credits. So in that sense, it's like, well, how do we explain the rise of American industries in the 1950s and '60s? Well, they were exporting to Europe because Europe could only basically import from America. So that's like, there is precedent there too, but in any case, is it politics or is it bottom lines? Like, would China be excited to have a country that basically hates it, but is nonetheless like open to Chinese firms and able to pay them back? And how do you see that trade-off playing out? And then a second kind of related question is about domestic politics. So some of the countries you're looking at are democracies. Others are nominally kind of socialists or communist type dictatorships. However you wanna categorize Venezuela

these days. And so do you find a difference in domestic politics and how it affects basically interactions with China? I mean, my hypothesis would be that democracies extract better deals from China when they renegotiate, for basic reasons we might expect in terms of two tabled games, etc. And is that basically what you find in Latin America or is that variation? Not something you really explore. Thanks.

- Excellent, thanks. Thank you very much for these questions. Terrific. So, yeah. So does China want friends or does it want monetary power? I don't know if it's quite that dichotomy, but I will try to prioritize or weight those. I think, for the most part, and in particularly initially, a big part of the drive within the Latin America does reflect the internationalization of Chinese firms. And Chinese geoeconomics. And so, because of that, I think the countries that have a large share of commodities, large share of important markets, this is not necessarily development. This is much more commercial. So I think it's willing to sort of engage in an economic first kind of diplomacy Or geo-economic diplomacy much more when there are markets or commodities at stake. I think even as we sort of talked about before, I think in the case of many Central American countries, it ends up being more about politics, particularly with something like the political conditionality about the one China policy. I think there's variation even in Central America. But I do think you see those differences. I also think in terms of undoubtedly, they're very aware of the optics. So with Venezuela, not only is Venezuela an issue in Chinese domestic politics to some extent. As sort of, wow, what happened with those investments? But even internationally. Because you had essentially China investing in a country that's a dictatorship. And the debts going awry, there was a lot of criticism throughout the region from other democracies. So effectively, China was really aware of those kind of criticism. I would even argue in the case of Ecuador, it was willing to renegotiate because that's generally what they've done when they've run into trouble. But there's also, I think an element of optics with Ecuador. After what happened to Venezuela, I think there was sort of a desire to renegotiate in part for political reasons. Because of the kind of flack and soft power politics that China was worried about within the region. Then you also have sort of the broader question in terms of this renegotiation and how important is regime type for negotiation. I think what's clear from both the field research on the Chinese side, talking to bankers. And this is implicitly, not explicitly. And then talking with people within Latin America is that China prefers to deal state-to-state. If it had its preference, undoubtedly, they prefer the efficiency. They prefer the state-to-state kind of negotiation. That being said, they're very flexible. And they'll also sort of use these market mechanisms I talked about based upon the country they're confronting. So in Brazil, they're much more likely to invest FDI, directly in corporations, etc. So you see a diversified portfolio. Then comes a question in renegotiation. I think, and I haven't tested this. But I would agree

with your prior where I think to some extent, in Venezuela, the fact that you just have sort of this outstanding debt moratorium, and you even sort of have a willingness of Venezuela authorities to prioritize Russia over China. And then this debt is sort of an overhang as you have really poor economic governance, I'd be surprised in a democracy if you could facilitate that kind of economic behavior for that long of a time. But again, that's just a prior. Comparatively, I think in democracies, and some of this comes back to the point about labor I was making earlier. When you have stronger institutions that are willing to push for issues that people care about such as labor. In Argentina, when I met with folks there, one key thing that they highlighted whereas within the negotiations with China, the labor minister said, "Listen, we have to use Argentine labor. There is no choice. We have to use Argentine labor on the manual labor with these deals. Has to happen. Otherwise I'm gonna get killed by the unions." And so that's a kind of trend that you would see in democracies, but you might not necessarily an autocracy. So I think in terms of negotiation, particularly in terms of labor, local content, some of these issues that evolve local labor and firms, I would agree with that prior that democracies may be able to extract more out of these negotiations.

- Great. So we have a couple more questions and not too much time, so if you have a last minute question, you should throw it in here. But a couple of interesting questions about basically comparing with the US. So I mean, what's interesting, I tend to know more about China's engagement in Central Asia and Southeast Asia, but nothing about its engagement in Americas. But here you have China engaging in the place where it's typically been American companies and American international financial institutions and financial institutions that have been doing this. So to what extent is the US trying to counter what China's doing in Latin America? Is there any sense of us competition either from the corporate side or this idea that Laura concluded with and you conclude with, with the competition of world bankers. So has the competition been enhanced? Do we see increased fervor from the US or the West in general? And how do you see that playing out in the region?

- Sure. So I think there's been two trends along those lines. One, I mentioned that since the commodity downturn, China has established these state-backed equity funds. In other words, using China's reserves in order to allocate specifically towards investment in corporate enterprises, in Latin America, Africa throughout the world. Now, what we've seen comparatively in order to meet the competition challenge from China, is we've seen things historically, entities like OPEC or Export Import Bank in the United States. Remember, there was a political debate that oriented towards closing the Export Import Bank. Now, what we've seen since China has emerged more aggressively on the world stage as a competitor, we've actually seen a willingness to capitalize those institutions. And through the BUILD Act, actually

support private equity, US private equity abroad. Now the scale is nowhere near what China's committed, but there's a realization politically that this might be a necessary thing to compete better on the world stage. And so certainly, now you have an institution development, finance corporation that is marshaling resources in this way. I also think industrial policy. Things have changed on the global stage to some extent in terms of industrial policy. We know East Asia in general has always used sort of industrial policy, national guidance, national champions, things along these lines. But I think with China using the subsidized finance to create market share internationally, you see with the conversation about value added chains this summer, a lot of concerns from the US about its own capacity. We see a willingness to invest in industrial policy to some extent. Early industrial policy, but crafting semiconductor industry. Reinvesting in semiconductor industry in the United States. We've seen deals with South Korea over this past summer to have a shared alliance in order to invest and build semiconductor ties directly between South Korea and the United States. And so I think that there's a realization that not only competing with China through private equity is important and subsidizing that to some degree, through credits, but then simultaneously, that it's also very important to start to think more holistically about industrial policy. And we not only see these kind of thoughts coming out of the United States and policies, but also in terms of the UK as well. The difference is now we're seeing a Biden administration using alliances to accomplish this compared to a Trump administration that's primarily going at it bilaterally.

- Yeah, the way I usually put that is that we're all becoming a little Chinese actually. And so that is interesting. Laura points out that the head of the IDB is from the US for the first time, which is maybe perhaps not insignificant.

- Exactly, yes. Completely agree.

- So this has been fun. I've learned a lot. I admittedly know so little about Latin America and have appreciated this. And I can't wait to delve deeper into the book which I have purchased. Well, actually your publisher sent me a copy, but I encourage people to get out while it's hot. You're an academic, it's more about getting ideas into the world--

- Exactly.

- We're happy to be out there. So please let me express my gratitude to Laura Alfaro and to Stephen Kaplan and to the DRCLAS and to the Fairbank Center for co-sponsoring the event. And it'll be on YouTube and we thank you. So there'll be two more seminars in the spring, but I haven't scheduled them or announced them yet. And so stay tuned for that, but thanks.

- Yeah, thank you very much. It's been a wonderful conversation. Thank you very much to both of you for facilitating this and having some great comments and feedback and thanks to the audience as well.

- All right, congratulations on the book.

- Thank you.

- Hi team, thank you.

- Thank you.

- You're free to go if you need.