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Banking unconditionally: the political economy of Chinese finance in Latin America

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ABSTRACT

Globalization scholars have long-debated to what extent economic integration, and, specifically, mobile private capital, constrains national policy-making. With Western capital reeling from the 2008 financial crisis, state-owned capital made inroads globally. China, as the world's largest saver, expanded its cross-border lending, funneling almost US$300 billion to developing countries since the crisis. What are the implications for debtor governments' room to maneuver? I contend that China's state-led capitalism is an important form of patient capital, characterized by a longer term horizon. I argue that its rapid global expansion has transformed the traditional relationship between economic interdependence and national policy autonomy. Without the market's threat of short-term capital withdrawal, national governments have considerably more room to maneuver. Given the recent emergence of Chinese financing, I employ a comparative case study analysis of two of China's largest debtors – Brazil and Venezuela – before and after the introduction of Chinese credit. I find that government budget deficits increase as Chinese state-to-state financing accounts for a larger share of total external public financing. These findings offer important new insights for the study of globalization, Latin American development, and China–Latin American relations, by helping explain the conditions under which nations veer from Western governance models.

KEYWORDS

economic policy; Chinese investment; Latin America; global banking; austerity; governance.

INTRODUCTION

The rise of Chinese capital globally coincided with a watershed moment in the history of international markets – the 2008 global financial crisis.

Confronted with shrinking US demand for its exports, China intensified its search for third market destinations, employing overseas investment as a tool to create new trade opportunities. While China's 2001 WTO entry had long-ago forged trade ties with Latin America, it hoped that regional investment in infrastructure, construction, and heavy extraction industries could meet two important strategic national goals simultaneously: improving China's access to raw materials and energy supplies, while also securing new export markets to replace those lost to the US recession. Consequently, during a time where Western financial centers were reeling from the 2008 financial crisis, growing Chinese economic interdependence offered Latin American governments a potentially new source of capital.

Compared to the short-term horizon of mobile capital that was characteristic of depending financial integration at the end of the 20th century, the recent emergence of Chinese state-owned capital has some distinct features. Chinese lenders are not terribly different from market-based creditors. They too are concerned with debt repayment, but their long-term horizon differentiates their lending. Their willingness to incur uncertainty today in hopes of a more substantial return later is particularly appealing to those debtors who are frustrated by market-based capital's short-term volatility, and its emphasis on austerity. Market investors have often considered such budgetary restraint a credible signal of sound governance and debt repayment. However, many developing countries fear that such a governance approach and its capital exit threat might constrain their political agendas, budgetary power, and social responsiveness.

In contrast, China's form of patient capital is often willing to endure emerging market business cycle risk. It signals such risk tolerance through promises of non-intervention in sovereign affairs. In fact, the rising power has avoided onerous policy conditions, or credit being contingent on a country's macroeconomic performance. Under the guise of non-intervention, however, it also promoted long-term profit and market-share opportunities for its firms. In fact, almost three-quarters of Chinese loans support investment in the energy and mining sectors, or infrastructure – a convenient outlet for the country's construction overcapacity.

Because China has largely benefited from such a patient capital approach, it shows no signs of retreating from Latin America, notwithstanding its slowing growth back home. After lending more than $100 billion to Latin America since 2005 (Gallagher, 2016; Gallagher and Myers, 2014), it pledged to invest $250 billion more in the region over the next ten years. In fact, overseas investment is a key part of Beijing's economic adjustment strategy. To alleviate overcapacity domestically in such sectors as infrastructure, construction, steel, and energy, Chinese officials leverage development financing to create opportunities internationally for Chinese firms and workers. In this regard, China's bank finance today is reminiscent of 'tied-aid' historically, where credit lines were often extended to developing countries by the US and Japan through commercial bank loans, bilateral development loans, and supplier credits from export–import banks in exchange for the purchase of goods and services from the creditor nation.

Much scholarly attention has focused on the implications of China's deepening trade relationship in Latin America (see Gallagher and Porzecanski, 2010), but Chinese finance has received considerably less attention by scholars, leaving many important questions regarding the rise of Chinese banking in the Western Hemisphere unanswered. Has China's emphasis on non-interference in sovereign affairs removed fiscal constraints, and thus contributed to some of the region's renewed debt problems? Does China's state-led capital facilitate programmatic shifts away from market-led governance?

In this paper, I show that China's emergence as a new Latin American creditor has restored a patient capital approach to global finance that has allowed the region to escape those budget constraints traditionally imposed by global capital markets (Kaplan, 2013; Mahon, 1996; McNamara, 1999; Mosley, 2000, 2003; Wibbels, 2006), and international financial institutions (Nelson, 2015; Thacker, 1999; Vreeland, 2003). The commodity boom provided such an alternative funding source during the early to mid-2000s, often helping governments increase their budgetary spending (Kaplan, 2013; Murillo et al., 2011; Weyland, 2009). However, in the wake of the global financial crisis, a commodity correction left Latin American governments searching for new financing options.

I expect that the rise of Chinese banking has enhanced governments' fiscal space, conditional on its domestic investment channel. When Chinese financing takes the form of state-to-state lending, the funds directly enter government coffers, enabling incumbent politicians to increase their spending on their political agendas. By contrast, when these loans are instead booked to a corporate entity (either a private firm or a separately managed state-owned enterprise) through government concessions, the central government does not benefit from the loan directly. Consequently, they do not secure new budgetary financing, which creates considerable national variation in China's regional underwriting of public financing.

I exploit this variation in the type of sovereign financing to test whether Chinese financing streams enhance Latin America's fiscal policy autonomy, and, ultimately, yield higher deficit spending. I focus on fiscal policy not only because of its centrality to market governance, but also because of its importance in understanding government objectives. Indeed, a government's economic priorities are reflected in its national budget, just as a firm or household's preferences are conveyed through its balance sheet.

Given the recent emergence of Chinese global financing, I employ a comparative case study of two of China's largest debtors – Brazil and Venezuela – before and after the onset of Chinese credit in the wake of the crisis. I find that in Venezuela, the once-lofty primary budget surpluses of the mid-2000s morphed into wide deficits as Chinese state-to-state financing accounted for a growing share of external public financing. By contrast, notwithstanding its recent swing to primary budget deficits during its recession, Brazil's government was more disciplined fiscally than its Andean neighbor in the years following the global crisis. Unlike China's direct, bilateral public financing of infrastructure and development in Venezuela, public tender is a constitutional requirement in Brazil. It contracts unfulfilled public services through private procurement, increasing the importance of using budget discipline to signal its good credit standing to private investors. Even amid its economic doldrums today, Brazil targets fiscal restraint in an effort to boost market confidence. I also extend this comparative analysis to China's other major regional debtors, Argentina and Ecuador, finding that the link between Chinese financing and budgetary expansion may hold more broadly.

These findings offer new insights for studies examining globalization, neoliberalism, and the Latin American left, which have found considerable variation in the extent of government intervention in national economies. On one side of these debates, scholars have contended that economic integration (Cerny, 1995; Rudra, 2002), global capital markets (Mahon, 1996; McNamara, 1999; Mosley, 2000, 2003; Wibbels, 2006), and international financial institutions (Nelson, 2015; Vreeland, 2003) have led to a retrenchment of Keynesian-style countercyclical fiscal policies in developing countries, including budget deficits and social safety nets. In support of this view, scholars find that a variety of factors, including a weak labor movement (Roberts, 2002), party-brand dilution (Lupu, 2014), strong business interests (Fairfield, 2010; Schneider, 2004; Thacker, 2000), reform-seeking politicians (Corrales, 2000), centrist economic voters (Baker, 2008; Baker and Greene, 2011), and increasingly non-economic voters (Hellwig, 2014) helped facilitate a broad-based acceptance of this neoliberal consensus (Murillo, 2002; Stokes, 2001; Weyland, 2002; Levitsky, 2003; Roberts, 2012). Notwithstanding such policy retrenchment, other scholars find that neoliberal reforms have not been uniform. Rather, many countries with import substitution industrialization (ISI) legacies crafted political bargains (Frieden, 1991) that preserved supply-side economic interventions, including industrial promotion, public employment (Kurtz and Brooks, 2008), labor protection (Carnes, 2014), and social insurance (Wibbels and Ahlquist, 2011). However, they did not have much macroeconomic flexibility (Kurtz and Brooks, 2008). I engage with this important issue, showing that the emergence of Chinese state-led financing has endowed governments with greater fiscal space compared to market-centric governance.

