The China Boom in Latin America:[1]
An End to Austerity?

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December 2014

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[1] Earlier versions of this paper were prepared for the 2014 annual meeting of the American Political Science Association and the 2014 annual congress of the Latin American Studies Association. I would like to thank Nathaniel Austin, Helen Harris, Aparna Ravi, Alexa Woods, and Jackson Woods for their superb research assistance.
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ABSTRACT

How does a shifting economic power balance between the United States and China affect the strategic choices of Latin American governments? During the last several decades, Latin America has often relied on a Western development model that aimed to attract global market capital. After excessive borrowing led to financial busts, however, many countries have sought to insulate themselves from market volatility. Rising terms of trade and a commodity boom, driven in part by China, helped buttress economic growth during much of the 2000s. But, what accounts for the growing variation in national policy approaches, ranging from ongoing market orthodoxy to heavy government intervention? I argue that governments that tap new Chinese income streams – both non-conditional lending and taxable commodity flows – have reduced their reliance on conditionality-linked Western financing, giving them more autonomy to use budget deficits to intervene in their economies. Employing a systematic comparative analysis of three Latin American countries – Argentina, Brazil, and Venezuela – I find that Chinese non-conditional funding endows governments with greater budgetary discretion, making austerity less likely. These findings offer important new insights for the study of globalization, the Latin American left, and China-Latin American relations, by helping explain the structural conditions that enable nations to veer from Western governance models.

Key Words: economic policy, Latin America, China, investment, fiscal policy

Word Count (without notes): 9,970

Introduction

Over the last few decades, China has become a leading global player in international trade and finance. Catalyzed by Deng Xiaoping's economic reforms in the late 1970s, China experienced three decades of breakneck growth that has catapulted the country to the center of the world economy. In light of its sizeable economic power, China's emergence has important political and economic implications for the entire world. The key question is whether China can rise peacefully, with scholars and practitioners contemplating the dangers of power transitions in an emerging multi-polar international system. Will China, for instance, destabilize the current liberal economic order or challenge U.S. leadership?

Latin America, a region characterized by a powerful U.S. presence and an emerging Chinese footprint,[3] provides a vital window for examining the significance of such shifting economic power balances. At the turn of the 21st century, the widespread acceptance of neoliberalism was emblematic of U.S. regional power. To attract global capital, many countries around the globe adopted a development model centered on economic liberalization. Shallow domestic financial markets and narrow tax bases left many countries with few alternatives. Under this paradigm, if Latin American governments wanted to fund their long-term development needs, they had to convey their commitment to market governance to global creditors.

A primary tenet of this market governance was budgetary austerity – or a sovereign commitment to fiscal restraint – that was intended to both improve a country's debt repayment prospects and credibly signal prudent economic governance to global creditors. Following the runaway inflation of the 1980s, government intervention in the macroeconomy had been widely

[3] China's Latin American exports have surged more than fifteen times above its 2001 WTO entry level, enabling the country to become the largest trading partner for several South American countries, including Brazil, Chile, and Peru. China's foreign direct investment in Latin America has rocketed from virtually zero to about US$68 billion by 2013, while its banks have lent more than $100 billion to Latin American countries since 2005 (Heritage Foundation's *China*

discredited, opening the door to a monetarist view of economics[4] which favored control of budget deficits as a pathway to low inflation and economic stability.

Given the centrality of budgetary financing to domestic political initiatives; however, these austerity pressures posed a threat to a government's national autonomy and social responsiveness. Fiscal discipline might help promote economic stability by improving a country's credit standing, but the extent to which austerity necessitated deep budget cuts it simultaneously jeopardized social stability. Moreover, for those governments hoping to use Keynesian countercyclical policies – or fiscal stimulus to offset an economic downturn – there was often very little scope for deficit spending beyond those expenditures dedicated to foreign interest payments. In light of this debt-induced austerity, many Latin American countries have sought to insulate themselves from financial market scrutiny by searching for alternative funding sources.

In this paper, I show that China's rapid economic expansion into the Western Hemisphere has provided Latin American countries with such a funding source that is independent of global financial markets. Governments that directly access new income streams from China are able to enhance their budgetary sovereignty through two primary channels: non-conditional government-to-government lending and taxable commodity flows. New government revenues from these sources are not contingent upon a country's macroeconomic policy stance, enabling governments the flexibility to veer from fiscal discipline, the hallmark of market governance. For example, Chinese financing today accounts for more than two-thirds of the Ecuadorean government's borrowing needs, helping finance a widening deficit that has averaged about 1.5 percent since the 2008 global financial crisis (which not coincidently also marks China's first foray into Ecuadorean lending) compared to a lofty budget surplus during the previous four years.

Global Investment Tracker; Inter-American Dialogue's *China and Latin America Finance Database*).

[4] Monetarism diagnosed inflation as a supply-side excess that could be cured with balanced budgets.

Not all governments, however, seek to directly secure such new budgetary financing, creating considerable variation in Chinese funding streams throughout the region. Some governments may have high economic interdependence with China, but they do not attempt to raise new government revenues by either implementing trade taxes or tapping direct Chinese sovereign lending. Rather, these governments are more market-oriented, and hence, more likely to fund their unfulfilled public services by either raising more revenues through domestic taxes or offering government concessions to the private sector. Given the need to court private investors, they are also more likely to pursue budget discipline to signal their good credit standing to private investors. For example, to sustain public investment in Colombia, the government has announced a US$30 billion infrastructure program, financed by private capital though concessions. It has also increased income, corporate, and financial transaction taxes to maintain fiscal sustainability, an important governance criteria for attracting global financing into Colombia. According to current Finance Minister Mauricio Cardenas, "the anchor of the whole [governance] structure is fiscal responsibility, and that has actually provided us with very positive results...that of course have been rewarded by the markets."[5]

I exploit this variation in the type of sovereign financing to test whether Chinese financing streams enhance Latin America's economic policy autonomy, and ultimately, yield higher deficit spending. My comparative case study of three Latin American countries – Argentina, Brazil, and Venezuela – finds that when governments tap revenues from Chinese trade and non-conditional lending, they are more likely to use high budget deficits to intervene in the domestic economy. By comparison, those governments that continue to depend on global private capital markets for a large portion of their financing are more likely to exhibit budget discipline.

These findings offer new insights for studies examining globalization, neoliberalism, and the

[5] Colombian Finance Minister Mauricio Cardenas' remarks at the 2014 IMF/World Bank annual meetings.

