

# latin america-asia review

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## China's changing relationship with Latin America

**Two years ago, when Latin American & Asia Review made its debut, we depicted a situation in which, broadly, South America was keen on doing more business with China but Mexico feared the challenge from China. The South Americans were enjoying the surge in commodity prices (and export revenues) largely generated by China. The problem for South America now is that the commodities it exported so gladly to China are coming back in the form of cars, white goods, computers and textiles, providing unwelcome competition for South American manufacturers in their home markets.**

For the first time ever, China is on course to run a trade surplus with the whole of Latin America this year. In the first part of the year it even ran a trade surplus with Brazil, the region's most sophisticated economy. According to figures from China's Department of Commerce, China exported goods worth US\$12.4bn to Latin America in the first five months of this year and imported goods (principally commodities) worth US\$11.4bn. This change cannot be good news for the economic development of South America. China is such a low-cost producer that Brazilian manufacturers, as we point out inside, cannot compete even with the Mercosur's 30% external tariff. What is interesting, however, is that Mexico has, over the past couple of years become more relaxed about China's challenge. Mexico believes that it is well placed to pick up fresh investment (and jobs) from the shake-up going on in the US motor industry. China is too far off, and not integrated enough into US supply chains, to compete with Mexico.

Beyond Mexico, China's challenge is unnerving many policymakers. China is building up its sales networks in unexpected bits of the region. One of its motor manufacturers, First Autoworks, has carved out a niche selling pickups and small vehicles in Ecuador and Guatemala. In Venezuela, Great Wall Motors, China's biggest car manufacturer, is selling cheap cars in decent numbers. What is worrying for Latin American policymakers is that China has the financial firepower to build up the distribution networks it needs to dominate Latin America. In 2005, China's total foreign direct investment doubled (rising by 123%) to US\$12.6bn. The worry for Latin America is that as China now has central bank reserves of US\$954bn (at the end of July) it can invest far more, should it want to.

The optimists in Latin America argue that the commodity boom will deliver longer term benefits to the region. The Brazilian state development bank, BNDES, points out the investment in new production capacity is booming in Brazil. This will lower production costs and could, if Brazil takes a policy decision, give Brazil competitive advantages. It is worth noting that already Brazilian mining companies and steel companies are significant players in the international mergers and acquisitions that are shaking-up their respective industries. China's companies are not as accepted by international investors.

## Getting closer

**The three-way summit between Brazil, India and South Africa, which began in Brasilia on 14 September was drowned out by the noisier Non-Aligned Nations' summit which was gearing up in Cuba at the same time. Brazil's guests, Manmohan Singh, the Indian prime minister, and Thabo Mbeki, the president of South Africa, went on to Havana. Brazil was represented at the Non-Aligned summit by Celso Amorim, the foreign minister. Arguably, what emerged in Brasilia is more important than what was decided in Havana. Singh was the most senior Indian leader to visit Brazil since Indira Gandhi's visit in 1968.**

Brazil and India comprise half the Brics (Brazil, Russia, India and China). The Brics are being touted (by Goldman Sachs) as the successors to the Nics (Newly industrialised countries) which began their ascent up the world's economic league table in the 1980s. China and Brazil were often considered Nics, along with South Korea, Malaysia, Thailand and Mexico.

The Brics are in an altogether different league. Goldman Sachs coined the term in 2001 and claimed that by 2041 the Brics' economic output would be greater than the combined GDPs of: the US; Japan; Germany; the UK; France and Italy.

The sustained pace at which Goldman Sachs reckons that the Brics' economies can grow over a period of a generation and a half is not their only substantial difference with the Nics. The Brics also carry international political clout. All of the Brics are nuclear powers. Only a minority of Nics were. Services and technological knowledge are also much more important to Brics: the Nics aimed to produce manufactured goods that were the same quality as those produced in traditionally industrialised countries, but far more cheaply and efficiently. The Brics all have cutting-edge technology in fields as diverse as aerospace; alternative energy; medicine; computing and mining.

The ups and downs of Brazil's trading relations with China have been covered in lots of articles in LAAR. Brazil's relations with Russia are outside the brief of this publication. Brazil's trade with India has grown extraordinarily. In 1985, Brazil's imports from India were worth around only US\$300,000 a year. In 2005 they were worth US\$2.5bn. In percentage terms, India's share of Brazilian imports has risen from a piffling 0.02% (in 1985) to 1.63% now. India's main export to Brazil is diesel.

Interestingly, the Indians have been sharper at exploiting the Brazilian market than the Brazilians have at breaking into the Indian market. Until President Fernando Henrique Cardoso paid a state visit to India in 1996 Brazil ran a trade surplus with India. Since the visit, India has run a surplus. In the first seven months of 2006 India's surplus came to US\$227m.

Brazilian businessmen are still leery about trading with India. It is worth noting that there was little interest from the Brazilian private sector in the business meetings that accompanied the summit with Prime Minister Singh. José Augusto Fernandes, the director general of the Confederação Nacional da Indústria, said that there had been little interest in the events his organisation had laid on. This cannot come as a surprise to the CNI: the Câmara de Comércio e de Indústria Brasil-Índia, based in Rio de Janeiro, closed down earlier this year.

The Federação das Indústrias do Estado de São Paulo points out that the opportunities for Brazilian exporters to India are now better than ever. In

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the past 10 years India has opened up its economy. The Fiesp notes that India's foreign trade (excluding trade with Brazil) is growing by between 20% and 30% a year.

Indian business groups accept that there are major difficulties in increasing bilateral trade, principally distance and logistics, but there are lots of opportunities for joint ventures. The Fiesp agrees and reckons that the best opportunities are in Information Technology; energy, especially environmental fuels; cosmetics and bus and automobiles.

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Reliance Industries, one of India's biggest conglomerates, announced on 14 September that it was close to making a major investment in an ethanol plant in Brazil. India currently imports 30% of the ethanol it consumes. India and Reliance are also interested in using Brazilian techniques of mixing alcohol and petrol to run engines. Brazil has developed flex-fuel engines that can run on more or less any mix of alcohol and petrol.

Reliance argues that it is more cost-effective to build an ethanol plant in Brazil than in India because the raw materials are so much cheaper in Brazil. Shipping costs for sugar and ethanol are much the same, though ethanol has a much higher value. Reliance reckons that the cost of producing ethanol in Brazil is a third of what it would cost in India.

Brazil and India, along with South Africa, have championed developing countries' complaints about the biases in the World Trade Organization's rules. These allow industrialised countries to protect their (inefficient but politically sensitive) agriculture while forcing developing countries to dismantle any protection they may have for their weaker industrialised sectors. President Lula da Silva and Manmohan Singh agreed on 12 September that they wanted to change the "world's economic and political geography" and promote fairer trade rules.

Singh is the first Indian leader to have visited Brazil since Indira Gandhi in 1968. He said that Brazil and India share several international policy goals. These included UN reform: both countries want permanent seats on the Security Council. Singh is also intrigued by Brazil's development of ethanol as fuel for vehicle engines and its experiments with biodiesel. If environmental issues move to the centre of world concerns over the next generation, Brazil looks well placed to sell its technology. (Environmentalists point out that the destruction of the Amazon forest is actually a greater environmental problem than pollution from cars).

Nuclear energy will, almost certainly, have to play a larger role in electricity generation in 2041 than it does now. The current burning of fossil fuels to produce electricity is the biggest single source of carbon emissions in the world today. By comparison, nuclear powers' environmental drawbacks look much more manageable.

