

Setting the Agenda:

Asia and Latin America in the 21st Century

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8 | What Can South America and Australia Learn from Each Other in Relation to China?

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That emerging economies are becoming the center of global economic dynamism is no longer disputed. More topical is the challenge of managing the boom in natural resource exports underpinning this transformation. Over-reliance on primary sectors has long concerned Latin American analysts, many of whom draw inspiration from Raúl Prebisch's seminal 1950 book, *The Economic Development of Latin America and Its Principal Problems*. Central to Prebisch's argument was the observation that the prices of raw materials and food in international markets tend to fall over time, while the prices of manufactured products steadily rise. This, he argued, leads resource exporters into dependence on the industrialized countries that consume their primary products in return for more valuable manufactured goods. The fault lines between South American industrialists and resource exporters are deepening as primarization "kicks away the ladder" underneath hard-won national manufacturing sectors (Gallagher and Porzecanski 2010; Maciel and Nedal 2011). Natural resources now account for 75% of Chile's exports (with copper accounting for 53% of this figure), 60% of Argentina's (oil seeds, 67%), and 43% of Brazil's (iron ore, 27%) (Bank for International Settlements 2009). A staggering 90% of the region's exports to China are in mining and agriculture (Dadush and Shimelse 2012).

If the prospect of economic dependence on China is a concern for South America, then it should be equally so for Australia, whose primary sectors have grown to 60% of total exports. With an expansive land area of 7.7 million km² and 17% of the world's iron ore, Australia has long relied on primary exports to underpin its economy and provide for its relatively small population, 23 million people in 2012. Australia has serviced Japan and other industrializing countries since the 1960s, but in 2009 China replaced Japan as Australia's largest trade partner. Bilateral trade with China reached \$105 billion in 2011, and Australia is the largest destination of Chinese FDI, with 220 Chinese investment projects approved as of 2011, worth more than \$62 billion (Raby 2011). Of Australia's commodity exports, iron ore comprises 17%, coal 15%, and liquid natural gas 3%. In 2010, sixty-nine percent of Australia's iron ore exports went to China, and total Australian commodity exports are expected to exceed \$251 billion in 2012 (Christie et al. 2011). As Saul Eslake has written, Australia is "unusual for an advanced economy" in its reliance on Asian natural resource markets, and in that only 16% of its exports are manufactured goods (Eslake 2011:145).

Latin America and Australia share a set of challenges in managing their economies. Driven by China, the primarization phenomenon is generating pressure on both to ensure that the benefits of the commodity boom flow on to citizens and advance national interests, including support to manufacturing sectors. This think piece explores two strategies for mitigating the risks inherent in this process: (1) the formulation of effective and appropriate taxation regimes that respond to the

resource boom, and (2) more sophisticated management of foreign land titles. Given the prominent role of sovereign wealth funds in China's penetration of foreign primary sectors, interregional dialogue on these issues is becoming increasingly necessary.

Mitigating the Risks

China's unprecedented pace of urbanization is likely to sustain demand for agricultural products over the coming decade. However, three factors signal troubled times ahead for exporters of mining and metallurgical resources. First, as the Chinese economy becomes increasingly driven by domestic consumption, demand for metals will fall along with Chinese government investment (currently around 45% of GDP, compared to around 21% in most developed countries). Second, recent discoveries of iron ore deposits in West Africa by Australian companies, backed by Chinese capital, will likely put downward pressure on the metal's international price (Hale 2012). Third, expanding commodity exports have driven up currency values in Latin America and Australia, negatively impacting the competitiveness of non-resource sectors. Both regions have seen a growing number of manufacturers close their operations or move to China to take advantage of more favorable margins. Consequently, the capacity of the two to adjust to a slowdown in Chinese demand, or a fall in international commodity prices, has narrowed. Latin American and Australian exporters are exploring strategies to mitigate these risks. Two of these strategies are examined below.