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 (Rudra 2002; 2008), global capital markets (Mosley 2000, 2003; Wibbels 2006), and international financial institutions (Vreeland 2003; also see Nelson 2015) 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 have found that a variety of factors, including a weak labor movement (Roberts 1998, 2002), party-brand dilution (Lupu 2015), strong business interests (Thacker 2000, Schneider 2004; Fairfield 2010, 2011), centrist economic voters and increasingly non-economic voters (Baker 2008; Baker and Greene 2011; Hellwig 2014), and reform-seeking politicians(Corrales 2000) helped facilitate a broad-based acceptance of this neoliberal consensus (Roberts 1998; Stokes 2001; Murillo 2001; Murillo 2002; Weyland 2002; Levitsky 2003). Notwithstanding such policy retrenchment, other scholars have found that neoliberal reforms have not been uniform. Rather, many countries with import substitution industrialization legacies (ISI) have crafted political bargains (Frieden 1991) that preserved supply side interventions in the economy, including industrial promotion, public employment (Kurtz and Brooks 2008), and social insurance (Wibbels and Ahlquist 2011). To date, however, there has been relatively scant indication that even these ISI countries maintained much macroeconomic flexibility (Kurtz and Brooks 2008).

In this paper, I engage with this important issue, showing that the emergence of Chinese state-led financing has helped remove the budget constraint imposed by the International Monetary Fund (Vreeland 2003) and global financial markets (Mosley 2003; Wibbels 2006) throughout the 1990s and early 2000s. This additional fiscal space has allowed some governments to engage in greater macroeconomic intervention, mainly through considerably higher budget deficits.

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 seeks to import the primary goods, like soybeans, that Latin American can produce cheaply and efficiently. Hence, rebalancing trade ties with China should improve the region's welfare (Santiso 2007) and even its security (Escudé 2011). By contrast, other political economy analysts are more skeptical about the relative merits of Chinese trade interdependence. According to this perspective, China may be as much of a threat as an opportunity. In other words, China's booming demand for commodities and its highly competitive manufacturing sector is reinforcing a dependency relationship in Latin America (Jenkins 2010, 2012; Ortiz 2012). As the region further specializes in commodity production to meet Chinese demand, its manufacturing sectors are simultaneously contracting under the weight of increased Chinese competition (Moreira 2007, Gallagher and Porzecanski 2010). This asymmetric relationship ultimately leaves the region exposed to a severe commodity correction that could impair Latin American growth and development.

My argument seeks to complement this literature focusing on the welfare effects of China's deepening economic integration by offering a systematic examination of how this structural transformation affects the specific policy choices of individual Latin American nations. In other words, notwithstanding the direct economic effects of Chinese integration, do governments have more or less room to maneuver their economic policies compared to periods of time when they were primarily sourcing funds from Western 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 the unilateral power of the United States regionally and globally (Lanxin 2008). Some analysts, for example, question the motivation behind China becoming a key supplier of military hardware to Venezuela (Ellis 2011). Other scholars have offered a more nuanced assessment of China's role in the region, but they are nevertheless cautious about the country's aspirations. Battling an increasingly negative image[6] 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,[7] however, remains unclear amid ongoing concerns about its economic threat, corrupt business practices, human rights record, and growing military power (Shambaugh 2013).[8] Notwithstanding these multi-dimensional concerns about the rise of China, many thinkers suggest that China's presence in Latin America is solely driven by economics, offering little challenge to the United States' 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, the Chinese government has little interest in sparking anti-American sentiment in the region, or even participating in populist regional institutions like the Venezuelan-led Bolivarian Alliance for the Americas (ALBA).[9]

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 in the Western Hemisphere. The Chinese government's stated intentions for its Latin American

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[6] 2012 Global Pew Attitudes Survey regarding public opinion of China in Brazil and Mexico.

[7] `Soft power' describes the ability to attract and co-opt (through culture, political values, or legitimacy) rather than coerce (through military force of financial incentives) as a means of persuasion (Nye 2004).

[8] Note that China's military presence in the region remains limited, with China's first military deployment to the region in September 2004 being part of United Nations peacekeeping mission in Haiti.

[9] Ironically, scholars have found that China gives the least diplomatic priority to those countries with overriding political motivations -- such as Venezuela and Cuba -- preferring instead to forge the deepest relations with those countries that

expansion include securing access to energy and raw material resources for its domestic market and developing internationally-competitive firms (Chen 2008). Government officials also appear to prioritize more than simply commerce when they discuss the importance of the region's role in "creating a more multi-polar world and increasing the democratization of international relations."[10]

While assessing China's political motivations behind its Westward expansion is beyond the scope of this paper, the heft of its rising regional footprint has important policy implications for the region. Even if we assume that China has the most benign diplomatic intentions, China unquestionably has become a huge economic player in the Western Hemisphere -- a role which may have unintended political consequences. These findings support recent literature showing that China's global economics and politics are inextricably linked (Flores-Macías and Kreps 2013). In fact, I expect that the region's growing Chinese interdependence places both opportunities and constraints on national policy making that endow governments with more room to maneuver beyond a traditional Western governance approach that emphasizes minimal economic intervention.

The article unfolds as follows. The next section contains the main theoretical contribution; here I explain how China's growing economic interdependence has helped increase national policy discretion. In Section 3, I provide qualitative empirical support for this theory using comparative case studies in Latin America, a region that has seen a rapid Chinese economic expansion in the last few decades. Finally, I close by discussing the study's broader scholarly and political implications.

Theoretical Framework: Non-Conditional Lending Boosts Autonomy

Latin American history is replete with episodes of leftist governance, but what accounts for the recent resilience of the Latin American left? Governments like Argentina and Venezuela have been

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China deems most salient economically -- such as Argentina and Brazil (Domínguez 2006).

[10] *Xinhuanet,* June 8, 2013.

placed under a similar radical or populist banner by political science scholars.[11] But, when and how are these governments 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 such as Brazil willingly embrace economic discipline while other governments such as Venezuela choose to heavily intervene in the economy?

A country's room to maneuver often reflects its government's fiscal space,[12] 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 leaves 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 United States' massive deficit spending during its 2008 financial crisis had historically proved much more difficult for crisis-ridden developing countries.[13]

Latin American governments first attempted to overcome this problem by financing their domestic political initiatives with an "inflation tax," which entailed printing money or borrowing money from the central bank to cover budget shortfalls. Monetizing their government deficits, however, catalyzed a period of runaway inflation known as hyperinflation in the 1980s. This

[11] A burgeoning scholarly literature offers a variety of classification schemes to explain the rise of the left and its consequences for Latin America (Panizza 2005; Castañeda 2006; Lynch 2007; Weyland 2009; Weyland, Madrid, and Hunter 2010; Levitsky and Roberts 2011).
[12] Fiscal space can be defined as the availability of budget room that allows governments to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position (IMF 2005).
[13] The 2008 global financial crisis was the first time that many Latin American countries were able to pursue countercyclical policies to offset economic weakness.

traumatic price shock not only delivered a sizeable income shock to the living standards of Latin American citizens, but also pushed many of them below the poverty line.