On 12 September, India asked Brazil for its cooperation in nuclear technology. Both countries, like Iran, which will feature prominently at the Non-Aligned Summit and the UN, have controversial nuclear programmes. India has not signed the Nuclear Non-Proliferation Treaty and Brazil has developed its own nuclear centrifuges, to the dismay of the US.

Brazil is important to India because Brazil holds the presidency of the

“ Nuclear issues were not the only subject at the pre-summit meeting between Singh and Lula da Silva on 12 September. They agreed to elevate their "strategic dialogue" into a "strategic relationship". Singh claimed that the change would bring about a "qualitative transformation" in the two countries' relations. ”

Nuclear Suppliers Group (NSG), which seeks to stop nuclear weapons proliferation by controlling the export of nuclear materials and technology. India needs to receive the group's backing if it is to convince the US congress that its nuclear intentions are peaceful. Without the NSG's support it is unlikely that the US congress will approve an agreement signed in March by Singh and US President George W Bush allowing India access to US nuclear technology.

The Brazilian official response to India's request is expected to be given just after the India-Brazil-South Africa (IBSA) summit. Brazil is likely to accede to the Indian request, though some influential Brazilians are resentful of the privileges received by India, whose nuclear programme has run into only the mildest criticism from the US administration, despite India not signing the NPT. Nuclear issues were not the only subject at the pre-summit meeting between Singh and Lula da Silva on 12 September. They agreed to elevate their "strategic dialogue" into a "strategic relationship". Singh claimed that the change would bring about a "qualitative transformation" in the two countries' relations.

#### India's investment in Cuba

India's Oil and Natural Gas Corporation (ONGC) agreed to start exploring for oil in Cuban territorial waters on 10 September. ONGC now has exclusive rights over six blocs in the Cuba bit of the Gulf of Mexico. In May it dipped a toe in the business by going into partnership with Repsol-YPF, Norsk Hydro and the Cuban state oil company, Cupet. Repsol now wants to reduce its stake in the blocs to 40%: ONGC and Norsk Hydro are increasing their stake to 30% each. Cupet owns the oil.

Cuba claims to have a lot of promising oilfields in its bit of the Gulf of Mexico. The only properly explored areas of the Gulf are those belonging to the US and they have been full of oil.

Cuba currently produces 80,000bpd of mostly heavy crude. It imports 98,000bpd of oil from Venezuela on easy terms.

## COMMODITIES | COPPER

### The implications of the strike at La Escondida for Asia

**Miners at La Escondida, Chile, the world's largest copper mine went on strike on 7 August demanding their share of the windfall gains from the soaring price of copper. The strike ended on 31 August. The strike involved just 2,052 workers but probably cost BHP Billiton, the biggest shareholder in La Escondida, between US\$375m and US\$500m. BHP Billiton can afford this its profits in the year to June 2006 were US\$10.5bn, up 58% on the the previous year. Whether Chile can afford further strikes in its strategically important copper industry is another matter.**

The settlement of the strike on terms that most commentators see as a victory for the miners will have the major consequence of continuing to depress mining investment in Chile. The uncertain start the government of President Michelle Bachelet has made to its term, and the increasing cost of mining in Chile, is unlikely to prompt international investors to modify their increasing reluctance to invest in Chile. The sluggish rate of investment in Chilean copper mines in recent years is one reason why the copper price has gone up like a rocket in the past 18 months.

Chile is not the only important mining country where mining companies are having second thoughts about investing. In Asia, Mongolia, which is a significant copper producer, has seen a sharp change of sentiment by for-

Dependence on  
copper exports  
% share of total  
exports, 2000 to 2004

Zambia	41
Chile	31
Mongolia	20

source: IMF

eign mining companies since a new mining law was approved in May. This law imposes windfall profit taxes. It is not clear yet how the windfall taxes work and when they kick in as the law has not been published.

The buzz in Ulan Bator, however, is that the windfall tax rate will start at 68% for copper when the price is over US\$2,600 per tonne. Copper last traded that low in September 2004. For gold, the windfall tax kicks in, also apparently at 68%, when the price is over US\$500 per ounce.

What the strike at La Escondida (and the windfall taxes elsewhere) is likely to do is to encourage mining companies to invest in cheaper and less grasping locations. In Latin America, Peru is likely to be a major beneficiary of the La Escondida strike and the general increasing cost of mining in Chile. Globally, mining companies are likely to revisit the Central African copper belt. The lack of investment, until recently, in Zambia and the Congo has meant that these deposits have not been exploited as much as they might have been. China, in particular, is again becoming active in developing copper projects in Zambia.

### Chile

The slowdown in investment in Chile is the big macro-economic disappointment of 2006. In the second quarter of this year, investment was up by only 3.3% year-on-year. Most local analysts had expected an increase of around 10%.

This feeble performance is a reflection of the fall in investment by mining companies in the country. The problem is that few mining companies have the attractive acreage of the state mining company, Corporación del Cobre (Codelco). Although Codelco has gone into partnership with international mining companies to develop new(ish) projects such as El Abra (with Falconbridge CK), it has launched fewer such joint ventures in recent years.

International mining companies have been more attracted by the comparatively under-explored prospects in Peru and the lax tax system there that, effectively, gives mining companies an option about whether to pay royalties or not. Several leading figures in the Chilean mining industry had hoped that the wild Peruvian nationalist, Ollanta Humala, would have won the presidential elections earlier this year. A Humala presidency would scare foreign investors away from Peru and back, the Chilean miners hoped, to Chile.

The dearth of investment in Chile does not matter much now when copper prices are so high. It will matter, however, when the copper price falls. Chile's economy is highly dependent on copper: according to the IMF between 2000 and 2004 copper accounted for 31% of Chile's total exports. This was before the recent surge in copper prices.

Chile's exports were up by 75% in July at US\$5.5bn. This was largely due to a 129% year-on-year jump in copper exports to US\$3.29bn. It is worth noting that Chile's copper output in the first seven months of 2006 was up by only 4.2% on the comparable period of 2005 at 3.06m t of fine copper equivalent.

La Escondida accounted for the bulk of the increase in copper output, followed by Codelco. Most other mines saw a contraction in their output in the first six months of 2006. Codelco increased its copper output by 4.9% in the first half of 2006 to 853,000t. La Escondida had expected to produce about 1.3m t this year, but admitted that the strike cut its output by around two-thirds for August. Anglo-American, which operates substantial Chilean mines such as Collahuasi, Los Brocos and El Soldado reported lower copper output in the first half of 2006.

" Short-term, the ending of the strike should take some of the speculative steam out of the world copper market. The miners' relative success will, however, encourage other miners in Chile to take on their employers for higher pay."

In cash terms, however, copper exports in July set a new monthly record. In the first seven months of 2006 copper exports came to US\$17.7bn, double what they were in the first seven months of 2005. Copper exports in August are likely to be down: there was an explosion at Chuquicamata at the end of July which will affect copper output from the state-owned mining company, Corporación del Cobre, until September. BHP Billiton reckons that the strike at La Escondida cost it between US\$15m and US\$20m a day.

The problem for Chile's mining industry is that another ratchet-up in operating costs is likely to make the country even less attractive to investors. La Escondida's miners were already among the best paid workers in South America (let alone Chile). Originally they wanted a 10% real increase in pay and a bonus of Ch\$16m (US\$30,000). They moderated their demands on 22 August to an 8% real increase in pay and a bonus of Ch\$10m (US\$18,800).