This study also has significant implications for scholars examining the rise of China in Latin America. In the field of political economy, two main perspectives have dominated the analysis. The first argument is that Latin America's specialization in primary commodities is complementary to China's economic structure. Unlike the United States that often seeks to protect politically sensitive agricultural sectors (Frieden, 1988), China is not a source of commodity competition. Rather, China imports the primary goods that Latin America produces cheaply and efficiently. Hence, rebalancing trade ties with China should improve the region's welfare (Santiso, 2007). By contrast, others are more skeptical of China, suggesting that its regional trade pattern reinforces Latin American dependency through an over-reliance on commodity specialization and an inability to compete with China's cheap manufacturing goods (Gallagher and Porzecanski, 2010; Jenkins, 2012; Moreira, 2007; Ortiz, 2012; Wise and Quiliconi, 2007). This asymmetric relationship leaves the region exposed to a severe commodity correction that could impair Latin American development. My argument seeks to complement this literature on Chinese integration by offering a systematic examination of how this structural transformation affects the policy choices of individual Latin American nations.

The international relations literature reflects a similar dichotomy, with scholars arriving at divergent conclusions about the security implications of growing Chinese–Latin American interdependence. The 'realist' perspective is deeply suspicious of Chinese motives (Mearsheimer, 2001), perceiving China's Western Hemispheric expansion as part of a geopolitical strategy to mitigate US hegemonic power (Lanxin, 2008). Other scholars have offered a more nuanced assessment of China's regional role, but they are, nevertheless, cautious about the country's aspirations. Battling an increasingly negative image in the wake of the influx of low-end manufacturing exports to Latin America, China has funneled billions of dollars into improving its global reputation. Whether investing in soft power yields dividends, however, remains unclear amid ongoing concerns about its economic threat, corrupt business practices, human rights record, and growing military power (Shambaugh, 2013). Notwithstanding these multi-dimensional concerns, many thinkers suggest that China's presence in Latin America is primarily driven by economics, offering less of a challenge to US regional influence (Roett and Paz, 2008; Stallings, 2008; Tokatlian, 2008). In other words, China primarily hopes to secure raw materials for its home market and a destination for its manufactured goods in foreign markets. Political stability is central to these goals, and hence, China has little interest in sparking anti-American sentiment, or participating in populist institutions like the Bolivarian Alliance for the Americas (ALBA). Rather, China has broad, cross-ideological relationships in Latin America (Domínguez, 2006), with the Communist Party engaging in a vast array of inter-party relationships (Shambaugh, 2007).

My analysis brings a new set of considerations to this work by employing a systematic comparative analysis of the shifting economic power balance between the United States and China. The Chinese government's stated intentions for its Latin American expansion include securing access to energy and raw material resources for its domestic market and developing internationally competitive firms (Chen, 2008). However, government officials appear to prioritize more than simply commerce when they discuss the importance of 'creating a more multipolar world and increasing the democratization of international relations,'[1] and their state-sponsored think tanks condemn neoliberalism as an ideological tool of American power (Ferchen, 2013b). While assessing China's political motivations is beyond this paper's scope, the heft of its rising regional footprint has important policy implications. Even if we assume that China has benign diplomatic intentions, it unquestionably has become a huge economic player – a role that may have unintended political consequences, given that China's global economics and politics are often inextricably linked (Flores-Macías and Kreps, 2013). I expect that Chinese state-to-state lending endows governments with more room to maneuver compared to a market-based approach that emphasizes minimal economic intervention.

The article unfolds as follows. The next section contains the main theoretical contribution; here I explain how the emergence of Chinese state-to-state lending has increased national policy discretion relative to traditional market governance models of sovereign borrowing. I then provide qualitative support for this theory using a comparative case study analysis of two of China's largest Latin American debtors, Brazil and Venezuela, which vary in their government's reliance on state-to-state lending. I then extend the analysis to Argentina and Ecuador, two of China's other major South American debtors, to observe if these patterns hold elsewhere in the region. Finally, I close by discussing the study's broader scholarly implications.

THEORETICAL FRAMEWORK: PATIENT CAPITAL BOOSTS POLICY FLEXIBILITY

The globalization scholarship has long-debated the extent to which greater economic interdependence compels governments to curtail their policy autonomy. Within the seminal debate between convergence and divergence thinkers, both schools of thought agree that mobile capital pressured government to adopt laissez-faire economic policies. They differ on the question of whether or not states had the capacity to respond to these pressures. Convergence thinkers anticipate a 'race to the bottom' where states have little power to resist the interests of capital owners, while divergence thinkers are more optimistic about states' capacity, expecting that governments could increase their role in the economy to offset globalization's dislocations.[2]

I engage with this important issue, developing new insights about the nature of global capital in an era of rising state-led capitalism. I contend that state-led capitalism is an important form of patient capital. Unlike the short-term horizon of private market capital, patient capital is characterized by both a long-term horizon and long-term relationships (Kahler, 1998; Wade, 1998). While market-based capital has to outperform short-term industry benchmarks (Mosley, 2003) and maintain profitability to appease corporate board of directors, patient capital is typically willing to forgo an immediate return in anticipation of more substantial returns later. Compared to the financial volatility of market-based financing (Armijo, 1999; Calvo, 1998), scholars have found that the personal or geopolitical ties associated with international bank lending (Frieden, 1987) and global development aid (Clough, 1992) were historically more likely to demonstrate patience. A more recent literature suggests that domestic and international financial systems based on such patient capital yield dramatically different outcomes for financial stability (Hardie and Maxfield, 2013) and national economic policy-making, respectively (Kaplan, 2013).

The emergence of state-owned capital represents the latest manifestation of patient capital in the global financial system. These state-owned creditors do not have to abide by such near-term criteria because they are backed by their governments' implicit guarantee of their loan portfolios, should their debtors encounter financial distress. Moreover, their home governments are also typically intimately involved in crafting their global operations strategy, meaning the lines between business and politics are often blurred. For example, China articulates its focus on long-term profitability, and its willingness to endure emerging market volatility as a development opportunity created by South-to-South complementarities.

I contend that these characteristics of state-owned creditors transform the traditional relationship between global economic interdependence and national policy autonomy. Its long-term horizon and geopolitical shrewdness make state-owned capital less likely to exit a debtor country. Without the threat of short-term capital withdrawal, national governments have considerably more room to maneuver. They are less prone to austerity-inducing credit shocks that spike their financing costs and impede governments from spending on their political constituencies. By mitigating globalization's constraint on national governments, state-owned capital may, thus, allow Latin American politicians to be more socially responsive, upending the globalization's traditional tension between markets and society.

Latin America's room to maneuver

Latin American history is replete with episodes of leftist governance, but what accounts for the recent longevity of Latin America's turn to the left?[3] Why was it able to survive the 2007–2008 global crisis, and ensuing commodity correction? Indeed, even the 2015 election of centrist Argentine president Mauricio Macri occurred nearly a decade after the beginning of the global financial crisis.[4] Throughout the 2000s, governments, such as the Kirchners in Argentina, Correa in Ecuador, and Chávez and Maduro in Venezuela, have been placed under a similar radical or populist banner (see Levitsky and Roberts, 2011; Weyland et al., 2010; Luna and Kaltwasser, 2014). But, when and how have these governments been able to maintain such policies in an era of global market governance where creditors have little tolerance for the economic populism of the past? Why do some leftist governments willingly embrace economic discipline, while other governments choose to heavily intervene in the economy?