After eventually stabilizing hyperinflation, many Latin American governments decided to instead raise external financing by issuing sovereign bonds in global capital markets. Their eventual overreliance on capital market financing, however, placed their domestic policy choices under the microscope of international investors. In return for global market financing, they were expected to follow certain conditions and sacrifice some policy sovereignty (Vreeland 2003; also see Nelson 2015), most notably in the area of fiscal policy. Investors favored austerity in the wake of the region's past struggles with hyperinflation. Against the backdrop of the neoliberal revolution of the 1980s, investors were skeptical of government intervention in the economy, fearing that large government deficits would once again catalyze inflation and jeopardize debt repayment. They instead favored control of budget deficits as a pathway to low inflation and economic stability.

Ironically, bond financing like central bank credit previously left countries vulnerable to economic crises. If governments did not pursue the market's calls for budget discipline, they risked instigating a new round of economic volatility grounded in investor capital flight. Investors could either refuse to renew their financing, or dump their bonds in secondary markets, creating severe credit shocks and financing pressures for governments.

Despite the political costs of such austerity, there was little political resistance during this period. The traditional left in Latin America may have historically viewed the budget as an essential tool for addressing redistributive pressures, but it either acquiesced or mounted little opposition to neoliberal movements (Roberts 1998; Stokes 2001; Murillo 2001; Murillo 2002; Weyland 2002; Levitsky 2003). Fiscal policy was more or less forfeited as a key policymaking tool in favor of the market's budget discipline, including using fiscal deficits and social safety nets during periods of economic distress (Mosley 2000, 2003; Wibbels 2006).

Notwithstanding this historic pattern of budget retrenchment, I hypothesize that the availability of non-Western financing sources, from the China-fueled commodity boom and state-owned institutions like the Chinese Development Bank, has increased the policy discretion of Latin American governments to more heavily intervene in their economies with higher budget deficits (see H_1 below). Over the last decade, China's increasing inroads into Latin America have endowed nations with an attractive alternative to funding government deficits. Rather than pursuing market austerity to attract bond market capital, governments that either defaulted on their debt or refused to comply with market conditionality, such as Ecuador or Venezuela, could instead spend freely on their political priorities.

H_1: The availability of financing sources that do not compel market conditionality increases governments' fiscal space, or the policy freedom to use budget deficits to stimulate the economy and target key political supporters.

Two primary mechanisms link deeper Chinese integration and policy orientation. The first transmission mechanism operates through an investment channel. Unlike the stringent borrower conditionality required by Western institutional lending, Chinese investors tend to impose less onerous policy conditions. They operate under an official doctrine of non-intervention in domestic affairs,[14] as stipulated in the country's *Five Principles of Peaceful Coexistence*.[15] For example, 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.[16] Chinese institutions are consequently willing to extend financing arrangements and direct investment to countries whose governments have been shunned from global capital markets for their non-compliance with Western governance standards. This trend is also observable beyond Latin America's borders, where China recently

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[14] UNCTAD's 2007 World Investment Report.

[15] China's *Initiation of the Five Principles of Peaceful Co-Existence*, Ministry of Foreign Affairs of the People's Republic of

funneled billions of dollars into Iraq notwithstanding the unstable security situation.[17]

By contrast, traditional IMF or Western style credit risk management emphasizes budget discipline. Compelling such austerity might in part reflect a U.S. ideological agenda, but also seeks to protect creditor interests by bolstering state finances, and hence, the chances of debt repayment. These initiatives typically help improve investor confidence and reduce a country's cost of borrowing in global markets. According to the China's Development Bank's (CDB) Vice Governor Lui Kegu, however, CDB officials don't use Western risk measurements (Sanderson and Forsythe 2013). When global capital markets, the World Bank, or other international financial institutions label a country like Venezuela as "high risk," Chinese officials deem that such calculations are political rather than economic. Given that Venezuela is the region's largest oil exporter, China does not fret about the country's credit risk, opting instead to supplement Western financing under the auspices of advancing "equitable" development in Latin America (Liu and Wang 2012).

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. With a mandate to promote the interests of the Chinese state globally,[18] the CDB basically underwrites borrowers' credit risk through promises of future business intended to extend the web of regional Chinese contractors and businesses.

Given the lack of conditionality, deepening Chinese ties empower countries to pursue alternative approaches to economic management. Former Venezuelan President Hugo Chávez, for instance, lauded Chinese lending saying, it differs from other multilateral loans because it comes

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China, November 17, 2000.

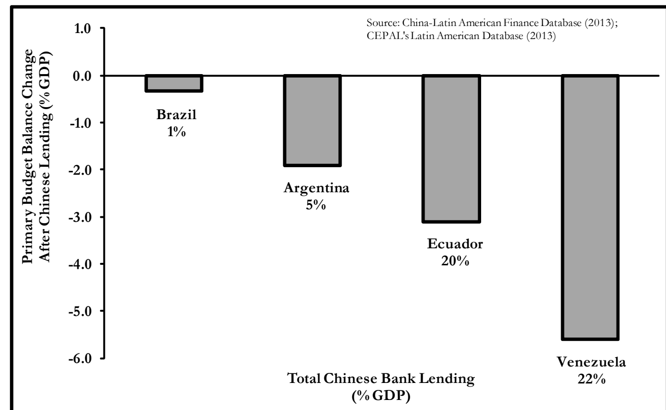
[16] State-owned Asset Supervision and Administration Commission, 2012.

[17] *New York Times*, June 2, 2013.

[18] Championed by Jiang Zemin in 1998, China's 'Going Global Strategy' seeks to internationalize Chinese investment

with no strings attached, unlike the scrutiny of international finances.[19] China lent over $50 billion to Venezuela since 2008[20] -- equivalent to 22 percent of the South American nation's 2007 GDP or a whopping 184 percent of its 2007 public external debt.[21] This new financing has been instrumental in funding massive state spending on social projects, known as *misiones* programs, which tallied $80 billion by 2011 (Rodríguez, Morales, and Monaldi 2012). Similarly, Ecuador has borrowed about $10 billion from China,[22] or 20 percent of its 2007 GDP, to help fund a government budget that swung from a primary surplus in 2008 into a sizeable and sustained deficit (see Figure 1). Without Chinese financing, it is hard to imagine that state intervention on such a scale would have been possible. The availability of a non-Western financing stream without traditional conditionality appears to have given Latin American nations greater economic policy autonomy.

