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CHINA

Latin America, Europe, and the U.S. must stick together in weathering the COVID-19 storm

By Evan Ellis / REvanEllis / May 28, 2020

COVID-19 has highlighted the interdependence between Latin America and Europe. The first cases in Latin America, in Brazil and Ecuador, came not from Wuhan, but from Italy and Spain respectively. The virus continues to play out in both European Union (EU) and the United States, leaving two of Latin America's three principal commercial partners (the other being Asia) economically and financially weakened, and with the attention of their leaders drawn to the challenges of the pandemic in their own countries.

The virus is just beginning to take off in Latin America, with consequences likely to be even graver and more enduring than those in Europe and the United States. Ironically, the political and commercial dynamics of the pandemic in both Latin America and Europe—as well as the U.S.—create strong pressures for both to turn away from their longtime limited and fickle, interest in each other, and to each become more dependent on the People's Republic of China, to the disadvantage of both, and to the United States.

Europe's turn (further) away from Latin America to China?

Because of the pandemic, the European Union economies are expected to contract 7.4 percent in 2020. The International Monetary Fund (IMF) expects that recovery may not begin until 2021.

In Latin America, the United Nations forecasts that the region's GDP will contract by 5.3 percent in 2020. The likely protracted nature of the crisis, and reinforcing negative effects on health, the economy, governance, crime, and social protests, could make matters far worse.

As EU governments cut spending to accommodate the massive debt they are assuming to combat COVID-19, they will face pressures to cut other spending, including developmental aid or institution-building programs that help Latin America deal with its own COVID-19 related woes. Similarly, as European policymakers develop economic recovery strategies, the PRC, with the prospect of positive—if limited—growth, and possible resources to invest in European companies and loans to beleaguered governments, may appear more attractive than trade deals or investment promotion with a Latin America whose economy is expected to contract at least 4.6 percent, and perhaps more as the COVID-19 related crisis deepens. Even before COVID-19, Europe's $230.2 billion in trade with Latin America in 2018 was less than half of its $535.7 billion with the PRC, and only 2.4 percent of its total $9.73 trillion in global trade.

Beyond Latin America's likely limited weight in European economic recovery strategies, the persistence of COVID-19 in the region, and the possibility of shuttered businesses, decreased government services, and increased crime will also decrease the attractiveness of the region to Europeans as a tourism destination. Such perceived risks will compliment calls by EU governments for residents to stay in Europe for their holidays.

At the same time that Europe may give Latin America less relative priority with respect to trade and tourism, it will also face pressures to decrease its corporate footprint in the region. In the period following the 2008 financial crisis, European companies such as Repsol, Statoil, Iberdola and others, sought to shore up their weakened financial positions by divesting assets, many of which were bought by Chinese companies. The financial pressures put on European firms is likely to lead them to act in a similar fashion during the present crisis, potentially on a greater scale. As a consequence, the EU corporate presence in Latin America, and associated EU member state interest, may diminish. As in the wake of the 2008 crisis, Chinese companies will likely be well represented among the buyers, increasing their own corporate presence in Europe.

Without addressing the financial situation of individual firms, the number of major EU-based companies operating in Latin America, and the potential impact if even a small number divest assets to focus on the Chinese or other markets, is significant.

In the petroleum sector, major EU-based companies include the French firm Total, the Italian firm Eni, the Spanish firm Repsol, and the Norwegian company Equinor. In agriculture, the French company Louis Dreyfus is one of the four principal international agroindustrial conglomerates operating in Latin America, long in the sights of Chinese competitors and clients like China National Cereals, Oils and Foodstuffs Corporation (COFCO). In the processed foods sector, the Italian company Parmalat and the German company Arcor, have an important Latin American presence. In the automotive sector, European companies facing difficult choices about focusing on a depressed Latin American market or a growing Chinese one include Volkswagen with multiple factories in Brazil (Anchiete, Taubate, Sao Carlos, and Curitiba), Mexico (Puebla), and Argentina (Tucuman, Cordoba, and Pacecho), Daimler/Mercedes Benz (manufacturing cars in Mexico and truck chassis in Colombia), and Peugeot (with plants in Brazil and Argentina). In electricity, the Spanish companies Endesa and the previously mentioned Iberdola are well established. In pharmaceuticals, operations of the German companies BASF and Bayer are of note. In banking, the Spanish firms Santander and BBVA have an important presence.