A country's room to maneuver often reflects its government's fiscal space, or the availability of resources to fund budget shortfalls. For developing country governments facing strong redistributive pressures, sufficient fiscal space to supply more jobs, higher wages, and better public services is often key to their political survival. To finance such domestic political agendas, however, developing country governments often must borrow externally to a much greater extent than rich countries. Indeed, underdeveloped financing markets and tax collection leave these governments with considerably fewer internal funding options than developed countries (Gavin and Perotti, 1997). Without such financing, governments lack the capacity to fund their domestic political initiatives and respond to economic shocks countercyclically with deficit spending (Pinto, 2010). For example, a Keynesian policy response like the US's massive deficit spending during its 2008 crisis has historically been more difficult for crisis-ridden developing countries.[5]

From private capital to public creditor: an end to austerity?

Despite this historic pattern of budget retrenchment, I expect that the availability of patient capital from a unitary sovereign creditor like China increases debtors' room to maneuver. Rather than pursuing market austerity to attract bond market capital during hard times, governments that either defaulted on their debt or refused to comply with market conditionality could instead spend freely on their political priorities.

The link between Chinese credit and national policy orientation has both an international and domestic dimension. First, the emergence of Chinese international lending has important implications for the structure of sovereign debt financing, elevating the role of geopolitics in creditors' investment decisions. I anticipate that state-centric financing extends sovereign borrowers' room to maneuver because of its longer time horizon compared to market-based capital. This relationship, however, is conditional on the domestic investment channel. When patient capital is funneled directly into central government coffers, an incumbent government is likely to consider it revenue, and increase its spending. By contrast, when these loans are instead booked to a corporate entity (either a private firm or a separately managed state-owned enterprise), the central government does not benefit from the loan directly.

The international dimension: an emergence of a new global creditor

With state-to-state lending, politics and economics are integrally tied together. For example, the international political economy literature on foreign aid flows has found that aid is often directed to strategically important countries (see Vreeland and Dreher, 2014). Similar to this study, the foreign aid literature has also found that policy discretion is often conditional on whether funds are allocated through the government or non-state actors (Dietrich, 2013; Winters, 2010). In contrast to such development finance, China's bank lending to developing countries is not considered to be Official Development Assistance (ODA). Rather, large international loans from Chinese policy banks, such as the China Development Bank (CDB) and China's Exim Bank, tend to fall outside such traditional aid channels (Bräutigam, 2011).

Notwithstanding these categorical differences, Chinese bank loans are also geopolitical, often targeting countries with abundant natural resources and energy supplies that can help China secure long-term access to these vital national assets. For example, China's *Central Economic Work Conference* in December 2014[6] touted the ongoing importance of the country's 'Going Global Strategy,' which encourages Chinese investment and lending overseas, to its overall national economic agenda.[7] Beyond achieving energy and natural resource security, Chinese officials also view outbound investment as one way of adjusting to China's 'new normal' of slower but higher quality economic activity. By strengthening 'global industry cooperation,' the government can help create opportunities for Chinese firms and workers abroad in sectors facing overcapacity within China, including infrastructure, construction, steel, and energy.[8]

According to Dr Feng Weijiang, the International Political Economy Director from the Institute for World Economic and Politics (IWEP) at the Chinese Academy of Social Sciences (CASS)[9]:

> These are win-win projects for Chinese citizens too. Investment outside of China creates more jobs in the domestic market because we sell our products to other countries; we also ask our firms to go abroad and build infrastructure, creating jobs and earnings for Chinese citizens in Africa and Latin America.

Indeed, such public goods provision is a key instrument of China's foreign economic policy, helping close the infrastructure deficit of developing countries while simultaneously serving the interests of Chinese exporters and firms investing abroad. In line with this strategy, Chinese lending to Latin America reached almost $30 billion to support infrastructure and energy investment in 2015, a year that featured a state visit from Prime Minister Li Keqiang (Gallagher and Myers, 2014). These funds help advance two important national goals: lowering transportation costs for Chinese imports (i.e. soybeans), and employing spare capacity abroad as China rebalances away from an investment-led and toward a consumer-driven model of domestic economic growth.

Compared to private capital, I expect that such state-to-state lending is less likely to lead to capital flight. Operating in a world of quarterly and yearly performance benchmarks (Datz, 2009), Western private capital tends to manage credit risks with short-term policy metrics such as budget discipline and inflation control in lieu of other economic policies with longer term implications (Mosley, 2003). Compelling such austerity might in part reflect a US ideological agenda, but it also seeks to protect creditor interests by bolstering state finances, and hence the chances of debt repayment. That said, it gives debtor governments less room to maneuver because the failure to meet market metrics can spur capital outflows and credit shocks.

By contrast, Chinese bankers tend to incorporate the national interest in their bottom line, seeking to foster China's long-term access to global trade and investment networks. This convergence of economic and political goals yields a different perception of sovereign risk. For example, Zhao Changhui, Chief Country Risk Analyst for China Eximbank, says that Chinese bankers prefer to establish "new business practices" with their borrowers. Freed from the shackles of short-term profitability, they emphasize investment continuity and long-term objectives, while accepting that some projects will "generate higher profits, others less or zero."[10]

Similarly, the China Development Bank's (CDB) Vice Governor, Liu Kegu, explains that CDB officials don't use Western risk measurements,[11] placing a higher premium on securing valuable assets like commodities and natural resources than traditional debt sustainability ratios, such as debt-to-GDP.

Chinese investors, thus, tend to impose less onerous short-term policy conditions than the stringent borrower conditionality required by private investors and Western lending institutions. They operate under an official doctrine of non-intervention in domestic affairs, as stipulated in the country's *Five Principles of Peaceful Coexistence*.[12] For instance, China's State-owned Assets Supervision and Administration Commission (SASAC) includes 'respect [ing] the laws and policies of the country being invested in and respect [ing] local customs' as one of its primary principles in its foreign investment guidelines. Chinese institutions are, thus, willing to extend financing arrangements and direct investment to countries whose governments have been shunned from global markets for their non-compliance with Western governance standards.

If not through conditionality, how does China mitigate the potential for higher-than-expected credit risk? Government lending is secured either through commodity-backed loans, which are collateralized by future commodity deliveries, or by guaranteed contracts with Chinese state-owned enterprises. By reducing their exposure to default risk with commercial ties rather than policy conditions, these banks can simultaneously promote the interests of the Chinese state globally. They underwrite credit risk through promises of future business to extend the web of regional Chinese contractors, suppliers, and workers. Essentially, policy bank financing has replaced an undervalued currency as the main tool of export promotion (Kaplan, 2006).

The domestic dimension: the local investment channel

Does such a longer term view of credit risk management immediately translate to greater discretion for governments seeking greater budgetary autonomy? I contend that achieving such fiscal latitude ultimately depends on the underlying structure of the market and the state, specifically whether a government acts as an intermediary for Chinese bank loans. Chinese loans to Latin American nations typically flow through one of two main conduits. They are either disbursed directly to national governments in the form of public finance, or instead extended to companies that have won government concessions for unfulfilled public services. I expect that governments increase their fiscal space, or the capacity to fund wider budget deficits, when they receive Chinese credit directly into their coffers. By contrast, when these loans are instead channeled outside the central government to a corporate entity, it does not gain any additional budgetary autonomy outside of those revenues that may indirectly result from China-fueled economic growth.

Chinese loans are classified correspondingly because this study aims to understand the relationship between Chinese loans, fiscal policy, and debt accumulation. According to the IMF's Government Statistics Manual, state-owned enterprises are not included in public debt calculations when they are a market producer, or a producer that sells its goods for economically significant prices. Moreover, many state-owned firms, like Petrobras in Brazil, are more like private firms in their financing profile because they raise large amounts of funds from private capital markets. While Petrobras is currently involved in a corruption scandal tied to the government's political party, such public linkages do not change its classification as a corporate entity. Indeed, both public and private firms may be subject to engage in such corruption. That said, when funds from state-owned enterprises are transferred to the national government, they are included in our debt calculations. For example, Venezuela's government development fund, FONDEN, receives transfers from its state-owned oil company, PDVSA, which have then been jointly allocated to the China–Venezuela Joint Fund (Fondo Conjunto Chino-Venezolano, FCCV), along with loans from Chinese policy banks.