Strategy 1: Taxation of mining, carbon, and "super profits"

The Chilean state-owned enterprise Codelco is the dominant player in the nation's copper sector, from which the government directly excises royalties. Public sector revenue from copper has historically varied between 5-17% of total tax collection. Chile's Copper Stabilization Fund finances public commitments, including guaranteed old-age pensions, tax cuts for small businesses, infrastructure, and, as recent history has shown, assertive countercyclical measures. Leveraged to international copper prices through a strategy of long-term national development, the Fund is recognized by the Organisation for Economic Co-operation and Development (OECD) as an example for other resource exporters (OECD 2009: 51).

In response to strong Chinese demand, in June 2011 the Brazilian government took legal steps toward implementing a special 25% "participation tax" on the mining sector. The states of Minas Gerais, Pará, and Amapa have announced a further levy of up to \$4 per ton of iron ore and other metals. State governments argue that the revenue generated by this tax will enable them to fulfill their constitutional obligations to monitor environmental impacts and manage territorial resources. By granting exemptions to companies that provide metals to manufacturers within their states, they maintain, they are strengthening the ability of local industries to compete with China.

Like Brazil, the Australian government draws public revenue from taxation rather than from a Chilean-style sovereign fund. Early in 2010, it proposed a Resource Super Profit Tax (RSPT) to capture a share of the proceeds from growing iron ore and coal exports to China. Mining interests argued that the RSPT's proposed levy of 40% would drive investment away from Australia. The government, characterized as a "risk free" partner, would get "something for nothing" because it had not invested

in operations and its outlays, including rail and port infrastructure, had been independently funded. Since it applied only to extractive sectors, its opponents described the RSPT as discriminatory and defeated it by mid-year. It is widely believed that Prime Minister Kevin Rudd was removed from his post in June 2010 on the basis of his support for the RSPT.

Australian lawmakers proposed a revised tariff, the Minerals Resource Rent Tax, for implementation in 2012. It is less significant than the RSPT and contains an “extraction allowance” that will reduce its excise rate to 22.5% for most mining companies, compared to the standard Australian company tax of 30%. A fixed price Carbon Tax, to be set initially at \$23 per ton, will also be implemented in 2012. Although the Carbon Tax applies to all carbon-emitting industries, it will weigh heaviest on mining companies, prompting a vow from the conservative Liberal Party to rescind it should it win office in 2013. Initial approval for the Carbon Tax was assisted by popular concerns about environmental responsibility and climate change. However, a recent opinion poll indicates that 60% of Australians now oppose its implementation because of concerns about its impact on their cost of living, despite compensatory credits and reimbursements (Coorey 2012).

Strong Chinese demand and high commodity prices are intensifying Latin American and Australian dependence on primary exports. Through different mechanisms, such as royalties, resource taxes, and carbon pricing, both regions are attempting to derive a larger share of public revenue from the mining sector. Their common predicament raises questions of mutual concern:

- What blend of state and market instruments (e.g., Chile’s stabilization fund vs. conventional taxation) provides an optimal structure for capturing public revenue from extractive industries?
- In what ways might Latin American excision schemes seek to integrate resource taxes with an environmental agenda, as Australia’s Carbon Tax attempts to do?
- To what extent can governments justifiably levy taxes that apply exclusively to mining companies when these same companies already provide inputs such as rail and port infrastructure?
- Is revenue from resource levies an effective source of tax relief for manufacturing and small business?
- Since governments in Latin America, Australia, and elsewhere are all imposing greater taxes on mining, how valid are opponents’ warnings that these taxes will drive investment offshore?

Strategy 2: *More sophisticated management of foreign land titles*

The entry of Chinese sovereign wealth funds brings a new level of complexity to Latin American and Australian approaches to FDI management. Both regions need to update their legal frameworks for governing foreign land use, environmental impact, and outcomes for affected communities. The “lessons” the two can share consist mainly of pitfalls to avoid.

The Río Negro-Beidahuang agreement in Argentina epitomizes the complications that can arise from FDI. Under the agreement, the provincial government of Río Negro plans to lease large tracts of fallow land for 20 years to China's Heilogjiang Beidahuang State Faros Business Trade Group for the production of export staples to China. Despite the potential for negative environmental impact resulting from questionable irrigation practices and the introduction of genetically modified products, the provincial government signed the agreement without the consent of the region's residents. The resulting uproar over the arrival of Chinese workers has left the Río Negro government open to legal reprisals under national and provincial transparency and environmental laws (Lopez-Gamundi and Hanks 2011).