In Logistics, as China's COSCO and other companies seek to expand their presence, dominating logistics and realizing its value added within the framework of the Belt and Road Initiative, European competitors considering what to do about COVID-19 related decreases in demand along Latin American routes include the enormous Dutch company Maersk (also owner since May 2019 of Hamburg Süd), and the German company Hapag-Lloyd. In the air passenger and cargo sector, major EU-based operators in Latin America facing COVID-19 related stressors include Air France, the Dutch firm KLM and the German-owned DHL Express.

Other European companies of note, which could be tempted to consider selling assets or other deals involving Chinese partners in a distressed Latin American market include the Spanish company Telefonica, the French manufacturing companies Alstrom and Danone, Germany's Thyssen Krupp, and the French-Swiss cement firm Lafarge Holcim.

Europe's economic interest in the Chinese market, versus a Latin America still in crisis will be bolstered by the substantial investment Chinese companies already have in Europe. By one estimate, this includes at least $255 billion in direct Chinese investment, taking over 360 companies in the EU since 2008, plus 355 mergers, as well as $40 billion in greenfield projects, and sizeable minority stakes in companies, including the $9 billion interest by the Chinese car producer Zhejiang Geeley in Daimler AG. At the government level, as occurred in 2008, it is possible that financially distressed governments, such as Spain, currently mired in political and fiscal chaos, could focus on a bailout from China, limiting their attention to Latin American affairs.

A further reduction in priority given to Latin America by EU governments and interest by EU firms in pursuing seemingly more lucrative opportunities in China, would accelerate the already underway movement in this direction, gravely damaging the strategic position of the EU globally. Reinforcing the growing political rift with the United States, a move away from Latin America would make the EU more isolated and susceptible to PRC influence. A closer partnership between the two would make it harder for the EU to continue to openly object to bad Chinese behaviors such as imprisonment of Uighurs in Xinjian, its territory grab in the South and East China Seas, and its suppression of Hong Kong protests. Heightened EU dependence on the PRC would make it more difficult to push back on PRC attempts to expand their positions in EU markets, and to influence political debate and public discourse, even though for many Europeans, the ability of China to indirectly shape their public discourse is unthinkable.

Deepening EU dependence on China could also make it more difficult for EU members to exclude Huawei and other Chinese firms from 5G and other telecommunications architectures, opening a door for the PRC government to obtain sensitive data on European companies, technology and leaders stored in, or passing through those architectures, per the obligations of Chinese companies such as Huawei to share its data with the Chinese government if asked under the PRC 2017 National Security Law.

Latin America stranded with China as a dangerous partner?

Ironically, the same dynamics that push Europe away from Latin America and into a dangerously expanded dependency on China, are likely to make Latin America more dependent on the PRC and vulnerable to its proposals as well.

Prior to the crisis, the $230.2 billion in trade between Latin America and Europe represented 10 percent of its $2.19 trillion in trade globally. That trade was on the same order of magnitude, although increasingly overshadowed by Latin America's $330.5 billion in trade with the PRC. The forecast continuation of the COVID-19 induced economic problems in Europe, as well as in the United States, at the time that PRC demand for Latin American commodities and foodstuffs is picking up again, will tempt Latin American politicians and businessmen, like their EU counterparts, to look increasingly to the PRC, despite their own distrust of the practices of the Chinese communist government and its companies.