Figure 1: Chinese Bank Lending & Latin American Budget Balances
(Selected Countries, 2004-2013)



The second transmission mechanism linking deepening Chinese interdependence to greater policy discretion operates through the trade channel, and ultimately, a country's national budget. Governments can exploit growing Chinese trade to build state capacity, without borrowing directly from China. By taxing trade and state-owned enterprise earnings, politicians can leverage China's growing demand for commodities and raw materials to line government coffers with higher revenues. Compared to direct government-to-government lending relationships, trade taxation is often a less effective financing tool due to political resistance. Nonetheless, these taxes are still likely

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and lending.

[19] *New York Times*, April 15, 2009.

[20] Gallagher, Irwin, and Koleski's (2013) *China-Latin American Finance Database*.

[21] Calculated from the World Banks' Global Financial Development Database.

to deliver more revenues than simply relying on those more indirectly linked to China-fueled growth.

For example, Argentina has opted to mostly tax commodity flows, keeping its borrowing from China below 5 percent of GDP and mainly targeted toward transportation infrastructure. This has helped relieve some of the country's fiscal constraints, but the country has struggled to raise sufficient tax receipts to cover its expenditures. Export taxes, which account for more than ten percent of total government revenues,[23] have been an important source of government finance. In fact, China's surging demand for soybeans, critical to its food security and social stability, has also helped feed Argentine politicians. Tax receipts from Argentina's thriving soybean exports[24] have allowed politicians to invest in domestic priorities, such as energy and transportation subsidies that benefit the urban working and middle classes.

However, direct trade taxation has its political limits, and has not delivered as much budgetary flexibility as non-conditional lending. Reliant on central bank financing to cover its budgetary shortfalls, Argentina has had to be somewhat wary of budget deficits, out of fear that severely monetizing the deficit will aggravate inflationary pressures. Hence, since the onset of Chinese lending to the region, Argentina's budget deficit has not reached the same heights as Ecuador and Venezuela (see Figure 1). Relative to Brazil which engages in very little direct taxation or Chinese borrowing (a mere 1 percent of its GDP), however, Argentina, Ecuador, and Venezuela have had more policy flexibility to stimulate their economies, and been free of the fiscal austerity that is often imposed by the international investment community.

H_2: Direct government-to-government lending creates the most budgetary flexibility, but trade taxes create more fiscal maneuverability than a passive stance toward Chinese interdependence.

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22 Gallagher, Irwin, and Koleski's (2013) *China-Latin American Finance Database*.

23 Author's August 2012 interview with Chief Economist Juan Louis Bour from Fundación de Investigaciones Económicas Latinoamericanas, a private think tank in Buenos Aires, Argentina.

24 In Argentina, soybeans have become the top export commodity, generating three times as much export revenue as beef and wheat combined (Turzi 2012).

Comparative Case Evidence

Research Design and Case Selection

To test the above hypotheses, I conduct a comparative case study analysis across three countries, Argentina, Brazil, and Venezuela, using national-level government policies as the unit of analysis. These three countries are similar along economic and political indicators, (they are presidential, middle-income South American countries), yet they maximize the variation in the main independent variables of interest (King, Keohane, and Verba 1994). I focus the analysis on three cases with mixed-market economies,[25] based on the assumption that these countries would be most likely to veer away from market governance models based on fiscal discipline. I can then test whether or not directly raising revenues from Chinese financing streams leads to greater fiscal drift.

According to a variety of economic measures, Argentina, Brazil, and Venezuela are often considered mix-market economies relative to their upper-middle income counterparts in South America, including Chile, Colombia, and Peru. For example, the Wall Street Journal and the Heritage Foundation's Index of Economic Freedom considers Argentina, Brazil, and Venezuela, to have considerably fewer market freedoms in terms of trade barriers, capital constraints, and financial insulation from government intervention.[26] This relationship is corroborated by the World Bank's *Doing Business Survey,* which routinely ranks these three countries outside its top-100 ranking. By contrast, their more market-oriented regional peers, such as Chile, Colombia, and Peru, often rank among the top-50 places for conducting business in the world. Reliant on market financing, their fiscal rules and inflation-targeting leave little doubt about their commitment to fiscal discipline. By comparison, Argentina, Brazil, and Venezuela were once as disciplined economically as their Pacific

[25] The Venezuelan constitution, for example, establishes a mixed economy. It recognizes private enterprise, the right of property and economic freedom, but also allows the state to intervene in the economy to uphold social justice.
[26] All three countries are below the index's 60 percent threshold of economic freedom, compared to countries like Chile,

coast peers during the heyday of neoliberal market governance during the 1990s and early 2000s. Do we observe the same commitment to fiscal discipline in these mixed-market economies today? Why or why not?

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. In fact, the emergence of Chinese investment as a competitor in the region coincides with a watershed moment in the history of international markets - the 2008 global financial crisis. Confronted with shrinking U.S. demand for its exports, China intensified its search for third market destinations, employing overseas investment as a tool to create new trade opportunities in Latin America. While China had long-ago forged trade ties with Latin America following its 2001 WTO entry, it hoped that investment in infrastructure, construction, and heavy extraction industries could meet two important strategic national goals simultaneously: improving China's access to regional raw materials and energy supplies, while also securing new export markets to replace those lost to the U.S. recession. A senior political officer at China's Brazilian Embassy discusses these national goals in relation to Brazil:

> "We are happy because this is a complimentary relationship: we export a lot of manufactured products to Brazil, while Brazil exports a lot of commodities to us which are essential for our economic boom."[27]

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 revenue stream.

However, it did not automatically translate into greater proceeds. Some governments, such as Brazil, may have higher trade and investment ties with China, but their governments do not attempt to leverage new budget financing from this economic relationship. Rather, opting to source

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Colombia, and Peru that are all firmly above and considered moderately to mostly free.

financing from global markets, they continue operating within the confines of an economic model grounded in fiscal discipline. These governments take a more passive approach, only indirectly benefiting from the higher revenues associated with China-fueled economic growth.

This pattern also shows that increased Chinese economic interdependence alone does not necessarily lead to greater policy flexibility (see Table 1). Despite being China's top regional trading partner,[28] the Brazilian government does not directly tax the trade sector. Similarly, while Brazil's private sector receives about one-quarter of Chinese foreign direct investment to Latin America, Brazil's government has relatively few loans from Chinese banks as a percentage of GDP (Figure 1).

Perhaps, most importantly, the channel for this funding operates through Brazilian government concessions rather than direct, government-to-government lending. The Chinese Development Bank might offer project finance that helps a Chinese company secure a winning bid for public services, but it does not funnel proceeds into national development funds like in Venezuela. The market acts as the intermediary, rather than the government. In other words, investment is more insulated from government intervention, or as the Chinese embassy official framed it in our interview, "it's more market-oriented in Brazil." Even if Brazil was to receive greater Chinese investment, its private procurement system would likely constrain the government from considerable budgetary drift.

