Journal of Asian Economics 47 (2016) 58–66

Contents lists available at ScienceDirect

Journal of Asian Economics

Full length article

The impact of exports to China on Latin American growth

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ARTICLE INFO

Article history:
Received 30 November 2015
Received in revised form 18 August 2016
Accepted 13 October 2016
Available online 19 October 2016

JEL classification:
F14
F43
F21
F31

Keywords:
Trade policy
Export-led growth
Foreign direct investment
Exchange rate

ABSTRACT

This article analyzes the relationship between GDP growth in seven major Latin American countries and China's demand for their exports. GLS panel estimation using annual data for the period 1994–2013 shows that the relationship was both statistically and economically significant. Control variables found to be significant in positively affecting GDP growth include the investment-to-output ratio, the exchange rate, and the terms of trade, and, in negatively affecting it, population growth and the unemployment rate. Consistent with recent literature, foreign direct investment was found not to be significant. A sharp drop in exports to China for many of the countries in the sample in 2015 raises questions about the region's vulnerability to China's growth slowdown.

1. Introduction

After a decade of strong growth in Latin America's exports to China, observers have been quick to tie the recent decline in the region's performance to weakening demand by China. Slower growth in China has been branded the "new normal" by President Xi Jinping.[3] After years at double-digit levels, China's GDP growth fell to 9.3% in 2011 (Fig. 1). Confirming the declining trend, Premier Wen Jiabao in March 2012 set a growth target of 7.5%, a level that was re-affirmed in March 2014 by Premier Li Keqiang in his speech at the annual meeting of the legislature in Beijing (Bloomberg News, 2014).

Latin American economies have been hit since the global crisis in 2008 by a negative trade shock, falling commodity prices, an increase in currency valuations, and a decline in foreign direct investment inflows. Strong growth in exports to China stood as a bright spot, at least until 2015. By that year, Argentina was suffering double-digit inflation while Brazil's growth forecast was barely positive, down from 7.5% in 2010. In Chile, investor confidence was shaken by reform of the

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[2] The opinions in this publication are the author's responsibility, not necessarily expressing the viewpoint of the Ministry of Finance of Brazil.

[3] Blázquez-Lidoy, Rodríguez and Santiso, (2006) comment that the growing impact of China on Latin America has garnered the interest of major institutions, such as the Inter-American Development Bank (IDB) which has stepped up the number of studies into the impact of Chinese growth on Latin America. Chen and Chen (2013) argue that potentially slower Chinese growth will result in a reduction in Latin America's export growth. The World Bank (2014) showed that a 1-percentage point deceleration in Chinese growth has been associated with a 0.6 percentage point slowing of growth in Latin America and the Caribbean. In contrast, Garcia-Herrero, Ferchen and Nigrinis (2013) claim that Latin American GDP growth is minimally exposed to export dependence on China.

http://dx.doi.org/10.1016/j.asieco.2016.10.002
1049-0078/

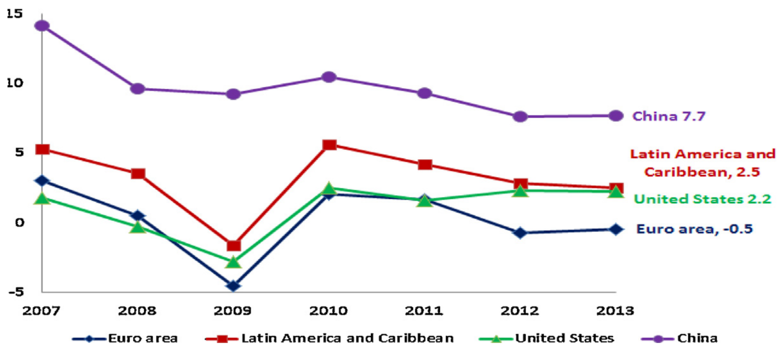

Fig. 1. GDP annual growth rates, in percent per annum.

Source: World Bank (2015).

corporate tax system. Peru had experienced reduced export revenues due to falling commodity prices that led to a contraction in mining output. Venezuela ended 2014 with an inflation rate of 64% accompanied by shortages in food and medicine. Mexico overhauled its energy and telecommunications sectors in 2014, ending the year with better prospects than in the previous year when it grew by just 1.1%. By these standards, Colombia was faring relatively well with growth prospects above 4%.

This paper examines the impact on Latin American GDP growth of China's demand for the region's exports. The analysis is based on a Solow–Swan growth model supported by robustness tests to address endogeneity and causality issues.

The paper proceeds as follows: Section 2 outlines the previous literature; Section 3 describes the data and methodology; Section 4 reports the results; Section 5 summarizes the robustness tests for endogeneity; and finally, Section 6 presents conclusions.

2. Previous literature

In the first decade of the twenty-first century, China's rapid growth and robust foreign direct investment (FDI) inflows impressed the world. Indeed, China's emergence was the topic of the decade, according to Wall Street analysts (Blázquez-Lidoy, Rodríguez, & Santiso, 2006). Yet despite China's attraction of global FDI, Chantasasawat, Fung, Iizaka, and Siu (2004) presented evidence that FDI to Latin America was little affected. And Dominguez (2006) argued that in the 2000s, Latin American countries became more important than ever for China, which in turn had become important for Latin American countries. On the other hand, García-Herrero and Santabárbara (2007) found a significant negative impact of Chinese inward FDI on that received by Mexico until 2001 and on that received by Colombia after that date.

Exports to China are potentially important to Latin American growth, as evidenced in an article by Hausmann, Hwang, and Rodrik (2007) that shows that what a country exports matters. They constructed an export index designed to predicts a country's economic growth. Moreover, Gallagher and Porzecanski (2008) argued that China accounts for a significant amount of the boost in Latin American exports and foreign investment in recent years, and that Latin America, with the exception of Mexico, is not significantly threatened by Chinese exports in global markets. Accordingly, Hsiang (2010) affirmed that China's purchase of regional commodities was the main factor in Latin America's economic growth in the preceding decade.

At the end of the 2000 s decade, researchers explored the possibilities for China's economic future. Kharas (2011) argued that an active policy to promote the middle class in China was desirable and should be complementary to the ongoing efforts to combat poverty in order to avoid the risk that structural pressures would constrain China's growth. The rise of China's consumer class offers opportunities for brands looking for new revenue streams, but, at the same time, the consumer demand for more cars, air conditioners, and larger homes will put pressure on commodity markets and add to global tension (Rein & Roy, 2012).

What none of these papers foresaw was that the financial markets would again be hit, this time by the crisis with the euro, which had its first symptom with the Greek debt crisis of 2009 and later spread throughout Europe with global spillovers. Yu (2011) analyzed mining commodity prices, China's economic growth, and their implications for Latin America, and concluded that world demand was nevertheless likely to remain strong, reflecting the recovery of the global economy. Likewise, according to Ryczkowski (2012), China's continued engagement diminished the prestige of the United States in Latin America and, he suggested that if the United States desired a role in shaping the future of the Americas, it would be necessary for it to change its engagement policy with Brazil.

After the deepening of international financial troubles in 2011, the literature on China's economy shifted focus to the country's economic slowdown and its spillover effects on trading partners. For instance, Cai and Lu (2013) showed that an increase in labor force participation and improvement in total factor productivity could significantly enhance potential GDP growth, while Eichengreen, Park, and Shin (2012) provided evidence that an exceptionally low consumption share of GDP was associated with the probability of a slowdown. Both hopes and anxieties tied to Latin America's decade-long boom in