On 31 August the miners voted overwhelmingly to accept BHP Billiton's final offer of a 5% pay increase and a bonus of Ch\$9m (US\$17,000). The agreement is only a slight improvement on the offer from BHP Billiton that the miners rejected on 22 August. On 20 August BHP Billiton offered a wage increase of 4% and a one-off bonus of US\$18,000. What is important is that the final deal is a major advance from BHP Billiton's initial offer of a 1.5% pay increase and a small bonus.

Short-term, the ending of the strike should take some of the speculative steam out of the world copper market. The miners' relative success will, however, encourage other miners in Chile to take on their employers for higher pay. La Escondida produces 8% of the world's copper and a fifth of Chile's total copper output. In the first half of 2006, Escondida made a profit of US\$2.9bn, more than three times the amount earned in the same period of the previous year.

BHP, the Australian company which is the controlling shareholder in La Escondida had threatened to sack the strikers and hire fresh workers as the strike looked as though it would go into a second month. This threat looked hollow. The World Bank's affiliate, the IFC, retains a 2.5% stake in the mine. This means that governments and labour organisations could have put pressure on BHP Billiton through the World Bank if it tried anything too controversial.

To be fair, there is still some investment in Chilean copper mines, but mostly on a comparatively small scale, increasing output by less than 100,000t a year. Falconbridge is investing US\$335m in expanding Lomas Bayas's output by 75,000t a year over the next 17 years, while Aur Resources is spending US\$336m on expanding its Andacollo gold and silver mine so that it produces 71,000t of copper a year and 59,200 ounces of gold. These projects, however, are expensive compared with what Konkola, Zambia is planning: it is spending US\$80m on a copper processing plant that will deliver 50,000t of fine copper a year. The mine currently produces 450,000t of concentrates.

The outlook for prices

The Comisión Chilena del Cobre (Cochilco) increased its forecast for the copper price in 2007 to an average of US\$2.8 a pound. It had been forecasting US\$2.44 for 2007. Cochilco has also increased its forecast for the copper price for this year from US\$2.64 a pound to US\$3 a pound. Cochilco is still forecasting that in 2007 the copper production will exceed demand, albeit by about 56,000t. This year Cochilco is forecasting that copper demand will exceed supply by 153,000t. Cochilco expects Chile to produce 5.45m t of fine copper this year and 5.65m t of copper in 2007.

Chile's biggest copper mining company, the state-owned Codelco, is likely to contribute at least US\$8bn this year to the government in tax, royalty and dividend payments.

## A better partner than Chile?

"In his election campaign, President García promised to make mining companies do more for the communities in which they worked. Yanacocha, the biggest goldmine in Latin America, is located in Cajamarca, one of the poorest departments in Peru where 75% of the population live in poverty."

**Most of the recent investments in Peru by international mining companies were made under the controversial constitution introduced by President Alberto Fujimori. This constitution lowered tax payments for mining companies and, effectively, eliminated royalties.**

Ollanta Humala, the nationalist candidate in the recent presidential elections, had promised to repeal and rewrite the Fujimori constitution if he was elected. This worried mining companies. They originally backed the rightwing, pro-business candidate, Lourdes Flores but eventually supported the winner of the elections, Alan García, now installed as president. One payment for their support is a promise from García to stick with the Fujimori constitution.

The Fujimori constitution protects foreign investors, particularly mining companies, against increases in tax and, the companies believed, absolved them from paying royalties. The supreme court, however, ruled earlier this year that the mining companies' fond interpretation of the royalties issue was wrong. As 25 of the 27 big mining companies operating in the country have not been paying royalties, they now face a substantial bill for unpaid royalties. The unpaid royalty bill for 2005 alone is around US\$158m, according to another former presidential candidate, Diego Canseco.

García's solution to this problem has been to suggest that mining companies should make "voluntary" payments. Some have already been doing this: BHP Billiton Tintaya, Yanacocha, Barrick Gold, Cerro Verde and Antamina have all been making voluntary contributions usually based on their profits. These contributions, critics say, do not reflect the surge in profits they have been enjoying: Yanacocha, the gold mine increased its profits in the first half of 2006 to US\$682m (from US\$210m) but it is volunteering to pay the government only US\$20m a year.

The fear amongst mining companies is that the García government might impose some sort of windfall tax on them, though García stressed during the campaign that he would not compel the companies to do anything. García's prime minister, Jorge Del Castillo, has told congress that over the next five years mining companies would make "voluntary" contributions of NS2.5bn (US\$776m) to the Peruvian government. This looks a reasonable compromise: between 1996 and 2002, mining tax revenues were US\$682m.

In his election campaign, President García promised to make mining companies do more for the communities in which they worked. Yanacocha, the biggest goldmine in Latin America, is located in Cajamarca, one of the poorest departments in Peru where 75% of the population live in poverty.

According to the national statistical agency, 51% of the 27m Peruvians live in poverty and 24% in extreme poverty.

Mining companies in Peru are flush thanks to the surge in metal prices: in the past couple of years copper prices have doubled, zinc prices have surged by 150%; silver prices have risen by two thirds and gold is up by 40%.

GDP growth: In the first half of the year the Peruvian economy grew by 6.6%, led by mining, the energy industry and construction. Manufacturing output was up by 4.7% while agricultural output was up by 3.2%.

## Mutún: Bolivia delays

**Bolivia and Jindal Steel and Power from India agreed to delay the signing of a contract to develop the Mutún iron ore deposit until mid-September. Jindal won the public auction to develop Mutún on 1 June. Bolivian ministers stress that they still expect to go ahead with the project.**

"What makes the Mutún project so important to Bolivia is that it bucks the trend for foreign investment in the country. The Banco Central de Bolivia reported that in the first half this year foreign companies withdrew US\$103m of their investments made in the country."

What makes the Mutún project so important to Bolivia is that it bucks the trend for foreign investment in the country. The Banco Central de Bolivia reported that in the first half this year foreign companies withdrew US\$103m of their investments made in the country. The central bank said that they did this because they were unhappy about the legal status of their investments. Although the central bank does not say this directly, the companies feared that their assets in Bolivia could be expropriated.

The Cámara Nacional de Industrias said that without an improvement in the legal position, foreign companies would continue not to invest in Bolivia. Businessmen from the prosperous east of the country are particularly bothered. Gabriel Dabdoub, president of the Cámara de Industria, Comercio y Servicios in Santa Cruz claimed that in 2005 US\$260m had been pulled out of the country. Businessmen say that without investment there will be no improvement in the jobs situation.

The Cámara Boliviana de Hidrocarburos (CBH) said in mid-August that even Bolivian energy companies were giving up on the country, despite the huge discoveries of gas in the past 10 years. They had switched from investing in Bolivia to investing in Peru, Colombia, Brazil, Argentina, Ecuador and even Paraguay. José Magela Bernardes, the president of the CBH, said that investment in the energy industry has dropped from US\$600m in 2000 to around US\$100m now.

#### Mining in Mongolia

The Mongolian mining code has some similarities with Peru where changes to the constitution under President Alberto Fujimori gave foreign investors important tax breaks. Mongolia's biggest goldmine, Boroo, which is operated by Centerra, is covered by a so-called Stability Agreement, which prevents the Mongolian government from changing taxes and royalties for the mine. The mine is scheduled to produce 275,000 ounces of gold in 2006. Centerra, which is the gold mining operation of Cameco, the world's largest uranium producer, holds a 95% stake in Boroo.

Until the uncertainty about the windfall tax on mining started in July, foreign mining companies were flocking to invest in the country's mining industry. Mining is the country's only significant industry, accounting for almost half of industrial output. Mongolia is a cheap location, and, most importantly, borders China, the world's big user of metals and coal. Besides copper and gold, Mongolia also has several promising coal projects.