By comparison, Venezuela provides us with a case of direct government-to-government funding, given that China and Venezuela established a joint financing mechanism, known as the China-Venezuela Fund, during the late 2000s. Through this fund, the government began funding an unprecedented amount of development aid[29] directly from the Chinese Development Bank (CDB).

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[27] Author's Interview, Embassy of the People's Republic of China, Brasilia, September 30, 2014.
[28] Brazil's total Chinese trade as a share of its overall trade is 16 percent compared to 10.6 and a mere 3.7 percent in Argentina and Venezuela respectively (Calculated from the United Nation's Commodity Trade Statistics Database).
[29] See Winters 2012 and Dietrich 2013 for more details on the relationship between foreign aid donors and recipients.

The CDB financed politically-essential social and infrastructure projects in Venezuela with few policy conditions in exchange for future oil shipments to China. In 2008 -- a time when the global commodity correction would have normally prompted Venezuela to more heavily rely on global capital markets for its financing needs -- China's unconditional financing through this mechanism helped free Venezuela's budgetary choices from the scrutiny of the international investment community. In fact, I expect that this type of non-conditional funding should yield the highest amount of new budgetary and off-budgetary revenues for the Venezuelan government, and hence, the most budgetary flexibility (see Table 1).

In addition to government-to-government borrowing, there is another possible channel for directly raising revenues from Chinese income streams. As discussed above, the Argentine government has sourced funds from the trade sector, reaping new tax receipts from excise duties levied on commodity exports, including massive soybean shipments to China.[30] Argentina has opted for trade taxation because, unlike Brazil, the country cannot rely on global market financing to fund its expenditures. Argentina's outstanding difficulties with its holdout creditors have closed its spigot from global market capital, leaving the country in search of alternative financing streams. However, Argentina is far less reliant on Chinese bank loans (see Figure 1) than Venezuela, and has only more recently begun to attract such investment for some new public works projects.[31] Compared to bank loans, however, government revenues derived from trade are often not as bountiful and are also more volatile and politically unpopular. Thus, I anticipate that export revenues may help temporarily boost government spending, but not in a sustained manner (see Table 1).

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[30] About one-fifth of export tax revenues can be attributed to Chinese commodity demand. In 2010, the country was the recipient of about 17 percent of Argentina's primary commodity exports (Calculated from the United Nation's Commodity Trade Statistics Database).

[31] Argentina has received $14.1 billion in Chinese Development Bank (CDB) loans since 2010, or about one-quarter of Venezuela's total bank loans. These proceeds were mainly targeted toward new public train and subway infrastructure (Gallagher, Irwin, and Koleski 2013).

Table 1: Government Financing from China		
Country	**Chinese Financing Source**	**Fiscal Autonomy from Market Governance**
Argentina	**Mainly Export Taxes**	**Medium**
Brazil	**Indirect via Economic Growth**	**Low**
Venezuela	**Chinese Bank Loans**	**High**

In the following pages, I conduct a comparative case study that exploits this variation in government reliance on Chinese funding sources across Argentina, Brazil, and Venezuela to test my research hypothesis. I examine the extent to which they endow governments with the expected fiscal benefits and policy autonomy outlined above, while adjudicating against a common alternative explanation: the 2000's commodity boom. In evaluating this claim, I employ a counterfactual analysis,[32] establishing that without Chinese funding, politicians would have to rely on Western financing sources, making austerity (or fiscal discipline) more likely. While the commodity boom temporarily padded government coffers throughout the region, I argue that it has not provided the same sustained policy flexibility as non-conditional bank lending.

Venezuela: Chinese Lending Offsets Commodity Correction

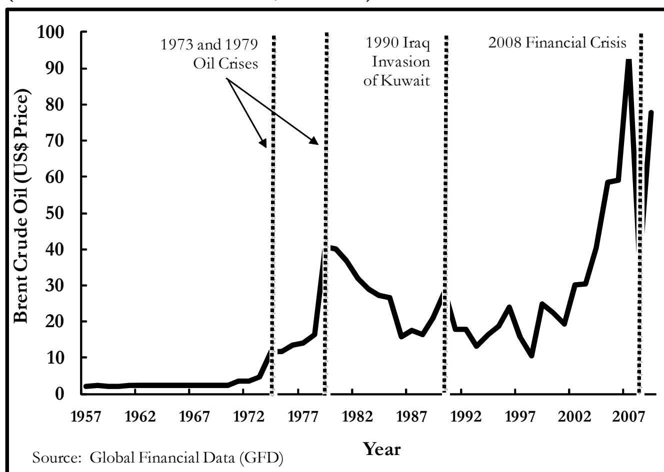
Oil has long been the lifeline of Venezuelan politics, delivering more than US$1 trillion into state coffers over the last 60 years. Benefiting from this exorbitant wealth, Venezuelan politicians often exhibit the classic symptoms of the resource curse (Karl 1997; Ross 1999). Without the accountability that derives from broad taxation,[33] politicians frequently and freely spend today with little concern for the health of finances tomorrow. For example, Venezuela's three previous oil booms (see Figure 2 below) all ended in fiscal crises characterized by depressed oil prices and empty

[32] Fearon (1991) argues that counterfactual propositions play a necessary and fundamental role in the efforts of political scientists to assess their hypotheses about the causes of the phenomena that they study.
[33] Personal and corporate income taxes account for 9 percent of total revenues (Rodríguez, Morales, and Monaldi 2012).

government coffers. In light of these historical patterns, Venezuelan politicians tend to refer to budgetary spending with a sense of determinism, declaring that "oil booms create an illusion of endless fiscal expansion possibilities" and that "in Venezuela, no government with income from high oil prices has saved even a little bit of money. They spend all of it!"[34]

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,[35] helping fuel a spending boom that included about $60 billion in massive state spending projects known as the *misiones* programs. Surprisingly, however, the Chávez government did not retrench spending when oil prices collapsed following the 2008 global financial crisis (see Figures 1 and 2).