The theoretical priors of a Chinese-infused fiscal expansion are in line with the expectations of the rentier state literature, which argues that natural resource booms help finance unsustainably high government spending (Karl, 1997; Ross, 1999; Weyland, 2009). This phenomenon was exhibited most recently in countries like Ecuador and Venezuela during the 2000's commodity bonanza. With a relatively small portion of government revenues derived from the domestic tax base, national budgetary operations are reliant on commodity-generated revenues. Global commodity corrections, thus, often precipitate severe fiscal adjustments unless governments find alternative funding. With the onset of commodity volatility in 2008, Chinese credit has provided such funding, helping governments delay adjustment and underwrite fiscal expansion.

Without such a Chinese funding infusion, however, I expect governments to have less budgetary flexibility. In Brazil, for example, Chinese bank loans are often channeled directly to corporate entities through private procurement. With public tender for government services a constitutional requirement,[13] Chinese credit is typically funneled to firms with successful government bids in exchange for contracts with Chinese suppliers. For example, after winning a 2010 public bid to build a 3G telecommunications network, Nextel Brazil received a $500 million loan from the China Development Bank in exchange for sourcing its 3G network infrastructure from Chinese telecommunications equipment manufacturer Huawei Technologies.

In summary, given China's long-term view of credit risk management, I expect Chinese bilateral credit is unlikely to yield the same capital flow volatility as market-based financing. When allocated directly to national governments, it can thus increase the political room to maneuver.

COMPARATIVE CASE EVIDENCE

To test the above theoretical priors, I conduct a comparative case study analysis across two countries, Brazil and Venezuela, in the five years before and after the emergence of Chinese bilateral credit. These two countries are similar along economic and political indicators: they are presidential, high middle-income South American countries that are among the largest Latin American debtors to China, yet they maximize the variation in the main independent variables of interest (King et al., 1994) – the domestic investment channel for Chinese lending. I also extend this analysis to two additional middle-income debtors, Argentina and Ecuador, to help observe if the theoretical priors hold more broadly.

I focus the investigation on these four countries given their mixed-market orientation, expecting that budgetary drift may be more likely than in liberal market economies. A variety of economic measures suggest that Argentina, Brazil, Ecuador, and Venezuela have mixed-market economies, particularly relative to their upper-middle income counterparts, Chile, Colombia, Peru, and Uruguay. For example, the *Wall Street* Journal and the Heritage Foundation's Index of Economic Freedom consider Argentina, Brazil, Ecuador, and Venezuela to have considerably fewer market freedoms in terms of trade barriers, capital constraints, and financial insulation from government intervention. This relationship is corroborated by the World Bank's *Doing Business Survey*, which routinely ranks these four countries outside its top-100 ranking in contrast to its more market-oriented regional peers.

However, even among these mixed-market economies, there is considerable variation in their domestic governance structures for public investment, with some countries like Brazil more likely to exhibit liberal market features. For example, the majority of public investment on roads, railways, trains, ports, and energy infrastructure is typically financed with private capital through constitutionally required public tender.

Recall that I expect the budgetary effects of Chinese loans to be conditional on this domestic investment channel. When funds are allocated directly to central government, political leaders are likely to take advantage of the lack of policy conditions and increase their deficit spending. By contrast, when these bank loans are instead booked directly to a corporate entity (including state-owned enterprises), governments do not gain additional policy flexibility.

To measure these economic policy changes over time, we can take advantage of the discontinuity created by the global financial crisis, which marked the emergence of Chinese credit as a viable alternative to Western financing. Before this shock, we should observe relative adherence to fiscal discipline in the region, even among traditional skeptics of Western governance in Ecuador and Venezuela. After the global financial crisis when China begins to promptly expand its direct regional lending ties, we should observe a greater extent of fiscal drift among governments that directly receive these funds in their coffers.

Tables 1 and 2 demonstrate this pattern. Based on data collected from a variety of sources (including Latin American finance and planning ministries, US SEC filings of foreign governments, investment bank reports, AidData, and the Inter-American Dialogue's China-Latin American Database), Table 1 illustrates total loans from Chinese policy banks to Latin America's four largest debtor nations. Brazil and Venezuela, on average, received the largest amount of nominal loans annually since the global financial crisis. However, when classifying these loans according to whether or they are distributed directly to central governments (see Table 2), there is considerable variation between the four debtor countries. For example, Brazilian loans fall to virtually nil because they are predominately channeled through procurement with corporate entities.

Table 1 Chinese policy bank loans to major Latin American debtor nations (average debt outstanding in Argentina, Brazil, Ecuador, and Venezuela)

	Total Chinese Loans (US$billion)	Total Chinese Loans (% GDP)	Total Chinese Loans (% External Financing)
Argentina			
Pre-2008 crisis (t-5)	$0.01	0.00%	0.02%
Post-2008 crisis (t+5)	$8.33	1.51%	12.19%
Brazil			
Pre-2008 crisis (t-5)	$0.37	0.02%	0.46%
Post-2008 crisis (t+5)	$12.37	0.56%	11.86%
Ecuador			
Pre-2008 crisis (t-5)	$0.00	0.00%	0.00%
Post-2008 crisis (t+5)	$3.50	4.10%	33.43%
Venezuela			
Pre-2008 crisis (t-5)	$1.33	0.52%	4.69%
Post-2008 crisis (t+5)	$28.49	7.92%	66.03%

Notes: Calculations are based on amount actually disbursed to countries, and not initial project announcements. They are also adjusted for when creditors roll over tranche disbursements to avoid double-counting of debt obligations. Data are collected from a variety of sources, including central government's debt statistics from Latin American finance and planning ministries, US SEC filings of foreign governments, investment bank reports, AidData, and Inter-American Dialogue's China–Latin American Database.

Table 2 Chinese policy bank loans to major Latin American central governments (average debt outstanding in Argentina, Brazil, Ecuador, and Venezuela)

	Total Chinese Loans (US$billion)	Total Chinese Loans (% GDP)	Total Chinese Loans (% External Financing)	Primary Fiscal Balance* (%GDP)	Primary Fiscal Balance (pp change)
Argentina					
Pre-2008 (t-5)	$0.00	0.00%	0.00%	2.24%	
Post-2008 (t+5)	$8.22	1.49%	12.03%	0.15%	-2.09%
Brazil					
Pre-2008 (t-5)	$0.00	0.00%	0.00%	2.38%	
Post-2008 (t+5)	$0.00	0.00%	0.00%	1.76%	-0.62%
Ecuador					
Pre-2008 (t-5)	$0.00	0.00%	0.00%	1.35%	
Post-2008 (t+5)	$2.82	3.23%	26.37%	-2.12%	-3.47%
Venezuela					
Pre-2008 (t-5)	$1.33	0.52%	4.69%	0.75%	
Post-2008 (t+5)	$19.19	5.32%	45.12%	-4.33%	-5.08%

Notes: Central government debt calculations (compared to those in Table 1) do not include Chinese loans to state-owned companies, unless central government debt is directly incurred as part of the loan. For example, the joint China–Venezuelan Fund (FCCV) includes concurrent investments from the Economic and Social Development Bank (BANDES) to the central government. Data are collected from a variety of sources, including central government's debt statistics from Latin American finance and planning ministries, US SEC filings of foreign governments, investment bank reports, AidData, and Inter-American Dialogue's China–Latin American Database.

*Source: Calculated from CEPALSTAT. A positive (negative) number represents a budget surplus (deficit).

In Table 2, a pattern emerges over time and space with Chinese state-to-state loans. Fiscal deficits tend to widen as these loans account for a larger share of governments' total external public financing. In the five years preceding the global financial crisis – with such state-to-state lending averaging less than 5 percent of their external financing – Argentina, Ecuador, and Venezuela posted annual budget surpluses that ranged from 0.75 to 2.38 percent of GDP. However, in the wake of the global financial crisis, these surpluses became deficits with the rise of Chinese state-to-state bank loans. In the five years following the crisis, these type of bank loans accounted for 12, 26.4, and 45.1 percent, respectively, of public external financing. Correspondingly, the same three countries witnessed a fiscal deterioration of 2.1, 3.5 and 5.1 percentage points, respectively. Figure 1 shows their aggregate deterioration, which is even more pronounced when adjusting for discretionary spending associated with Venezuela's off-balance sheet development fund.