In response to the growing interest of foreign, mainly Chinese, clients in arable land, Mercosur is exploring the feasibility of registries as a basis for regulating land purchases and leases. Many in Australia, galvanized by the National Party, are in favor of establishing such a registry but the Federal Trade Minister is reluctant, arguing that this "monumental task" is too difficult to achieve. Australia should stay abreast of Mercosur's advances and setbacks in this endeavor.

The Australian Bureau of Statistics reports that 11.3% of national land is owned by foreigners, though this figure is widely believed to be too low. The Foreign Investment Review Board (FIRB) presides over a relatively open trade regime that permits foreign individuals to purchase Australian land up to the value of \$244 million. As most tracts of farmland sell for considerably less, the approval rate for purchase applications is very high. Nevertheless, Australia is exploring policy initiatives to ensure that agricultural produce, particularly from foreign-owned farms, remains available to global customers at market rates and is not diverted to pre-determined foreign markets, including China, at concessional prices. The formulation and implementation of such legislation could harbor useful insights for Latin American agriculture sectors in their pursuit of market diversity, competitive pricing, and food security. Faced with common challenges in the management of foreign land titles, Latin America and Australia could fruitfully compare notes on several questions:

- Does the entry of Chinese and other foreign state enterprises into the land market carry unique implications for national food security? How do the priorities and objectives of state enterprises differ from those of private firms?
- As foreign interests increasingly seek access to Latin American and Australian land, how can the two ensure that their agricultural produce remains bound for competing markets, rather than predetermined customers at concessional prices?
- How can work-visa schemes evolve to accommodate and regulate the size, length of stay, and activities of foreign agricultural workers?
- Should foreign land titles be subject to trial periods that enable monitoring and assessment of impacts on the environment, soil, water, and local communities?
- How might restrictions on foreign land titles affect present and future Free Trade Agreements? For example, would such restrictions jeopardize Australia's existing FTA with the United States and proposed FTA with South Korea, both of which permit land purchases of up to \$1 billion?

Interregional Dialogue on China's Rise

The potentials and pitfalls of resource exploitation have historically produced both nationally oriented responses and internationally coordinated strategies. The pursuit of multilateral accords is premised on the notion of addressing a challenge that harbors a shared set of ramifications for multiple actors (Hira 2007). Whether or not China's rise warrants an organized collective response is debatable, but the fact that Chinese investments in foreign resources consist mainly of sovereign wealth funds, rather than conventional private FDI, suggests the need for multilateral dialogue at the very least.

The presence of Chinese state-owned enterprises in foreign primary sectors raises important challenges for exporting nations. Beyond the potential distortion of agriculture markets and associated food security concerns is the broader risk of "pushing back" against Chinese interests. This risk stems from the Chinese government's influence across a range of industrial sectors. For instance, shortly after Argentina pursued anti-dumping measures against Chinese manufactured goods in 2009 and 2010, Chinese importers boycotted Argentine soy oil, wreaking havoc on the South American country's economy. Similarly, following Chinalco's failed attempt to become the dominant shareholder in Australian mining giant Rio Tinto in 2009, a Rio Tinto executive was arrested in China—to international incredulity—on unrelated bribery charges and sentenced to 10 years. While the causality of events was clearer in the Argentine case, the coordination of trade, investment, and civil law enforcement under the Chinese state remains a concern for recipients of Chinese investment (Garrick 2011).

Resource exporting nations have a shared interest in managing such challenges and would benefit from deeper inter-regional dialogue about them. China should be party to this debate, for which reason the Asia-Pacific Economic Cooperation (APEC), and ultimately the G-20, are well positioned to shape its parameters. Academic and policy workshops that bring together researchers and analysts from stakeholder countries can play a useful role in canvassing the key issues and preparing the way for official dialogue. In this regard, the recent proliferation of workshops on China's relations with Latin America, and China's foreign affairs more broadly, provides an opportune platform for setting the agenda.

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