Bolivia's planning and development minister, Carlos Villegas, claimed that there is no problem with the Mutún deal. He said that he had met members of Jindal's board regularly in the first half of August to discuss the US\$2.3bn project which gives Jindal a 40-year concession to develop the 40bn t of iron ore Mutún holds. What has happened is that the government has agreed to extend the 60 day "second thoughts" period, which began in mid-June, by a further 30 days. The government stressed that Jindal was committed to the project and had signed a binding agreement to develop the deposit.

“ It is also clear that there is a considerable amount of small print attached to Ric's clarification that Jindal will be paying 68% of the project's revenues in taxes and royalties. In the first few years, the tax and royalty rate is only 5%; it then rises to 10% but will take some time to reach the 68% highlighted by Ric. ”

What has not been agreed is exactly how the joint-venture to develop the project should work. The Bolivian government said that it will be a 50% partner in the steel mill Jindal will build as part of the project. The government also claims that it will be a 50% partner in the mine that will produce iron ore. This ore is likely to be exported to China, probably via either Chile or Peru. The government has said that it will give Jindal management control of the project for the first 20 years of the concession.

Villegas said that he believed that the project would produce annual revenues for the country of US\$200m. He claimed that under the previous scheme to develop Mutún, the government would have earned only US\$18m a year. Jindal is taking all the investment risk in the US\$2.3bn project.

The government said that Jindal should start producing iron ore by 2008. The public services and works minister, Salvador Ric, said that it should take US\$350m to get the project into a state at which iron ore exports can start. The next phase will produce a semi-processed product, iron-ore sponge, which will be exported from 2011. Ric said that in the first phase Jindal expects to export between 4m t and 5m t of iron ore. Ric claimed that the government would take royalties and taxes worth 68% of the value of the exports. He clarified Villegas's figure that the project would yield US\$200m a year for the government: Ric said that this money would only come through from 2015 when all parts of the project had been completed.

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Ric said that congress would have to approve the contract with Jindal and that all the agreements covering every aspect of the project would be transparent. Jindal is also committed to providing a goodwill deposit, worth US\$30m or just over 3% of the total planned investment of US\$2.3bn. World demand for iron ore is buoyant. In 2005 iron ore prices, which are agreed between producers and consumers, increased by 71%. This year they have risen by 19%. In 2007, they are likely to rise by at least 10%. If this happens, iron ore prices will have doubled in three years.

China is the world's biggest user of iron ore, swiping about 45% of world production. What is not clear is whether iron ore demand will remain high.

#### Which way out will the iron ore go?

Mutún lies on Bolivia's eastern border with Bolivia just above Paraguay. This is more or less equidistant from both the Atlantic and the Pacific. There are several different schemes for getting the iron ore to the bulk carriers that will then carry the stuff to China. The most likely scheme is to send Mutún's iron ore to Tacna in Peru for shipment on to China. At the end of July, Peru's congress approved a project to build a megaport at Tacna. This will be connected by rail to Mutún. Shandong Luneng, a Chinese company, is interested in building a two-track railway from Mutún to Tacna.

Tacna is not the only option for shipping the iron ore out. There are other schemes to ship the stuff out through Chilean ports such as Arica, Iquique, Antofagasta and Mejillones.

Jindal is also looking at shipping the iron ore out to the Atlantic. This would mean that it would go by barge down the River Paraguay and thus to the River Plate estuary. This project will require a much shorter (and cheaper) railway. This is the option that Jindal's likely partner in the Mutún project, the state-owned mining company, Comibol, prefers.

Steel prices are already easing down as the world attempts to cope with the surge in Chinese output.

**Nickel:** Latin America has three big nickel producers; Cuba; the Dominican Republic and Colombia. Arguably, nickel has been the star of the recent commodity boom. On 22 August the nickel price hit an all time high of US\$30,250 per tonne. Cuba now produces around 12,400t of nickel a year. It is investing heavily, thanks to an aid package worth US\$500m from China, its biggest nickel buyer, in expanding production in Holguín. Cuba claims to have the world's fifth biggest nickel and cobalt reserves. It is expecting to increase output to over 100,000t in 2007. World nickel production is around 1.5m t.

## COFFEE

### Profiting from Vietnam's problems

**Latin American coffee producers, whose businesses were undermined in the early 2000s by Vietnam's (World Bank financed) expansion of its coffee industry, are delighted that the Asian country's crop has again suffered problems.**

Although the main effect of Vietnam's problem has been a surge in robusta prices (which Latin America does not produce as much as it does of arabicas and other milds), Latin America should benefit in the long term. South America's production of robustas, mostly from Brazil, is rising strongly: in the current crop year output was up by 62% at 8.4m bags. The immediate beneficiaries of Vietnam's problems are African coffee producers: Robusta prices are now double their 2005 level.

Vietnam's crop peaked in 2003 at 15.2m (60kg) bags. In the current crop year, which ends at the end of September, its production is likely to be as low as 11m bags. Although the International Coffee Organization (ICO) is forecasting that Vietnam's output will increase in the 2007/07 coffee year which starts on 1 October, coffee traders are sceptical.

Néstor Osorio, the executive director of the ICO, said that Vietnam's low production was not the only problem facing the robusta market. Production in the Ivory Coast and the Democratic Republic of the Congo was also down. He also noted that countries such as Brazil, which produce between 8m and 9m bags of robusta a year, have increased their demand for this type of coffee. Robusta is mainly used to make instant coffee, and Brazil has increased its imports of robusta to around 16m bags.

Osorio said that the surge in robusta prices in late July and August was due to the fact that coffee users could not find higher quality arabicas to substitute for the shortage of robusta as they could three or four months ago. The problem is that Central America and Colombia has harvested, and sold, all of this year's crop, while Brazil is just finishing harvesting its 2006 crop.

Now that the frost season is over in Brazil, the next turning point for the coffee industry is likely to be November and December. This is when the first estimates of the Brazilian crop, which will be picked in the (Brazilian) autumn of 2007 (i.e. the first half of the year) are made.

Speculative money is being attracted back to the coffee market because stocks have diminished and supply and demand are virtually in balance.

" Although the main effect of Vietnam's problem has been a surge in robusta prices (which Latin America does not produce as much as it does of arabicas and other milds), Latin America should benefit in the long term. "

## Deals, and dispute, follow Chávez's visit

"Chávez met all of China's top leaders during his visit from 22 to 27 August: President Hu Jintao; Wu Bangguo, the number two in the leadership; and Wen Jiabao, the prime minister. This was Chávez's fourth visit to China since won the presidential elections. The previous ones were in 1999, 2001 and 2004."

**President Hugo Chávez's visit to China produced plenty of agreements in its wake, but also, one dispute over whether a Chinese oil company had paid all the tax it should have.**

Chávez met all of China's top leaders during his visit from 22 to 27 August: President Hu Jintao; Wu Bangguo, the number two in the leadership; and Wen Jiabao, the prime minister. This was Chávez's fourth visit to China since won the presidential elections. The previous ones were in 1999, 2001 and 2004.

Chávez brought half his cabinet with him: Nicolás Maduro (foreign minister); Nelson Merentes (finance); Wilmar Castro (tourism); Elías Jaura (agriculture); José Cabello (infrastructure); Rafael Ramírez (energy and oil); Jorge Giordani (planning and development); Marlene Yadira (science and technology); William Lara (communications and information); Francisco Sesto (culture) and Gustavo Márquez (foreign trade).