By contrast, in Brazil, where the majority of Chinese bank loans are booked to corporate entities (including state-owned enterprises) rather than the central government, we observe a pattern of fiscal discipline (see Table 2). In light of the recent political scandal in Brazil involving

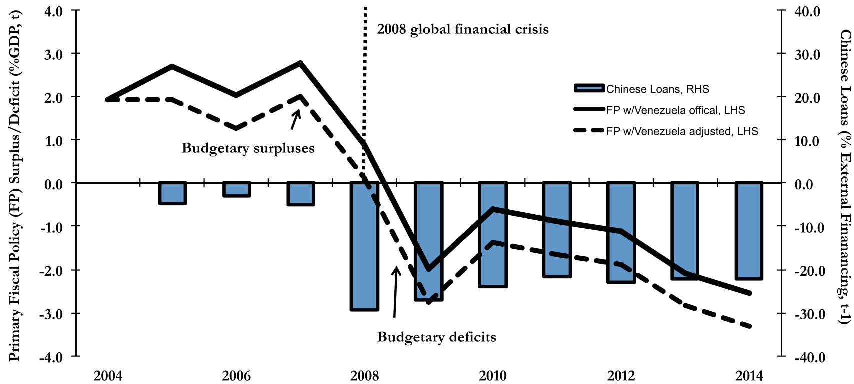

Figure 1 Chinese state-to-state loans and Latin American fiscal policies (2004–2014, Argentina, Ecuador, and Venezuela).
Source: Table 2; CEPALSTAT.

Petrobras and the government's party, we could instead account for the possibility that some Chinese loans made to Petrobras were siphoned to the central government. Even with such a robustness check, however, these loans would amount to less than 5 percent of the government's external financing.

With the market primarily acting as the intermediary, policy-makers were not able to gain greater fiscal policy flexibility after the onset of Chinese credit (see Table 2). The Brazilian government averaged a primary budget surplus of almost 2 percent of GDP in the five years following the crisis. Even amid the recent recession, Brazilian finance ministers, such as Joaquim Levy and Nelson Barbosa, continued to emphasize the importance of 'the sustainability of public finances.'[14]

Even if Chinese bank lending were to significantly expand, Brazil's private procurement system would likely ensure that the government continues to target budget discipline. For example, China pledged $50 billion for a Brazilian infrastructure project fund in May 2015, but it will be channeled through the Brazilian bank, Caixa Economica Federal, and used to support procurement projects.

In the following pages, I first explore the comparative cases of China's two largest Latin American debtors: Brazil and Venezuela. Examining fiscal governance before and after the introduction of Chinese credit, I exploit the variation in government reliance on Chinese funding sources. I assess the extent to which direct state financing endows governments with the expected policy autonomy outlined above, while adjudicating against such alternative explanations as the 2000's commodity boom. In evaluating this claim, I employ a counterfactual analysis, establishing that without Chinese state-to-state lending, politicians have to rely on market financing sources, making fiscal austerity more likely. While the commodity boom initially sustained high government spending, I argue that non-conditional Chinese bank lending helped compensate for falling government commodity revenues following the 2008 global financial crisis. Finally, I briefly extend this analysis to two additional South American debtors, Argentina and Ecuador, to observe whether or not these patterns hold more generally in the region.

Venezuela: Chinese state-to-state lending offsets commodity correction

Venezuela has often exhibited the classic symptoms of the resource curse (see Karl, 1997; Ross, 1999). Politicians ride the wave of commodity booms, spending without bounds until crashing on the economy's shores. Typically, during a commodity downturn, Venezuelan politicians pursue fiscal adjustment to receive a funding lifeline from global market creditors and the IMF.

In the wake of the last crisis-driven commodity correction, however, Venezuela was buoyed by direct Chinese lending to its government that averaged $19 billion annually, or nearly half of the country's total external financing. This new financing has been instrumental in funding massive state spending on social projects, known as misiones programs, which average about US$15.2 billion per year.[15] Chinese financing also helped free Venezuela's budgetary choices from the scrutiny of the international investment community. Excluding off-balance sheet spending, the Hugo Chávez administration moved from an average primary budget surplus of nearly 1 percent of GDP annually to average deficits of more than 4 percent of GDP following the global financial crisis (see Table 2). Notably, this deficit would be about 2.3 percentage points higher (see Figure 1), if we were to include PDVSA government transfers, which were facilitated by the influx of Chinese financing to the state oil company.[16]

Without Chinese financing, it is hard to imagine that state intervention on such a scale would have been possible on the heels of the commodity correction. The availability of a non-market financing stream without traditional conditionality appears to have given Venezuela greater policy autonomy. Perhaps, the late Venezuela president, Hugo Chávez, most aptly describes this policy latitude, when he lauded Chinese lending after being able to spend countercyclically during the global financial crisis: it differs from other multilateral loans because it comes with no strings attached, unlike the scrutiny of international finances.[17]

In the following pages, I will explore this counterfactual of whether or not Venezuela could have intervened in the economy as aggressively without Chinese financing. Through this analysis, I will evaluate my theoretical claim against the alternative explanation that Venezuela's post-crisis policies fit those typically associated with the commodity boom-and-bust cycle.

Oil has long been the lifeline of Venezuelan politics, delivering more than US$1 trillion into state coffers over the last 60 years, creating its well-known paradox of plenty. Without the accountability that derives from broad taxation,[18] politicians frequently and freely spend today with little concern for the health of finances tomorrow. Venezuelan politicians, thus, refer to budgetary spending with a sense of determinism, declaring that 'oil booms create an illusion of endless fiscal expansion possibilities.'[19] For example, Venezuela's three previous oil booms all ended in fiscal crises characterized by depressed oil prices and empty government coffers. Even the free-spending Hugo Chávez oversaw a fiscal retrenchment when his presidency began in 1998 after oil had its worst price collapse since the 1970s.

At first glance, the most recent commodity boom appears to fit this pattern neatly. Between 2004 and 2009, oil proceeds amounted to 62 percent of total government revenues, helping fuel a spending boom. Notably, however, when oil prices collapsed after the 2008 global crisis, Chávez was able to avoid cutting spending this time, which led to a wider budget deficit (see Figure 2). If the government's spending flexibility was straightforwardly determined by the price of commodities, it would be reasonable to expect some fiscal consolidation considering the lack of alternative funding possibilities. Similar to early episodes in Venezuelan history, official government oil receipts fell precipitously.[20] With oil prices hovering at about US$35 per barrel, well below the budgeted price of

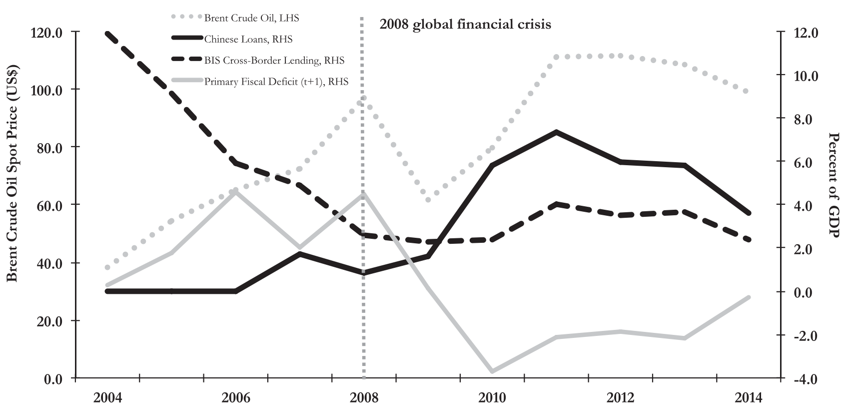

Figure 2 Oil prices, public financing and fiscal policy in Venezuela (2004–2014).

oil, fiscal austerity would have seemed unavoidable. Public sector revenue had fallen by more almost 7 percentage points of GDP by the end of 2009. Little relief could also be expected from the government's off-balance sheet development fund, FONDEN, where oil proceeds fell by more than US$5 billion between 2008 and 2010.