Figure 2: Venezuela's Oil Booms and Busts
(Brent Crude Oil Prices in US$, 1957-2009)



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.[36] With oil prices hovering at about US$35 per barrel, well-below the budgeted price of oil, fiscal austerity would have seemed to be 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

[34] Author's March 2007 interviews in Caracas, Venezuela with Carmelo Lauría, former party leader of the Acción Democrática (AD) during the 1980s and 1990s, and Gustavo Tarre, former budget director for the Partido Social Cristiano de Venezuela (COPEI) during the mid-1990s.
[35] This figure includes social spending by the state owned oil company, PDVSA, and its contributions to the National

proceeds also fell by more than US$5 billion between 2008 and 2010.[37]

Throughout this period, however, the government maintained its expansionary fiscal stance that included a series of extra-budgetary spending initiatives in 2009.[38] 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[39] and guaranteed infrastructure contracts for Chinese companies.[40] According to the CDB's Vice Governor Liu Kegu, who is charged with managing 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.[41] "We have lots of capital and lack resources, they have lots of resources and lack capital, it's complementary."[42] By the end of 2010, China had lent US$40 billion to Venezuela through the joint investment fund and other similar facilities, more than offsetting both its budgetary and off-budgetary revenue losses related to the commodity downturn.

Development Fund (FONDEN).

36 Government non-tax oil revenues fell by about 3 percentage points of GDP between 2008 and 2009 (CEPAL).

37 Beginning in 2005, both the Central Bank of Venezuela, and the state-owned oil company, PDVSA, have been legally obliged to deposit money in the National Development Fund, which is directly controlled by the president.

38 Economist Intelligence Unit.

39 Oil-for-loan agreements were first popularized by Japan in the 1980s, when the country had extended similar loans to China (Gallagher et. al 2012).

40 For example, State Grid Corporation, China's largest power distributor, is building power transmission equipment in Caracas, while the telecommunications firm ZTE has been constructing a fiber optic cable network in Venezuela. State-owned China Railway Group also won a contract from the Venezuelan Railway Authority.

41 Venezuela holds 20 percent of the world's crude oil reserves, much of which is extra-heavy crude from the Orinoco Oil Belt (Rodríguez, Morales, and Monaldi 2012).

If Chinese financing was not available, it's 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 almost $30 billion to the president's development fund during the decade, the lack of reinvestment in the state oil company was not only hurting PDVSA's productivity,[43] but also forcing it to increasingly borrow from global capital markets. By 2011, PDVSA's debt had reached $35 billion, which was 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, suggesting new funding would not have come cheap. Incurring more debt would have likely subjected Venezuela to greater investor scrutiny and perhaps even austerity.

In the wake of Hugo Chávez's 2013 death, his successor Nicolás Maduro has continued to use Chinese loan-for-oil agreements as a funding arm for its expenditures. The Maduro government borrows from China, often below its market rate, to boost politically-important spending today. Since 2008, Venezuela has now tapped more than $50 billion -- equivalent to 22 percent of GDP -- in non-conditional Chinese lending. Without having to adhere to the market's calls for discipline, the country has maintained its economic policy autonomy, overseeing a large primary budget deficit

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[42] See Sanderson and Forsythe, 2013.

[43] The state oil company was producing about 3 million dollars of oil daily compared to its goal of 4 million dollars.

since the global financial crisis (see Figure 1). It has also further expanded its off-balance sheet social spending through both FONDEN and the China-Venezuela joint investment fund.

However, with about one-half of its 640,000 barrels of daily oil production destined for the Pacific,[44] such borrowing comes at the cost of the state-oil company's health tomorrow. While PDVSA has always underwritten the Venezuelan government with its current proceeds, it's now leveraging its future oil assets and profitability to keep the government in the black, casting a cloud over the country's future solvency.

These loan-for-oil agreements also create a moral hazard problem for China that is similar the one experienced by U.S. banks during the 1980's Latin American debt crisis. If the Chinese Development Bank were to cut 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 lend defensively, with President Xi Jinpeng extending the China-Venezuela fund by another US$4 billion during his Latin American tour this summer. More recently, at Venezuela's request, China's government also decided to loosen the terms of its loan-for-oil agreements by both removing the minimum quantities for oil shipments and extending repayment deadlines. Over the longer run, the question is how long China is willing to extend such preferential conditions. High ranking Chinese officials are already expressing their discontent about their financial relationship with Venezuela, with one recently complaining that "we thought we were

[44] *Financial Times*, October 22, 2014.

getting into a cruise ship, but it was a pirate ship."[45]

Chinese-Argentina Ties: More than a Hill of Soybeans?

For the majority of the 2000s, Argentina's economic relationship with China primarily existed through the trade sector. Benefiting from China's global emergence after its 2001 WTO entry, Argentina's total trade with China increased from 3.8 percent in 2000 to 10.8 percent by 2010.[46] Primary commodity exports were the main driver of these trade ties, accounting for about two-fifths of China's total trade with Argentina.

The government took advantage of China's booming demand for its commodities by increasing its export taxes, particularly on soybeans. By comparison, Argentina received relatively few direct investment or bank loans from China during this period.[47] It primarily sourced funds from its trade relationship with China until the commodity boom slowed and export taxes became politically less viable. Like in Venezuela, the commodity correction increased the incentive for Argentina to forge greater financial ties with China, albeit at a slower pace. Hence, Argentina provides us with an intermediate case, where China's soybean demand gave a temporary boost to government revenues in Argentina, but not a sustained boost in fiscal flexibility (see Table 1).

The recent history of the export tax dated back to Argentina's 2001-02 financial crisis, a time when China was first emerging in the global trade scene. A silver lining to Argentina's crisis was that the ensuing currency devaluation boosted the peso-denominated incomes of farmers who had been receiving dollars for their exports. Recognizing these windfalls, a revenue-starved Argentine government implemented a 10 percent export tax beginning March 2002. According to the Minister

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[45] Conversation between top executive from China National Petroleum Corporation (CNPC) and high ranking Chinese government official (Monaldi, 2014).

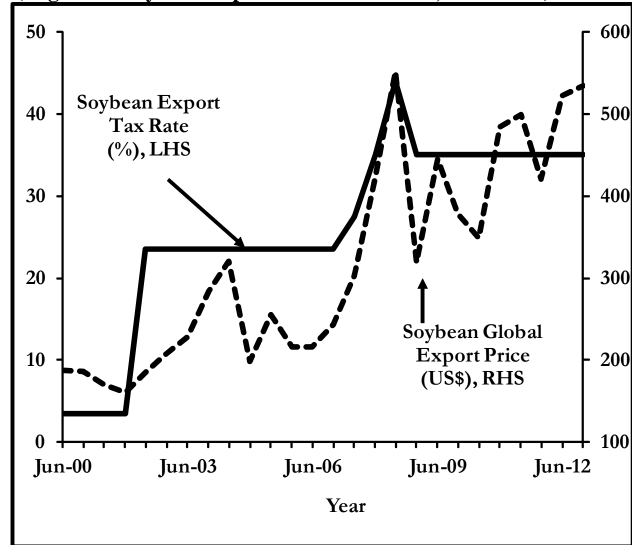
[46] United Nation's Commodity Trade Statistics Database.