Chávez delivered on the two promises he made when he arrived: that China and Venezuela would do more joint oil developments, especially in Venezuela's heavy-oil Orinoco belt and offshore. Secondly, he said that China would help Venezuela develop a fibre-optic communications system. He also said that Venezuela was evaluating Chinese-made computers and implied that the government could switch its IT platform to Chinese made machines and software. Chávez also got US\$1.2bn in Chinese finance for his house-building programme. He wants to build 20,000 houses in the next two years.

A lot of other business was also done. The governor of the state of Bolívar, Francisco Rangel Gómez, who accompanied Chávez, wants China to invest in a bus factory and another plant to make electrical equipment, including generators, in his state. Chávez and his team also visited the eastern mining state of Jinan to meet mining experts. Two Chinese mining companies, Shandong Gold and Yankuang have speeded up plans to invest in Venezuela. Shandong expects to invest US\$21m by the end of this year. Chávez and co also went to visit Chinese sisal factories to assess the contribution China could make to developing a sisal industry in the states of Lara and Falcón.

Oil, however, is the key element in any relationship between Venezuela and China. Besides securing Chinese involvement in the Orinoco tarbelt, Chávez also bought 12 (or perhaps 24) oil drills from China and signed a licence to set up a drill-bit making plant in Venezuela to make Chinese-designed drills under licence. He also commissioned (a still officially unspecified number of, but apparently 18, according to China Daily ) large tankers, Chávez called them "superpetroleros", from Chinese shipyards.

Chávez is making something of a habit of ordering oil tankers during official visits. He ordered two small (47,000 deadweight tonnes) tankers during a trip to Argentina in 2005. In Brazil, in the same year, he ordered 36 tankers of various shapes and sizes.

China's need for more energy is driving Chinese investment. The energy and oil minister Rafael Ramírez announced in mid-September that joint investment by China and Venezuela to develop oil and gas fields in Venezuela will reach US\$5bn. The Chinese firm, CNPC, is involved in the development of 19 oilfields in the east of the country and agreement has been reached for it to take part in a block in the Orinoco tarbelt and another in the east of the Gulf of Paria.

## Figures

It is also worth noting that Venezuela's trade with China is still less than 5% of Venezuela's total trade. The two countries traded US\$2.1bn of goods in 2005. Venezuela's oil exports to the world are worth over US\$50bn a year. By the end of this year China should have taken an average of about 150,000bpd of crude oil from Venezuela: 2006 started with China importing 70,000bpd but should end with it importing 200,000bpd. Even so, 200,000bpd is only 13% of what the US buys.

Exports of oil to China, virtually nil two years ago, have risen to at least 70,000bpd and should hit 200,000 barrels per day by the end of this year. Venezuela's target is to raise the volume to 300,000bpd by the end of 2007 and to 500,000bpd by 2009 or 2010. The official target (ie agreed between the two countries at the head of state level) is to get to 500,000bpd "within five years."

President Chávez went further. "In a few years time we hope to reach 1m bpd [in exports to China]" he said on 24 August. He made it clear that it would probably take 10 years to reach this figure.

China currently imports 3m bpd of crude oil. By 2009 its imports of crude are likely to be about 9m bpd. This means, in percentage terms, that Venezuela's exports to China will barely increase. Currently, Venezuela is supplying about 5% of China's oil imports (150,000bpd out of 3m bpd). By 2009 the proportion of Venezuelan oil in China's imports will have only increased to 5.5% (500,000bpd in 9m bpd). Indeed in the first six months of 2006 Venezuela's share of China's oil imports was 1.72m t or 2.3% of the total.

There are technical problems with Venezuela's oil. Most of it is high sulphur (or sour) crude, which China's oil refineries are not set up to handle. The other problem is shipping the stuff: the supertankers which are needed to transport the stuff cannot (yet) use the Panama Canal so the costs of transport the oil from Venezuela to China are high.

**Sensibilities:** China's Latin Americanists were quick to stress that China's growing links with Venezuela did not pose a threat to the US. Wu Hongying, director of Latin American research at the Institute of Contemporary Relations, said that the "economic, energy and commercial relationship between China and Venezuela posed no threat at all to the US. Venezuela is seeking to diversify its market to ensure its economic security and find solutions for its growing [oil] output, China wants to broaden its sources of energy and to reduce its dependence on [oil from] the unstable Middle East." Wu pointed out, however, that energy cooperation between the two countries was "in reality, weak" compared with Venezuela's relations with the US.

**Problems:** 10 days after President Chávez got back from China, the Venezuelan tax office surprised the China National Petroleum Corporation by thumping down a tax demand for US\$10.9m (B\$23.5bn). The money was for unpaid income taxes in 2005. CNPC said that it knew nothing about the demand. An unnamed CNPC official in Beijing said that the company was surprised that Chávez had not brought up the problem during his visit.

The demand puts CNPC in the same boat as most other oil companies operating in Venezuela. The government has been chasing 20 companies and 14 joint ventures for tax since April 2005 when it increased oil taxes on those operating in the Orinoco tarbelt from 34% to 50%.

An official from the Venezuelan tax office, Seniat, said that it had done spot checks on 22 companies involved in 32 deals and found that most had made errors in the way they had calculated their tax payments.

**UN:** China's president, Hu Jintao, told President Chávez publicly on 24 August that China would support Venezuela's application to be Latin America's representative on the UN Security Council for the next two years. The US is pushing Guatemala for the post. The vote is due to take place in October. Venezuela is confident that it has lined up enough (anti-US) support to win a seat. Beside China, Venezuela is also backed by most of the Arab world and Russia.

## Negotiating with Japan, deal done with China

**Chile is the first country in the world to have agreed a free trade deal with China. It is also close to clinching a free trade agreement with Japan. Talks with Malaysia and Thailand are at a more embryonic, working party, stage. Chile already has free trade deal with South Korea.**

The deal with China does not come into effect until 1 October, but the run-up to this started earlier. On 5 September, Wu Bangguo, the president of the Chinese legislative assembly, and the number two in the Chinese hierarchy made a high profile visit to Chile. President Michelle Bachelet pre-empted congressional approval by promulgating the treaty at the end of August.

The free trade agreement (FTA) immediately eliminates tariffs on 92% of Chile's exports to China. Another 7% of Chilean exports will see their tariffs come down over the next 10 years. The only products excluded from tariff reform are wheat; wheat flour; rice; iodine; urea and some hardwoods.

In return Chile ends tariffs on half its imports from China. A further 21% of China's exports to Chile will not face tariffs in five years' time while another 26% will see their Chilean tariffs erode over the next 10 years. The only Chinese goods excluded from this are: tyres; cloths and refrigerators. China is Chile's second-biggest trading partner after the US. Between 1996 and 2005 trade between the two countries has increased eightfold to US\$6.98bn. In 2005, Chile's exports to China came to US\$4.6bn and its imports to US\$2.5bn.

Chile's government claims that the FTA with China will create 34,000 good jobs in Chile. They will be spread between small and medium sized exporters and importers who will now have access to cheaper (Chinese) products. The Chinese products that will benefit most from lower Chilean tariffs are: machinery; computers; cars; cell phones; DVDs and printers.

On 9 August the Chilean senate unanimously approved the free trade agreement with China and a statement of free trade intentions (A Strategic Transpacific Economic Association Agreement) with New Zealand; Singapore and Brunei. One of the first fruits of the Chile-China FTA is the opening of the first office of the Chilean bank in China. Banco de Chile was due to open a representative office in Beijing on 21 September. It is only the second Latin American bank to open an office in China.