Throughout this period, however, the government maintained its expansionary fiscal stance that included a series of extra-budgetary spending initiatives in 2009. How did the Chávez administration avoid austerity when even its discretionary funds were evaporating?

They turned to China. Beginning in 2007, Venezuela looked to diversify its financing sources by launching a joint China–Venezuela investment fund. The China Development Bank (CDB) – owned by the Chinese government and charged with the task of promoting Chinese commercial opportunities abroad – would invest directly into Venezuela's Bank for Social and Economic Development (BANDES) in exchange for two different types of economic claims: the delivery of future Venezuelan oil shipments and guaranteed infrastructure contracts for Chinese companies. According to the CDB's Vice Governor Liu Kegu, who manages Latin American operations, this relationship is mutually beneficial. Unlike credit rating agencies that fret about Venezuela's sovereign risk because of its volatile commodity prices, ballooning deficits, and swelling off-balance sheet obligations, Kegu was comforted by the country's rich oil reserves.[21] 'We have lots of capital and lack resources, they have lots of resources and lack capital, so it's complementary' (Ferchen, 2013a). By the end of 2010, China had lent almost $30 billion to Venezuela through facilities like the joint investment fund, more than offsetting the loss of cross-border lending from Western banks, which had begun consolidating their balance sheets in 2007, well before the 2008 peak of the crisis (see Figure 2).

If Chinese financing were not available, it is hard to imagine that Venezuela could have continued to unabatedly invest in Chávez's political priorities. In fact, the state oil producer PDVSA, Chávez's preferred off-balance sheet funding arm throughout the 2000s, was also showing signs of severe financing strain by the end of the decade. After having funneled more than $30 billion to the president's development fund,[22] the lack of reinvestment in the state oil company was not only hurting PDVSA's productivity,[23] but also forcing it to increasingly borrow from global capital markets. By 2011, PDVSA's debt had reached $35 billion – equivalent to the amount it had funneled through FONDEN – meaning the state-oil company had effectively financed a massive subsidy to the government for its social programs. Borrowing at high interest rates from global markets while siphoning its oil proceeds directly to the Venezuelan central government, however, was not sustainable over the long-run.

Without Chinese lending, the central government would have, thus, had to borrow more in global capital markets. In 2010, the major credit rating agencies – S&P, Moody's, and Fitch – had already rated Venezuela's sovereign debt below investment grade, meaning new funding would not have come cheap. Incurring more debt would have likely subjected Venezuela to greater investor scrutiny and thus austerity.

In the wake of Chávez's 2013 death, his successor Nicolás Maduro continued to use Chinese loan-for-oil agreements as a funding arm for its expenditures, maintaining a primary budget deficit (see Figure 2). The Maduro government has borrowed from China, often below its market rate, to boost politically important spending today. However, with about one-half of its 640,000 barrels of daily oil production being sold to China,[24] such borrowing comes at the cost of the state-oil company's health tomorrow. While PDVSA has always underwritten the government with its current proceeds, it is now leveraging its future oil assets and profitability to keep the government in the black, casting a cloud over Venezuela's future solvency.

These loan-for-oil agreements also create a moral hazard problem for China that is comparable to the one experienced by US banks during the 1980s Latin American debt crisis. During that crisis, banks first extended new money to Latin American borrowers, in hopes of recovering their initial investments and avoiding further sovereign defaults that would undercut their own profitability. But their losses mounted by decade's end, forcing them to write off their bad loans.

China could be headed for a similar situation. If Chinese banks were to cut their financing to Venezuela out of concern that the country's ongoing spending might jeopardize its credit standing, a likely default could impede the flow of Venezuela's oil shipments to China. On the other hand, if China continues to extend new credit to Venezuela, it may temporarily stave off any potential financial difficulties. However, such defensive lending risks further catalyzing moral hazard. The Maduro government may prefer to spend rather than reform, sowing the seeds for an even deeper debt crisis.

To date, China has opted to continue lending, helping sustain a Venezuelan government that would have otherwise had little choice but to pursue a fiscal adjustment following the commodity downturn. For example, it funneled another $10 billion to the crisis-ridden country in 2015 (or about one-quarter of Venezuela's external debt). At Venezuela's request, China also loosened the terms for one tranche of the loan-for-oil agreements by both removing the minimum quantities for oil shipments and extending the deadline for repayments. Over the long run, the question is how long China is willing to extend such preferential conditions. Currently, China's internal policy debate centers on whether the benefits of securing a cheap, long-run energy supply outweigh the current economic volatility. But, at what point might China play a role all too familiar to the West: attempting to mitigate the politics of excess with the politics of austerity? Surprisingly, some public bankers have already inched in this direction, advocating for greater 'collaboration in the formulation of policies' within China's non-intervention framework.[25] In fact, China Development Bank's most recent $5 billion loan is geared toward improving oil production through upgrading and reform.

Brazil: private procurement reduces policy discretion

I have argued that China's 'no strings attached' approach to their economic relations offers countries autonomy from international investors' scrutiny over their finances, and ultimately greater budgetary flexibility. However, greater Chinese lending alone does not necessarily lead to greater policy discretion – it is dependent on whether or not the central government receives direct Chinese funding. Let us now consider another country case where Chinese credit is channeled outside the government to corporate entities. If my theoretical priors are correct, we should observe considerably less fiscal policy room to maneuver.

In nominal terms, Brazil is China's second largest Latin American debtor. However, rather than funding the Brazilian government, Chinese policy banks typically offer project finance meant to help Chinese firms secure winning bids for public services. The Brazilian government instead funds its operations through a mix of domestic taxation,[26] and private procurement, while turning to global markets to finance any revenue shortfalls. In fact, capital markets have supplied 47 percent of Brazil's external financing since 2007.[27]

Brazil, thus, represents an ideal case for analyzing the post-commodity boom choices of governments that do not tap Chinese financing. Without such non-conditional bilateral lending, the Brazilian government was able to employ fiscal stimulus to offset the 2008 global financial crisis, but then returned to targeting a primary budget surplus in the half-decade following the crisis. Even today, the government has less scope to administer countercyclical policies amid its recession, with its global creditors calling for greater budget austerity rather than stimulus in the wake of Brazil's 2014 election-year fiscal relaxation.

Whether or not austerity is the best policy solution is beyond the scope of this paper; however, the Venezuelan case raises an important counterfactual question. If Chinese state-to-state lending grants Latin American politicians greater economic flexibility, why has the cash-strapped Brazilian government not engaged Chinese bankers more directly? Let us journey to Brazil to examine these patterns more closely.

Undoubtedly, Brazil benefited from its relationship with China, whose commodity demand catalyzed a mid-2000s export boom which helped buoy the economy, and consequently government tax receipts. These added revenues, along with sound macroeconomic fundamentals, allowed the Lula da Silva administration to respond countercyclically to the 2008 global crisis. Even though the crisis tapered the commodity boom, the Lula government was able to use its strong fiscal position to stimulate the economy,[28] helping it grow by a yearly average of 4.1 percent between 2008 and 2010.

Notwithstanding such benefits of growing Chinese interdependence, the Brazilian government has not directly turned to Chinese policy banks for financing (see Table 2). To the extent that China's policy banks are involved in public financing projects, they operate through constitutionally mandated government concessions rather than direct government-to-government lending like in Venezuela. In opting to rely on private procurement for much of Brazil's public services, the country continues to operate within the confines of an economic model that targets budget discipline. Brazil has been less interventionist than its regional counterparts with mixed-market economies. Why?

Compared to Chinese public bankers, financial markets are far less forgiving about large budget deficits and inflation, fretting that they not only erode investor confidence, but also the country's debt repayment prospects. According to Brazil's former Deputy Minister of Finance Bernard Appy, who governed at the Ministry of Finance during the 2008 global financial crisis:

> In Brazil, the market has more strength in controlling what the government can do than in other countries…You have a strong fiscal policy – otherwise, you would lose the confidence of the markets.[29]

In line with Appy's commentary, Brazilian presidents have employed two policy measures to assuage financial market concerns: targeting inflation to keep rising prices at bay, and pledging to maintain healthy state finances with primary budget surpluses under its fiscal responsibility law.