[47] Argentina did not receive any Chinese bank loans until 2010, and drew a paltry $219 million in total Chinese foreign direct investment by the end of the decade (Chinese Statistical Bulletin of Outward Foreign Direct Investment; Gallagher, Irwin, and Koleski 2013's *China-Latin America Finance Database*).

of the Economy, Jorge Remes Lenicov, the export tax was temporary and intended to protect social programs in "the face of the crisis."[48] In its quest for new tax receipts, the government also increased the export tax on soybeans from 3.5 to 23.5 percent (Figure 3).

This political lesson was not lost on Néstor Kirchner, when he ascended to the presidency in May 2003. His administration also guided the currency significantly lower to promote exports and broad-based economic growth, while simultaneously increasing export taxes. This policy produced a win-win for Kirchner's political coalition consisting of the major labor and industrial organizations. First, the tax tempered the fast-paced agricultural export growth – which led to greater domestic supply and lower food prices – providing a benefit to the urban middle and working classes that still had memories of runaway inflation. Second, it boosted government revenues, endowing the central government with greater fiscal scope to target its urban political supporters with higher social spending, public employment, and energy and transportation subsidies.

Figure 3: Leveraging the China Boom with Soybean Taxes (Argentina Soybean Export Taxes and Prices, 2000-2012)



The key link between this government policy and China was soybeans. Soybeans were the main contributor to government revenues, accounting for more than three times the export revenue of beef and wheat combined (Turzi 2012). At the same time, China's growing economic interdependence was largely responsible for the soybean boom. At the turn of the 21st century, China's policy of soybean self-sufficiency had limited its share of global consumption to six percent. However, as the country's domestic consumption patterns changed, the government scrapped its

[48] *New York Times*, March 5, 2002.

self-sufficiency policy and began gobbling up more than half of the world's soybeans.[49]

This surging Chinese demand drove soybean prices threefold higher over the past decade, creating a considerable rent-seeking opportunity for Argentina's government, the world's third largest soybean producer. After consuming virtually nothing at the beginning of the decade, China now dominates Argentina's export markets for soybeans, buying more than four-fifths of Argentina's total soy exports.[50] The country's farmers met this new demand by developing quicker maturing and cost-effective biotech soybean varieties, helping improve their market share.[51]

The Kirchner administration also readily responded to the rent opportunity created by China's soybean demand. It raised the commodity's export tax several times over his presidency until it reached 35 percent in the fall of 2007. Conveniently, these tax hikes preceded the 2007 presidential elections, helping Kirchner transfer benefits from the agricultural sector to his urban working class and industrial base. Kirchner used these tax receipts to fund line-item budgetary spending on popular energy and transportation subsidies, public investment, and transfers to the provinces[52] that were instrumental in securing the Argentine presidency for his wife and fellow Justicialist party candidate, Cristina Fernández de Kirchner.[53]

Upon receiving the presidential baton from her husband, Cristina continued to pursue the same political model, favoring the industrial working class over the agricultural sector. Further hikes on the soybean export tax were again central to this model, which quickly reached 44.1 percent with the introduction of a new progressive tax system in March 2008 (see Figure 3).[54] According to her

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[49] Between 2001 and 2010, China accounted for 45.2 percent of total soybean imports from the world (BBVA 2013).
[50] BBVA 2013.
[51] Author's interview with senior economist Francisco Gismondi of AACREA (Associación Argentina de Consorcios Regionales de Experimentación Agricola) -- a national research association that promotes the incorporation of technology in agriculture -- in Buenos Aires, Argentina on August 23, 2012.
[52] For example, public transfers to the provinces grew by 1.4 percentage points of GDP during the 2007 election year, equivalent to almost one-tenth of total government expenditures (CEPAL's Estadísticas de Finanzas Públicas).
[53] The 1994 constitutional reform had banned Néstor Kirchner from running for successive presidencies.
[54] The tax was a sliding scale system that would rise and fall along with commodity prices.

Minister of the Economy, Martín Lousteau:

> "They increased taxation because prices were booming - it was kind of a windfall tax...Soybeans were giving you lots of revenues. Prices were going up, production was going up, and the tax rate was going up...I think there was resistance because you were increasing it all the time...but also because Kirchner had entered conflict with the farmers since the very beginning, so they were really tired...and the farmers think your taking too much from them."[55]

In fact, farmers swiftly rejected this new tax system, launching a series of major strikes and government protests that included road blockades that impeded the flow of food to urban centers.[56] Suggesting that soybean farmers were better off than most Argentines, President Cristina Fernández attempted to rally the urban working class, saying that if they are forced to "take away these export taxes, everything that you have gotten in these past six years will be lost unemployment will return, prices will rise."[57] She instead saw her approval ratings plummet for mismanaging the crisis.[58] After the measure was rejected in the Senate, the Kirchner government eventually revoked the resolution.

In light of these political tensions, Argentina's attempt at leveraging the China-fueled commodity boom by shrinking the margins of soybean exporters was short-lived. During the Néstor Kirchner administration, government officials had used these export taxes to pad government coffers for four years, helping ensure budget surpluses. However, squeezing these margins eventually became politically untenable, leaving President Cristina Fernández searching for alternative funding sources. The ensuing commodity correction (see Figure 3) further eroded foreign trade taxes, as the government's budget surplus shifted into deficit by 2009.[59]

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[55] Author's interview, Buenos Aires, August 15, 2014.
[56] See Fairfield 2011 for more detail.
[57] *Associated Press*, June 18, 2008.
[58] President Cristina Fernández's approval rating reached a historically low 23 percent after beginning her administration at 57.8 percent (*El Pais*).
[59] CEPAL's Estadísticas de Finanzas Públicas.

Shunned from global capital markets,[60] Fernández launched a domestic quest for new budgetary resources. The Argentine president took increasingly desperate actions, first nationalizing the country's private pensions system[61] in 2008, and then tweaking domestic laws to redirect central bank reserves toward financing national accounts in 2010.[62] Navigating through the commodity slump, however, still meant unwinding some of the government's utility subsidies.

Hoping to avoid further fiscal retrenchment, the Argentina president increasingly courted China. In a 2010 visit with her Chinese counterpart, Hu Jintao agreed to lend the Argentine government more than US$10 billion, equivalent to 5 percent of GDP, to update Argentina's heavily subsidized national railways with Chinese trains and equipment.[63] The added resources relieved some budgetary pressure by raising external capital for much-needed public infrastructure, leaving Kirchner with more fiscal space to maintain an expansionary policy stance through her successful 2011 reelection bid. However, they were about one-quarter of the size of the Chinese bank loans to Venezuela, and therefore did not deliver the same degree of fiscal flexibility (see Figure 1). Today, the Kirchner government still struggles to raise new tax receipts to help it avoid fiscal restraint.

