The Time Is Now: Chinese Investment in Latin American Infrastructure

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Infrastructure is what most of us take for granted – roads, utilities, airports, and healthcare sites, and educational facilities. In Latin America, where governments face the age-old problems of budget deficits and strained public debt markets, the trend over the past few decades has been to depend more and more on foreign investment to improve the amount and quality of such infrastructure. It is in this area that China could step into the market, especially given recent policy adoptions benefiting the infrastructure investments sector.

Although China has not traditionally been a major foreign investor in the region, with its $22 billion per year paling in comparison to the European Union's $620 Billion, according to official Chinese data, its involvement in Latin America comprises about one-fourth of its total overseas investment.[1] Recent major Chinese investments include billions for Venezuela's transportation and telecomm sectors, as well as Brazil's aviation, rail, and shipping industries.[2]

A quick look at the projected growth of the infrastructure industry in Latin America shows how the time for Chinese investment is now. For example, South

[1] *China's Foreign Activities in Africa, Latin America, and Southeast Asia*, Congressional Research Service, Feb. 25, 2009, p. 13, *available at* http://www.fas.org/sgp/crs/row/R40361.pdf
[2] *Id*. at 15 (citing NYU Wagner School, *Understanding Chinese Foreign Aid: A Look at China's Development Assistance to Africa, Southeast Asia, and Latin America*, April 25, 2008).

America expects to triple its growth percentage in 2010 after a few down years. And Mexico, which had seen its infrastructure industry reach nearly 5% growth in 2007 before falling to -1.5% in 2009, is expecting to shoot up to nearly 3% growth in just one year.[3] What is more, total infrastructure investment in the region has fallen over the past two decades from a weighted average of 3.6% of GDP to 1.9% of GDP.[4]

In that climate, various regional governments have pledged economic stimulus packages with large earmarks for infrastructure development and reinvestment. Likewise, they are enacting new legal frameworks that encourage more public-private partnerships. Through those private-public engagements, the partners share the costs and benefits of the infrastructure itself. And finally more infrastructure managers are entering the market with the goal of privatizing assets and lending their operational and financial expertise. The result: improved efficiency.[5] At the same time, infrastructure capital funds are raising money like never before. In 2004, there were only six Latin America infrastructure funds with $3.4 billion in capital. This year, there are 24 active funds raising $44.4 billion to invest in the Americas.[6] Critically, despite the recent credit crunch, transaction activity for Latin American infrastructure projects has held relatively steady over the past few years.[7]

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[3] *Americas Infrastructure Update 2009*, RREEF Research, July 2009 ("RREEF"), p. 2 Exh. 2
[4] *Infrastructure in Latin America: Achieving High Impact Mgmt*., Stefania Scandizio and Pablo Sanguinetti, Emerging Markets Forum, p. 10
[5] RREEF, *supra* note 3, at p. 2
[6] *Id*. at p. 7
[7] *Id*. at p. 3

As Chinese investors start to be actively involved in infrastructure projects in Latin America, politics and economic and legal risks present paramount concerns. Moreover, due to the inherent language barriers and cultural differences, evaluating and mitigating those risks is not an easy job.

Politically, the risk of expropriation and transfer loss are usually the key factors in investment decisions – especially in the infrastructure field, where projects tend to be long-term. Investors are loathe to invest millions of dollars in a country where the government is likely to take their property without compensation or prohibit expatriation of profits. According to the Office National du Ducroire (March 2007), Venezuela and Bolivia present the most risk in terms of expropriation among all Latin American countries, while Bolivia and Argentina's transfer loss risks are the highest.[8] In addition, the consistency and continuity of governmental economic involvement is another aspect to consider when attempting to mitigate political risks. In order to best avoid that problem, invest in Chile, says the World Economic Forum.[9]

Teaming up with a local partner is often the most effective way to avoid legal setbacks.[10] Many Latin American countries have overly bureaucratic, unstable, and inefficient judicial systems,[11] so it is crucial to work with a reputable, local enterprise that is familiar with the domestic laws and regulations. It is also suggested to ensure that the country's government has a proven track record of maintaining continuity of the

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[8] Available at http://www.ondd.be. .

[9] *Benchmarking National Attractiveness for Private Investment in Latin American Infrastructure*, Irene Mia, Julio Esrada and Thierry Geiger, p. 21.

[10] *Minimizing Legal Risk in Latin American Project Finance*, Horacio Falcao, Geoff Groesbeck, p. 3.

[11] *Id*.

applicable investment regulations and policies for a long period of time – especially considering the often lengthy character of infrastructure projects. The worst-case scenario for any investor is to lose everything, without due compensation, merely because of the political whims of a volatile government.

Another crucial issue for Chinese investors to consider is the lack of truly effective mechanisms for resolving disputes in Latin America. Quality dispute resolution procedures form an essential part of one's overall investment, as it often becomes the last best chance to protect investors' interests. Thus, as the Chinese move into Latin America, they need to always make sure that such procedures are firmly in place before any work is done. Arbitration is usually considered a better approach than litigation because of the savings in terms of cost and time. A well-drafted arbitration clause in investment and partnership agreements should include, at minimum, a proper arbitration tribunal and the applicable laws, procedures, and language.

The time is right for China to invest in Latin America. The market is becoming more bullish every day, and the financing structures are in place. Although potential pitfalls abound, investors can avoid many of the most dramatic economic and legal risks with some simple planning at the outset. Doing things right from the get-go could lead to an overall increase in Chinese economic influence in Latin America, particularly at a time when the region is begging for capital and infrastructure improvements.