This market-imposed discipline can create an unenviable balancing act for sitting Brazilian presidents. During her first term, President Dilma Rousseff sought to preserve Brazil's hard-won macroeconomic stability, while struggling to overcome economic headwinds and reignite growth. To achieve these twin goals, she allowed a vigilant central bank to check inflation, while employing the Brazilian Development Bank (BNDES) as a tool to finance the expansion of industry and infrastructure. President Rousseff also provided electricity and education subsidies, while targeted poverty through the *Bolsa Familia* program, which grants cash stipends to 48 million poor Brazilians, or one-quarter of the country's population.

Further adding to these pressures was the seemingly irreconcilable demand for greater social spending. In the summer of 2013, millions of people first took to the streets to voice their discontent with the quality of public services and the sky-high price tag for World Cup and Olympic stadiums. Facing plummeting approval ratings,[30] Rousseff swiftly responded with a set of proposals to curb corruption and increase government investment in education, health, and public transportation. Improving the quality and accessibility of such public services is no small feat, however, and necessitates massive new spending commitments.

Placating the growing demands of Brazil's middle class thus created a political quagmire, where higher spending threatened to undermine budget discipline, and thereby Brazil's investment climate. The Brazilian government had averaged a primary budget surplus of almost 2 percent of GDP in the five years following the crisis (see Table 2). Controversially, however, Rousseff's balancing act had reached the boundaries of her fiscal safety net during her 2014 re-election bid. Her social spending commitments and corporate subsidies were politically difficult to trim. They swung Brazil's targeted primary budget surplus – a key gauge of debt service capacity – from a peak of 2.8 percent of GDP in 2008 to a 0.3 percent of GDP election-year deficit.[31] Moreover, President Dilma Rousseff had such little fiscal flexibility that she ostensibly tried to mask the budgetary deficit with state bank credit, an accounting practice that is illegal under the country's fiscal responsibility law, and grounds for her August 2016 impeachment trial.

That said, given Brazil's reliance on capital markets, the Rousseff government, nonetheless, attempted to return to budget balance in its second term. Hoping to bolster Brazil's deteriorating credit standing, the Rousseff administration hired orthodox economist Joaquim Levy to signal its commitment to fiscal discipline. It also proposed social spending cuts and a financial transactions tax. However, Rousseff's fiscal adjustment was unsuccessful as the sinking economy eroded budget revenues, and her political capital sunk to historic lows amid corruption scandals and impeachment proceedings. By May 2016, Rousseff was suspended from the presidency, and Vice President Michel Temer took office.[32] Notwithstanding the recession, Temer has continued to target austerity, proposing a constitutional amendment to cap federal spending that could prove to be politically unpopular.

In searching for an exit from this quagmire, one might think that the government would be tempted to directly borrow from Chinese banks. Certainly, China's US$10 billion loan package to the highly indebted Petrobras is likely to help its new management navigate rocky financial waters amid its ongoing corruption scandal. Why wouldn't the federal government follow course? According to Ambassador Carlos Marcio Cozendey, the current Undersecretary General for Economic and

Financial Affairs at Brazil's Ministry of Foreign Affairs, China's foreign content stipulations had historically made its financing less attractive.

> China's investment in Brazil took a long time to start because they had some expectations that we would not fulfill – in terms of how they would come in, and how they would control the processes; the story we have everywhere that China wants to come, and bring the workers, and bring everything – but this is not possible in Brazil, you cannot bring your laborers, you have to hire them here…we simply applied the rules, and so they did not come.[33]

Ironically, Brazil preferred to borrow with policy conditionality rather than give preferential treatment to Chinese suppliers and laborers, which has in turn limited its degree of maneuverability. For example, in 2004, the Chinese firm Sinopec bid on a major Brazilian infrastructure project, the Gasene pipeline linking Rio de Janeiro and the Bahia states. Backed by an inter-governmental agreement to expand infrastructure cooperation, Sinopec's bid was supported by a China Ex-Im Bank project-finance loan to the Brazilian development bank, BNDES. However, the project was repeatedly stalled due local content disagreements. The China Ex-Im Bank sought a larger share of labor, services, and goods procured in China, but Brazil was not willing to make concessions given its strict labor and local content laws (Alves, 2013).

Brazil's decision to pursue multiple sources of finance may also reflect its firms' distrust of Chinese motivations, and its perceptions that the influx of cheap Chinese manufactured goods has contributed to 'deindustrialization.' In fact, a 2014 study by Exame, a leading business magazine in Brazil, found that about one-third of Brazilian entrepreneurs view Asian competitors as 'threats' to Brazil.

If the Brazilian government is not willing to pay the cost of Chinese content for greater fiscal flexibility, how else might it exit the current crisis? Rather than directly tapping Chinese resources to help fund its deficit, the Brazilian government appears to be pursuing a more intermediate solution. It can outsource public services to the private sector through government concessions. To increase productivity and revive growth, the Rousseff government announced a $64 billion infrastructure package in the summer of 2015.

China has emerged as a potential suitor, but at greater arms-length from the government than in Venezuela given Brazil's public tender laws. Helping pave the way for such cooperation was China's increasing willingness to adjust its investment content expectations. For example, China reduced its equipment and machinery content conditionality to 30 percent for its $10 Petrobras billion loan in 2010 (Alves, 2013). Why? Facing its own economic headwinds, China sees a dual opportunity to export its infrastructure overcapacity and secure a long-term position in a key global marketplace. Chinese Premier Li Kequang reflected these goals, along with his country's new-found sensitivity to Brazilian workers during his May 2015 tour, saying 'We look to work with Brazil to reduce the cost of building infrastructure and to create jobs for the local population.'[34]

To help foster infrastructure opportunities for Chinese firms, the state-owned Industrial and Commercial Bank of China (ICBC) established a new $53 billion credit line in 2015. According to Fernando Alves, Price Waterhouse and Coopers' Senior Partner, local companies have already courted potential Chinese partners to bid on US$60–70 billion in government projects:

> Chinese firms are prepositioning themselves to finance infrastructure in Brazil…If you think about the size of the investment that we are going to have to make in Brazil in regards to infrastructure in the next five years…Not only don't we have enough money to invest, but also, in order to do everything that must be done, we need to invite foreign players through bids for airports, highways, and ports.[35]

Unlike China's direct government-to-government financing of Venezuela, China's credit will be channeled to the Brazilian private sector through Caixa Economic Federal, a public bank with expertise in infrastructure, housing, and urban development. Outside of being a fiscal for the government's social policies, it lends very little to the public sector, with about 94 percent of all loans destined to the private sector (Mettenheim, 2006). The Chinese credit line, accounting for 8 percent of the Caixa's assets, will help Brazil finance much-needed infrastructure projects through private procurement. Importantly, however, it will also allow the federal government to reduce its subsidies to state-owned banks like Caixa – which have amounted to about 10 percent of GDP since 2008, and contributed to Brazil's deteriorating credit environment.

In summary, the Brazilian government has not turned to Chinese banks to underwrite a fiscal expansion because of its need to court fiscally conservative private investors for government concessions. However, it has employed Chinese lending indirectly to simultaneously meet its twin goals of economic and social stability. Chinese credit lines to Brazilian firms not only provide space for the government to curtail its subsidies to state development banks, but also defrays the cost of big-ticket capital projects by helping spur private procurement. If Brazil's recession-busting infrastructure plan works, it will appease markets and society by allowing for both a return to market-sanctioned austerity and improved public services. If it fails, however, it could intensify its turmoil by further increasing the indebtedness of its state-owned banks.