Bruno Philippi, the president of the Chilean manufacturers' association, (Sofofa) said that on 6 September in the Foro de Cooperación Económica y Comercial, attend by Wu Banhhuo, that the next stage in developing trade relations with China should be the extension for the FTA to include services and investment. This should be done as soon as possible, he said.

Wu Bangguo responded enthusiastically to this call when he addressed the Foro on the following day. He said: "It is to be hoped that, in accordance with the principles of equality and reciprocal benefits, we reach in the second stage an agreement over investment and services. The advantages of this would produce another record in relations between China and Chile."

President Michelle Bachelet has high hopes of Chile becoming the entry point for Chinese goods going into the Mercosur. She said that the revival of the transandean railway between Chile and Argentina will help China get its goods to the east of South America.

"China is Chile's second-biggest trading partner after the US. Between 1996 and 2005 trade between the two countries has increased eightfold to US\$6.98bn. In 2005, Chile's exports to China came to US\$4.6bn and its imports to US\$2.5bn."

Argentina  
Yang went on from  
Peru to visit  
Argentina. He was  
also at the Non-  
Aligned summit, in  
Havana, before going  
to Peru.

Chile's negotiations with Japan are at critical stage. The fourth round of negotiations, in Santiago, was extended by a week for the original scheduled close on 31 August to 6 September. These talks had three main goals; to reduce the differences between both sides on market access; to define the texts for the chapters of the agreement and to have a complete vision of what a finished deal should look like.

Japan is negotiating its second free trade agreement with a Latin American country. Its first was with Mexico and came into effect in April 2005. Chile runs a thumping trade surplus with Japan. In 2005 Chilean exports to Japan were worth US\$4.54bn while its imports were worth US\$941m.

The big question for Chile is whether the free trade deals with Asia will transform its economy away from being a commodity exporter. A thumping 82% of Chile's export revenues are generated by commodities. This is on a par with Bolivia (83%) and below only Cuba (90%) and Venezuela (88%). By comparison 72% of Argentina's exports are commodities and 64% of Colombia's. All the figures come from the UN. What puts these figures into a context is that only 9% of China's exports are commodities and only 22% of India's are.

Chile, like the rest of Latin America, wants to sell more value-added products to Asia in general and China in particular. Arguably, the only country which is making a concerted effort to make the change is, surprisingly, Bolivia. The Mutún project shows that Bolivia does not want to be just a source of iron ore. The Bolivian government is also trying to get foreign investors interested in creating a plastics or petrochemicals industry in the country, using gas as a feedstock.

**Peru:** The new government, headed by President Alan García, wants to improve relations with Japan. The Peruvian foreign minister, José Antonio García Belaunde, said that better relations with Japan were as important as improving Peru's relations with its neighbours, Ecuador and Chile. Peru fought a brief war with Ecuador in 1995 and a major war with Chile 120 years ago. Peru's defeat by Chile in the War of the Pacific (1879 to 1884) still rankles.

Peru's relations with Japan, which had been close when President Alberto Fujimori, who is of Japanese extraction held office, deteriorated over the past five years when Japan refused to extradite Fujimori back to Peru.

**Visit:** On 18 and 19 September, China dispatched its deputy foreign minister, Yang Jiechi to visit Peru and then Argentina. He signed economic cooperation agreements and met President Alan García. Yang also met officials from the Comunidad Andina de Naciones, which might soon expand to include Chile, one again. Chile left the CAN in 1974 but has taken up an invitation from Colombia to rejoining the group. Venezuela left the CAN earlier this year when it joined the Mercosur. Bolivia is also hawking over whether to remain in the CAN.

Peru's prize from China, awarded by Yang was its designation as an "Authorised Destination." China started awarding this title to countries in 2005. Countries with this title find it easier to attract Chinese tourists. China is Peru's second biggest trade partner after the US and the country's second biggest export market.

**Ecuador and Colombia:** China will support Ecuador and Colombia in their applications to join the Asia Pacific Economic Cooperation (Apec) forum. The two countries want to become full members of the Apec in 2008. China said that it is increasingly keen on investing in Andean countries.

## Brown-Forman's astute move

"Tequila is popular in China. Sales are currently running at five times what they were in 2005. In the first six months Mexico exported 105,000 litres of tequila, up from 17,352 litres in the first six months of 2005."

**Brown-Forman, the US drinks company that owns Jack Daniels, Southern Comfort and Finlandia vodka, paid US\$876m for Grupo Industrial Herradura, a tequila manufacturer at the end of August. On 8 September China registered tequila as a brand. This opens the way to tequila being marketed in China.**

Mexico's Consejo Regulador del Tequila had been pushing for China's authorities to recognise tequila as a brand from April 2004. China's registration of tequila as a brand means that local distillers can no longer claim that what they have been passing off as tequila is the real thing. The trademark will be registered for the next 10 years.

Tequila is popular in China. Sales are currently running at five times what they were in 2005. In the first six months Mexico exported 105,000 litres of tequila, up from 17,352 litres in the first six months of 2005.

Brown-Forman will benefit from this development. Herradura's brands are its eponymous *Herradura* brand and *El Jimador*. The deal leaves Cuervo, whose top-selling tequila is distributed internationally by Diageo, as the only top 10 tequila maker still in Mexican ownership. According to the Secretaría de Economía there are 58 tequila exporters in the country, mostly in the centre west. Cuervo is based in Michoacán.

Herradura had been looking for an international partner to take a 25% stake in return for marketing its products more effectively in foreign markets. This followed the ending of its arrangement in 2005 with a Spanish drinks company, Grupo Osborne, under which Osborne took a 25% equity stake in return for marketing Herradura's tequila internationally. Herradura is owned by Pablo and José Guillermo Romo de la Peña, and employs around 1,100 people.

The drinks companies Herradura approached said, a month ago, that they would prefer to take full control of Herradura. Two other international drinks companies ran their eyes over Herradura: Pernod Ricard from France and the US rum company, Bacardi.

The price Brown-Forman ended up paying is a full one. Initially, analysts had expected *Herradura* to fetch between US\$650m and US\$800m. Herradura's sales in 2005 were about US\$200m a year: around a third come from export markets, principally in the US and Europe. The company distils just over 14m litres of tequila a year. It sold 380,000 nine-litre cases of *Herradura* tequila in 2005 of which about 70,000 were exported to the US. It produces 1.4m cases of *El Jimador* of which about 150,000 were sold into the US.

Brown-Forman admitted that the Herradura deal would cut its earnings by between US\$0.08 and US\$0.12 in 2007 and would depress profits for 2007. Paul Varga, Brown-Forman's executive president, argued that the deal would increase his company's business with the Hispanic market in the US and also give it a greater impact in the cocktails market in the US. He noted that margaritas, which have a tequila base, are the most popular cocktails in the US.

Wines and spirit companies in the US have been doing well as US consumers switch from beer drinking to longer drinks, such as cocktails, and wine. Herradura has broken into this market with its New Mix brand of tequila mixed with soft-drinks. It shifted 4m cases of this stuff in 2005, all of which were sold in Mexico.

"The tequila business employs about 200,000 people in Mexico. There are about 650 different brands that have been legally registered. In rural Mexico, there are also family-owned stills that produce the stuff on a tiny scale."

The US has overtaken Mexico as the main world market for tequila: it consumes around 46% of world's tequila, measured by case volume. Mexico swigs 40% and the rest of the world the remaining 14%. In 2005, according to figures from the central bank, Mexico's tequila exports were worth US\$552m. By volume its tequila exports came to 91.6m litres of which 74% went to the US.