As noted previously, the possible market logic driven sell-off, by EU-based companies, of portions of their Latin American holdings would decrease the weight of European companies in the region as employers and generators of tax revenues, while correspondingly increasing the presence, and associated influence of the Chinese in both business and political affairs in Latin America.

This increasing weight of the PRC through its expanding share of the Latin America's trade and corporate ownership, will likely be complimented by its heightened importance as a lender. Since 2005, Chinese policy banks have made over $137 billion in loans and lending commitments to the region, far more than Western multilateral financial institutions. Although the rate of new Chinese lending decreased after 2017 as problems developed with specific projects and loan recipients such as Venezuela, the protracted negative impact of the COVID-19 crisis on Latin America and the substantial debt-financing needs of its governments to battle the pandemic and its socioeconomic effects will give the PRC significant leverage as a lender of last resort, while Western financial institutions remain mired in a liquidity crisis, and are drawn to substantial, seemingly safer competing lending opportunities closer to home.

In Argentina, among other individual cases in the region, the prospects for a Chinese advance are particularly strong. The new leftist populist government of Alberto and Cristina Fernández entered into technical default on its sovereign bonds on May 22. If Argentina again loses access to Western credit markets, the PRC is waiting in the wings with a strong financial presence, including an $18.7 billion debt swap agreement, as well as Chinese institutions in Argentina's banking sector, including Standard Bank, owned by ICBC.

Increased strategic risk for the United States

Increased dependence on China by both Latin America and the European Union not only generates vulnerabilities for both regions, but also creates strategic risks for the United States.

Heightened EU dependence on the PRC could undermine member state willingness to openly cooperate on issues such as NATO funding, resistance to Russian oil blackmail and malfeasance, and cooperation against terrorism, particularly if the PRC signaled that specific U.S.-Europe cooperation might damage Europe's access to Chinese markets and financing. It could also decrease the likelihood of European cooperation with the United States in multilateral institutions from the United Nations to the IMF to the World Health Organization, where doing so goes against the positions of the PRC.

A Latin America more closely tied to China economically might not only be less cooperative with the U.S. in forums such as the United Nations and Organization of American States, but also less receptive to coordinate with it on regional security affairs, with direct implications for the United States through immigration flows, drugs and other criminal activities, and other threats to the U.S. homeland. In a manner similar to their reluctance to engage with China on military issues today (to avoid offending the United States), Latin American and Caribbean governments might shy away from types of security engagement with the U.S. they perceived might jeopardize loans, investments and imports of its commodities and other goods from the PRC. With increasing weight of economic and political ties to the PRC, select governments in the region might even become less reluctant to expand military ties to the PRC, to potentially include base access agreements.

The limited number of nations continuing to diplomatically recognize Taiwan in Latin America would arguably find it increasingly hard to do so, however good and generous Taiwan was as a partner, if commercial opportunities from the U.S. and EU decreased.

The path forward

To prevent the dictates of the market from creating a situation that would strongly disadvantage the EU, Latin America, and the U.S., it is imperative that each set aside their differences and work together toward a prosperous and secure Latin America, governed by transparent, well-functioning democratic institutions. The U.S. often focuses on regional security issues, while the EU focuses more on democracy, development and human rights, yet all three have a strong interest in working together to shape a prosperous, well-governed hemisphere in which both have a strong role, as well as a Chinese presence on a transparent, level playing field. That future must include cooperation to support a strong continuing presence by both European and U.S. companies which respect the rule-of-law. It must also include U.S.-EU cooperation in, and engagement with, Latin America in support of good governance, anti-corruption, and respect for human rights.

Such coordination between the EU, the United States, and the governments of Latin America would arguably be a departure from the current state of affairs in U.S.-EU and U.S.-Latin America relations. While requiring significant political will and resources at a time when both are arguably in short supply, the strategic consequences for all three, if the current COVID-19 shaped trajectory of affairs continues, would be grave. At the very least, such cooperation merits serious high-level consideration and discussion.

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