Case extensions: Argentina and Ecuador

To examine whether or not the relationship between patient capital and government spending holds beyond Brazil and Venezuela, I briefly extend the analysis to two more Chinese debtor nations: Argentina and Ecuador. Both of these countries became debtors to China following the global financial crisis; however, their governments' loan exposure to China varied as a share of their total external public financing. Total Chinese loans to Ecuador were more than double those loans extended to Argentina. At the same time, while both countries incurred a sustained fiscal deterioration after the global financial crisis, Argentina's decline was less pronounced (see Table 2).

I suspect that much of this pattern reflects Argentina's slower pace in courting Chinese bank loans compared to Ecuador. Similar to Brazil, Argentina had a public works law that required public bidding for all major infrastructure projects. It was not until 2014 that the country passed the Bilateral Agreement on Economic Cooperation and Investment with China, allowing the Argentine government to forego public bidding if Chinese banks offered financing. Until then, the Argentine government – which has been shunned from global financial markets – was desperately seeking out new government revenues in the aftermath of the global commodity correction. In the years following the crisis, President Cristina Kirchner's administration squeezed tax margins on unpopular export taxes, nationalized the country's private pensions systems, and tweaked domestic laws to redirect central bank reserves toward financing national accounts.

During the last few years of the Kirchner administration, Argentina took a cue from its Andean neighbors, increasingly looking to China's growing investment-led regional integration to finance its domestic political agenda. Argentina turned to Chinese credit to help fund its infrastructure plans and bolster its sagging reserves after its technical default in the summer of 2014. However, with Maurico Macri's recent election victory, his center-right government has pledged to review the most recently signed Chinese investment deals. He also appears more likely to channel such prospective investment through the private sector in contrast to Cristina Kirchner's proclivity to negotiate state-to-state agreements.

By comparison, Ecuador has routinely employed executive decrees for public procurement since the global financial crisis, allowing public entities like China's policy banks to bypass the traditional procurement process established under law. Ecuador's 2008 debt default coincided with the global financial crisis, but the emergence of Chinese credit quickly became a viable alternative to market-based financing, helping the country escape austerity. According to former political advisor Ecuadorian

President Rafael Correa, Decio Machado, 'we used the availability of Chinese financing as an alternative to Bretton Wood's financing that imposed conditionality through adjustment programs.'[36]

Ecuador has borrowed a total of 33 percent of its external financing from Chinese banks since its 2008 debt default (see Table 1). Despite recently announcing its intention to diversify its state-owned oil company debts beyond China with countries such as Thailand, direct loans from China still account for 26 percent of the central government's external debt (after adjusting for loans to PetroEcuador). In the process, China has become Ecuador's largest global creditor, with the government having explicitly used Chinese credit lines to cover budgetary shortfalls and large infrastructure projects. Being less subject to global market pressures, Ecuador has moved its government budget sharply into the red from lofty pre-crisis budget surpluses into sizeable deficits today that have averaged 2.1 percent since the 2008 global financial crisis (Table 2).

CONCLUSION

After excessive borrowing led to financial booms and busts, many countries have sought to insulate themselves from capital volatility, and to varying degrees, diversify away from market governance. In this regard, China's rapid economic expansion in the Western Hemisphere has presented regional governments with an important opportunity. The availability of its patient capital provides governments with an income stream that is independent of austerity-based market financing.

In this comparative case study analysis, I examined two mixed-market South American economies, Brazil and Venezuela, to test whether this non-conditional funding has the potential to enhance national budgetary autonomy. I found considerable variation within these cases. The Brazilian government – which predominately relies on private procurement and global bond market borrowing to fulfill its public services, and has not directly borrowed from China – targets budget discipline notwithstanding its microeconomic tendency to subsidize credit to consumers and businesses. By contrast, the Venezuelan authorities have tapped non-conditional government-to-government Chinese financing, which has considerably enhanced their capacity to sustain wider budget deficits and greater levels of economic intervention. Notably, these patterns appear to hold more broadly, with the Argentina and Ecuador cases illustrating that fiscal deficits tend to widen as Chinese state-owned capital accounts for a higher share of total external financing.

In conclusion, these findings offer important new insights for both the international relations and political economy literature, providing a systematic explanation for how the shifting economic power balance between the United States and China affects national political choices.

They also advance existing knowledge in comparative politics, in which scholars have widely documented the Latin American left's dissatisfaction with neoliberalism, but have not fully explained the conditions under which these political leaders veer from market-based governance models. This analysis also demonstrates that China's economic engagement may have some unintended consequences. By lending without policy conditions, Chinese financing may help enhance national policy autonomy and create a development opportunity. However, governments are agents with conflicting aims, and such unconditional funding may also be diverted for personal or political gain. If governments do not invest their borrowing proceeds prudently to benefit long-term societal welfare, it is possible that Chinese lending may sow the seeds for yet another Latin American debt crisis.

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NOTES

1. *Xinhuanet*, June 8, 2013.
2. For a more detailed discussion, see Kaplan (2013).

3. Levitsky and Roberts (2011) define the left as 'political actors who seek to employ public authority to protect individuals and groups from market insecurities, reduce social and economic inequalities, and strengthen the voice of underprivileged groups.'
4. The global credit crunch first began during the fall of 2007 when the UK government nationalized the beleaguered Northern Rock, a British mortgage lender.
5. Much of Latin America was able to pursue countercyclical policies for the first time during the 2008 global financial crisis.
6. *Xinhua*, December 11, 2014.
7. China has also promoted the use of its currency internationally with this strategy (Liao and McDowel, 2014; Steinberg, 2014).
8. *Xinhua*, May 25, 2015.
9. Author's interview in Beijing, China on April 1, 2015. This quote should not be interpreted as representing the views of the Chinese Academy of Social Sciences.
10. Inter-American Dialogue's *China–Latin American Working Group*, Peking University, Beijing, March 2015.
11. Sanderson and Forsythe (2013).
12. China's *Initiation of the Five Principles of Peaceful Co-Existence*, Ministry of Foreign Affairs, November 17, 2000.
13. Section XXI of Article 37 of the 1998 Brazilian constitution requires that public services are contracted through public tender.
14. *Reuters*, May 13, 2015; *Financial Times*, December 20, 2015.
15. Calculation based on a total of US$137.4 billion between 2005 and 2013 (El *Mundo*, October 4, 2014).
16. In fact, if we were to consider Chinese loans to PDVSA as direct government borrowing, Chinese loans would account for two-thirds (see Table 1 which includes Chinese loans to central governments and SOEs) rather than one-half of Venezuela's total external financing (see Table 2 which only includes loans to central governments).
17. *New York Times*, April 15, 2009.
18. Personal and corporate income taxes only account for about 9 percent of total revenues.
19. Author's March 2007 interviews in Caracas, Venezuela with party leaders and budget directors.
20. Government non-tax oil revenues fell by about 3 percentage points of GDP between 2008 and 2009 (CEPAL).
21. Venezuela holds 20 percent of the world's crude oil reserves, much of which is extra-heavy crude from the Orinoco Oil Belt.
22. PDVSA; FONDEN.
23. The state oil company was producing about 3 million dollars of oil daily compared to its goal of 4 million dollars.
24. *Financial Times*, October 22, 2014.
25. Zhao Changhui, Chief Country Risk Analyst, China Eximbank (see endnote 10).
26. About four-fifths of government revenues are derived from income, value-added, and social security taxes (Ondetti, 2012).
27. Calculated from International Debt Statistics.
28. It cut its 2009 primary surplus by half to 1.24 percent of GDP.
29. Author's interview, October 27, 2014.

30. Rousseff's approval fell by more than 20 percentage points following July's protests (Ibope, 2013; Datafohla, 2013).
31. CEPAL.
32. Should Rousseff be impeached by the Senate in August 2016, Temer will remain in the presidency until the 2018 elections. If she is absolved, however, Rousseff will return to office.
33. Author's interview in Brasilia on September 29, 2014, when Ambassador Cozendey was the Secretary of International Affairs at the Brazilian Ministry of Finance.
34. *Chinese Radio International*, May 20, 2015.
35. Author's Interview, Sao Paulo, Brazil, October 2, 2014.
36. Author's interview in Quito, Ecuador, November 10, 2015.

NOTES ON CONTRIBUTOR

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