US consumption of tequila is running at 9.1m 9-litre cases making the drink the eighth most popular alcoholic drink in the US. Even so, and despite fast sales growth in recent years, tequila still has a mere 6% share of the US alcoholic drinks market.

The prospects for tequila in the US market may be good but over the past eight years wine has been the star. Over that period it increased sales by 25% in the US: beer and spirit sales in the same period were up by 5.2%.

**Grumbles:** The Confederación Nacional Campesina (CNC) is grumbling about the Brown-Forman deal. The CNC now claims that nine of the 10 top-selling tequilas are foreign owned. The CNC claims that this may pose problems for local growers of blue agave, the raw material for the drink. The CNC is all but alleging that the distillers are rigging the market and forcing down the price of blue agave.

The CNC claimed, in mid-September, that the average price from blue agave has fallen from M\$15 to M\$2 (US\$1.3 to US\$0.20) per kilo in the past three years. Blue agave for distilling is grown in Jalisco, Tamaulipas, Nayarit, Michoacán and Guanajuato. What the CNC says is happening is that the foreign-owned distillers are setting up their own blue agave plantations instead of buying the stuff from peasant producers. This change is leading to peasants abandoning the crop. The CNC claims that over the past few years 240,000 blue agave plants have been destroyed. This is equivalent to the loss of about 5,000t.

Ricardo Chávez, the secretary responsible for agrarian action at the CNC, said that Brown-Forman's acquisition of Herredura was another sign that the Mexican drink was losing its essence. He pointed out that Brown-Forman already owned 33% of the Orendáin tequila brand.

The tequila business employs about 200,000 people in Mexico. There are about 650 different brands that have been legally registered. In rural Mexico, there are also family-owned stills that produce the stuff on a tiny scale. Total production of registered tequila brands is over 200m litres a year. According to figures for the Consejo Regulador del Tequila 117m litres are exported. The US accounts for 74% of Mexico's tequila exports.

The big tequila brands are: *Sauza* (which is owned by Fortune Brands from the US); *Viuda de Romero*, *Mariachi* and *Olmecca* (all owned by the French drinks company, Pernod Ricard) and *Cazadores* and *Camino Real* (both owned by Bacardi. Diageo, from Britain owns the *Don Julio* brand.

**Spin-offs:** Designers from Jalisco say that they expect the growing Chinese interest in things Mexican and tequila in particular will help their business. Juan Ignacio Michel, a representative for the CAIDI design studio in Jalisco said that his company was attending the Shanghai Design Show to try and get business from Chinese companies interested in the Mexican market. He argued that Chinese companies needed special labelling and design to make their products more appealing to Mexican consumers. Michel pointed out that Jalisco's five universities produced 2,500 qualified graphic designers each year.

“Taiwan is also interested in getting involved in the widening of the Panama Canal, even though the main reason for the widening of the Canal is the surge in exports from China to the US.”

**Taiwan:** Taiwan started the third round of talks about a free-trade deal with officials from Honduras and El Salvador on 11 September in Tegucigalpa, Honduras. The talks were scheduled to end on 15 September. The talks about the FTA started in May with an initial round in El Salvador. The second round took place in July in San Francisco, California. The Tegucigalpa round covered issues such as market access; rules of origin; sanitary and fito-santiary regulation and ways of promoting trade.

Taiwan is also boosting trade links with Guatemala in August the Guatemalan economy minister, Marcio Cuevas, led a 10-person business delegation to Taiwan. This visit was reciprocated at the beginning of September with a visit by 29 Taiwanese businessmen to Guatemala. Cuevas expects to return to Taiwan with another group of businessmen at the end of October. The two countries' free trade agreement came into force on 1 July. In 2005, Guatemala's exports to Taiwan came to US\$12m and its imports to US\$85m. According to Taiwan's ambassador to Guatemala, Francisco Ou, in the first five months of 2006 Guatemala's exports to Taiwan increased by 117%, compared with the same period of 2005, to US\$18.6m, while Guatemala's imports from Taiwan rose by 109% to US\$63.4m.

Taiwan is also interested in getting involved in the widening of the Panama Canal, even though the main reason for the widening of the Canal is the surge in exports from China to the US. Taiwan's foreign minister, James Huang, met Samuel Lewis Navarro, the first vice-president of Panama and the foreign minister on 14 August to discuss the project. He also met Rubén Arosemena, the second vice-president and the administrator of Panama's maritime authority.

Panama is the only other country in Central America, besides Guatemala, to have a free trade deal with Taiwan.

**Piracy:** Julio A Millán, the president of Mexico's Grupo Coraza and a member of the Mexican delegation to the business consultative council of the Asia-Pacific Economic Cooperation (Apec) council said that 93% of all goods sold in China were pirated. He said that the worst infringements of intellectual property rights were in films, music and software, though pharmaceuticals, chemicals, sports shoes, branded clothes, coats; foods and car parts were also vulnerable to being ripped off.

Millán argued that it was not only the holders of copyrights who were affected. He claimed that the Chinese government is losing between US\$3.2bn and US\$4bn in lost import duties because of the prevalence of knock-offs.

The most famous example of China ripping off a foreign car came in 2003 when General Motors saw an exact copy of its Chery pickup at a motor show in Shanghai. The Chinese vehicle was an exact replica in every detail. It was, however, priced at a US\$6,000 while the GM Chery cost US\$9,000. GM sued its Chinese partner Shanghai Auto which was building the knock-offs. A Chinese judge failed to find that GM's intellectual property had been stolen. Millán argued that another serious consequence of China's lack of respect for intellectual property rights is that US companies are now unwilling to transfer production facilities that use US patents to China; nor are they willing to allow their Chinese operations access to new inventions or industrial secrets.

China's disadvantages: Julio Millán, president of Mexico's Grupo Coraza and a member of the Mexican delegation also highlighted the structural eco-

"Venezuela's president, Hugo Chávez, infuriated the Mexican government by backing López Obrador's protests against the TEPJF's final decision, and Bolivia has also expressed doubts about whether Calderón should be recognised as president."

conomic problems facing China's policymakers. He said that China has 300m under or unemployed people and still had to work out how to cope with the dislocation that would be caused when its 700m peasants had to leave the land. He also sneered that China was not a democracy, was over-bureaucratic and suffered from appalling pollution and sharp differences between regions.

**Mexico and China:** China underlined its non-dogmatic approach to Latin American politics by promptly congratulating the rightwing and staunchly Roman Catholic Felipe Calderón Hinojosa on his victory in the presidential elections. The Tribunal Electoral del Poder Judicial de la Federación declared Calderón the narrow winner on 5 September, despite continuing protests from the defeated leftwing candidate Andrés Manuel López Obrador. The Chinese foreign ministry congratulated Calderón on 7 September.

Venezuela's president, Hugo Chávez, infuriated the Mexican government by backing López Obrador's protests against the TEPJF's final decision, and Bolivia has also expressed doubts about whether Calderón should be recognised as president.

China has no such doubts. President Hu Jintao sent Calderón a telegram of congratulations, the foreign ministry said. The foreign ministry added that "it attached great importance to friendly cooperation between the two countries which it wanted to build up, in partnership with the new Mexican government, and to keep on deepening relations between strategic partners."

**Beer:** Modelo, Mexico's biggest brewer, won a contract to import Tsingtao beer from China to Mexico. Modelo, which is 50% owned by the US brewer, Anheuser-Busch, brews Corona. It is also the exclusive importer of Anheuser-Busch products into Mexico. Anheuser-Busch owns 27% of Tsingtao.

**Beijing Restaurants:** The Alameda restaurant in Beijing, which has been voted the best international restaurant in Beijing for two consecutive years, is run by two Brazilians, Viviane Gonçalves and Gabriela Alves da Silva. Their experience was used by *Veja*, a Brazilian news magazine as a cautionary tale of the pitfalls and eventual payoffs of doing business in China. They took four years to find the right site. Gonçalves said that foreigners have to be very patient to be successful in China and they also have to be prepared for sudden changes in the rules.

**Brazilian investment in China:** Although only about 50 Brazilian companies have offices or operations in China, more and more Brazilian companies are considering setting up in China to survive. One of the most telling examples of a Brazilian investment in China is the opening of the huge new Coteminas/Springs plant. Coteminas, which was created by Brazil's vice-president, José Alencar merged with the US textile company, Springs, a year ago. Coteminas/Springs specialises in producing bed, bathroom and table linen.

The current head of the company, Josué Gomes da Silva, is president of the Associação Brasileira da Indústria Têxtil e de Confecção, and as such a frequent complainer about the surge in exports of Chinese textiles to Brazil. These are running at three times their level of a couple of years ago and in 2006 are averaging about US\$50m a month.

Yet Coteminas/Springs is opening a huge factory in China, using mostly Chinese imports, to produce products for both the Brazilian and US markets. Another example of a Brazilian company which has taken an even more radical approach is Paramount, a Rio Grande do Sul ladies shoe-maker.

" An FTAA is unlikely since Venezuela (the newest Mercosur member) and probably now its client, Argentina, are against the idea. President George W Bush only has fast track (which allows him to send a treaty to congress which the congress can either accept or reject) until the end of 2007."

It shifted its entire production to Dongguan in the 1990s and now produces 35m pairs of ladies shoes a year, virtually all of which are exported to the US. Paramount accounts for about 1% of all Chinese shoe exports. Paramount moved because Chinese labour costs are so much less: a Chinese worker earns US\$60 a month for working 12 hours a day, seven days a week. In Brazil, a worker with the same skills would get paid four times as much for a five-day week. Dongguan is now the centre of the world's shoe industry producing 9bn pairs of shoes a year.

This is 12 times what Brazil produces. The Brazilian involvement in the Dongguan shoe industry is considerable: there are at least 1,000 Brazilians working in Dongguan, a city of 7m people. Almost all of the Brazilians are in the shoe industry. Paramount alone employs 150 skilled Brazilians in its Dongguan. It now has a token operation in Campo Bom in Rio Grande do Sul that only accounts for about 5% of the company's total output.

**China, Brazil & Argentina:** Brazilian industrialists are becoming concerned that they re being pushed out of Argentine markets by Chinese products. The most affected areas are: bicycles; white goods; shoes and steel products. Brazilian businessmen say that Chinese competition is unfair: the Brazilian Real has appreciated significantly more against the US dollar than the yuan in the past 15 months since the Chinese authorities unpegged the Yuan from the dollar.

Between 1999 and 2005, Argentine imports from China have tripled to US\$2.24bn. In the same period Brazilian exports to Argentina have increased by only 82%, but they are still considerably higher than China's. In 2005 Brazil exported US\$9.9bn to Argentina. In the first eight months of this year it exported US\$7.5bn China's products are still cheaper than their Brazilian competitors in Argentina even after they pay the 35% Mercosur external tariff. As both Brazil and Argentina recognise China as a market economy they cannot slap quotas or compensatory tariffs on a broad range of Chinese manufactured products.

One way forward for the Mercosur is to get preferential access to developed markets before China. The Mercosur's problem is that its recent trade deals, with Pakistan and Israel, are insignificant. To be fair, the Mercosur is negotiating with the European Union and may still get preferential access to the US through the Free Trade Area of the Americas (FTAA). The agreement with the EU could be transforming for the Mercosur: the problem is that a deal will only work if the EU lowers its agricultural protectionism.

An FTAA is unlikely since Venezuela (the newest Mercosur member) and probably now its client, Argentina, are against the idea. President George W Bush only has fast track (which allows him to send a treaty to congress which the congress can either accept or reject) until the end of 2007.

Brazil's trade deficit with China: In the first four months of this year Brazil ran its first ever trade deficit with China. This is despite the continuing strength of commodity prices which make up most of Brazil's exports to China.

**Bolivia and China:** China's defence minister, Cao Gangchuan, met his Bolivian counterpart, Walker San Miguel in Beijing on 30 August and agreed to step up military cooperation. China's most controversial military aid to Bolivia were 28 ground-to-air missiles whose destruction the US masterminded just before the elections last year which elected Evo Morales president.

## TABLE COMMENTARY

It is staggering that economists are disappointed by the Brazilian economy, which is still managing to grow at over 3% (indeed we still believe that growth this year will be closer to 4%) with real interest rates where they are. On top of this the Real is still appreciating against the dollar. It is worth noting that the appreciation of the Real against the dollar over the past 12 months is greater than the Yuan.

Only three countries in this group of emerging economies have significantly negative interest rates: Venezuela (where interest rates are negative to the tune of 4.6%) and Indonesia (where they are three percentage points lower than short term interest rates). In Argentina, interest rates are starting to rise, though they are still not up to the level of inflation. Brazil still has double-digit real interest rates. Brazilian consumers (and business) seem to have worked out how to live with such rates, just as they did when inflation was running at over 30% a month before the Real plan was launched a dozen years ago.

Comparative data	GDP growth		Consumer price index		GDP US\$bn	Real interest rates	Exchange rate local currency vs US\$	
	% change year-on-year	quarter	% change	12 months to	2005 PPP	%	% change since 13/09/06	rate on 13/09/06
China	11.3	Q2	1.3	Aug	9,412	1.6	1.7	7.95
Hong Kong	5.2	Q2	2.3	Jul	233.3	1.9	0.1	7.8
India	9.3	Q1	6.7	Jul	3,633	0.0	-5.4	46.23
Indonesia	5.2	Q2	14.9	Aug	977	-3.3	8.9	9,111
Japan	2.5	Q2	0.3	Jul	3,910	0.0	-7.2	118
Malaysia	5.9	Q2	4.1	Jul	290.6	-0.2	2.6	3.67
Philippines	5.5	Q2	6.3	Aug	414.1	1.2	9.8	50.4
Singapore	8.1	Q2	1.1	Jul	123.4	2.3	5.9	1.58
South Korea	5.3	Q2	2.9	Aug	994.4	1.8	6.5	959
Taiwan	4.6	Q2	-0.6	Aug	631.2	1.0	-0.5	32.9
Thailand	4.9	Q2	3.8	Aug	544.8	1.5	8.5	37.4
Argentina	8.6	Q1	10.7	Aug	533.7	-0.6	-6.5	3.11
Brazil	1.2	Q1	3.8	Aug	1,576	10.3	6.8	2.17
Chile	4.5	Q2	3.8	Aug	193.2	1.2	7.0	5380
Colombia	6.0	Q2	4.7	Aug	337.3	1.8	-5.0	2,406
Mexico	4.7	Q2	3.5	Aug	1,072	3.6	0.0	11.0
Peru	6.9	Jun	1.9	Aug	167.2	2.6	0.1	3.25
Venezuela	9.2	Q2	14.9	Aug	163.5	-4.9	-1.6	2,696*
US	3.6	Q2	4.1	Jul	12,227	1.1		

**Sources-** Official data; CPI: LAWR; Real interest rates: LAAR estimate, based on short-term money market rate

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