These funding problems have been exacerbated by Argentina's July 2014 technical default on its global bond holdings, prompting the Kirchner administration to tap additional Chinese financing. Initially, Argentina had hoped to address its financing shortfalls by re-entering global capital markets. Over the last year, the Kirchner government had implemented a variety of policy measures, aimed at restoring its credibility with international investors. It had finally repaid its long-standing arrears with

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60 In an effort to re-open the spigot of global market financing, Cristina Kirchner negotiated a settlement with two-thirds of the outstanding holdouts from Argentina's 2005 debt restructuring in 2010. However, legal disputes involving the remaining original bondholders, the recent YPF nationalization, and the United States' opposition to new multilateral lending would likely place a high premium on any new sovereign bond issuance in international markets.

61 The private pension system was established in 1994 as an alternative to the public system, and had $30 billion in assets in 2008 (See Datz 2012 for more details).

62 Notably, the latter action also led to the ouster of Central Bank President Martin Redrado, who hoping to preserve central bank independence, protested against the presidential decree.

63 Argentina agreed to purchase 20 diesel locomotives and 220 passenger trains from China.

the Paris Club of creditor nations; compensated the Spanish energy company, Repsol, for the government's expropriation of YPF, Argentina's main oil company; and introduced a new International Monetary Fund-developed inflation index to restore the country's data reporting transparency after doctoring its inflation statistics for years.

Recently, however, Argentina decided not to comply with a US district court ruling demanding that it repay its holdout creditors after the Supreme Court refused to hear its July 2014 appeal. Without an orderly bankruptcy proceeding internationally, countries like Argentina are often forced to negotiate a settlement with their debtors when the meet hard financial times. Ninety-three percent of Argentina's creditors accepted new terms for the country's bonds in 2005 and 2010, but holdout creditors, known as vulture funds,[64] declined these restructuring deals. The Kirchner government fears that paying these holdouts could spark a cascade of claims from other bondholders that could surpass US$15 billion, potentially depleting the nation's dollar reserve funds meant to protect against future financial instability.

Notably, within days of the Supreme Court's July ruling, President Cristina Kirchner and her Chinese counterpart, Xi Jinping, had agreed to a fresh installment of US$7.5 billion of loans to the Argentine government for energy and railway projects and a US$11 billion currency swap agreement[65] among their central banks, which could help fortify Argentina's dollar reserves in the event of another currency crisis.

Notwithstanding the nature of China's intentions politically (the country often gives primacy to its bilateral relationship with the United States in the region), its financial backstop allowed Argentina to take a recalcitrant stance against its holdout creditors in the United States. Without this

[64] Vulture funds buy the distressed debt of developing countries at rock-bottom prices with the hopes of profiting through litigation rather than through market forces.
[65] For further details about China's role in international monetary affairs, see Steinberg 2014.

insurance against future financial volatility, Argentina would have likely not been as emboldened, instead having to appease international markets. President Kirchner's hard line stance against Argentina's holdout creditors has also played well domestically. In fact, a July 2014 poll by Poliarquía Consultores found that 47 percent of Argentines viewed Kirchner's aggressive rhetoric toward the hedge funds positively, up from 38 percent the month before the Supreme Court's ruling.

Kirchner has embraced this new found political capital, and even linked it directly to Chinese financing. It's not often that sitting presidents tout the importance of central bank currency swap arrangements in public speeches, but President Kirchner did exactly that this past summer. Kirchner praised the Chinese swap line, saying it offered "stability in exchange rates at the moment we are, as a country, suffering speculative attacks by vulture funds."[66] With the threat of further financial instability lurking and global market financing still lacking, Argentina's appears to have taken a cue from Venezuela and increasingly looked Eastward for more of its financing needs.

Brazil: Between Markets and Dragons

Unlike Argentina and Venezuela, the Brazilian government has taken a more passive stance to leveraging the region's growing economic interdependence with China. Notwithstanding being China's largest regional trading and investment partner, the government has not heavily taxed the export sector,[67] or significantly relied on the Chinese Development Bank's financing facility (see Figure 1). Rather, the majority of Chinese investment projects have been market-seeking and thus channeled through the private sector.[68] To the extent that the Chinese Development Bank is involved in public financing projects in Brazil, it operates through government concessions rather than direct government-to-government lending like in Venezuela. Hence, according to Alexandre Schwartsman, former director of the international affairs department at the Central Bank of Brazil,

[66] *Reuters*, July 19, 2014.
[67] Most exports are exempt from foreign trade taxes, which amount to less than 1 percent of GDP.

"it's far more difficult for the government to put its hand on the money."[69]

In terms of its approach to public financing, Brazil has been less interventionist than its regional counterparts with mixed-market economies, and hence, less likely to create economic distortions through new trade taxes or discretionary borrowing. Rather, the majority of its government revenues are derived from domestic consumption and income taxes (see Table 2),[70] which have helped the Brazilian state build a revenue base that is comparable to OECD countries.[71]

Table 2: Composition of Brazilian Tax Revenues

Tax	R$ Billion	% GDP	% Revenues
Corporate and Individual Income	77.8	6.6	40.7
Social Security	56.6	4.8	29.6
Value Added Consumption	19.3	1.6	10.1
Financial Transactions	17.2	1.5	9.0
Import and Export	9.1	0.8	4.8
Other	11.1	0.9	5.8
TOTAL	191.1	16.14	100

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, and also maintain a relatively accommodative stance since that time. However, the government has not had sufficient fiscal space to tread far from Western governance principles of budgetary discipline.

Undoubtedly, Brazil benefited from its relationship with China, whose commodity demand catalyzed an export boom in the mid-2000s which helped buoy the economy, and consequently government tax receipts.[72] These added revenues, along with sound macroeconomic fundamentals,

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[68] China-Brazil Business Council 2013.
[69] Author's interview, Sao Paulo, Brazil, September 25th, 2014.
[70] About four-fifths of the Brazilian government's revenues come from income, value-added, and social security taxes.
[71] Brazilian tax revenues are equivalent to about 36 percent of the country's GDP (see Ondetti 2012).
[72] Brazil is a relatively closed economy, but such terms of trade gains supported economic activity, mostly though higher consumption and investment (Author's interview with Alexandre Schwartsman, September 25, 2014).

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,[73] helping it grow by 4.1 percent per year between 2008 and 2010.

In recent years, however, the country – which continues to borrow extensively from global bond markets[74] – has had less fiscal policy room to maneuver. Compared to Chinese public bankers, financial markets are far less forgiving about large budget deficits and inflation, fretting that they erode a country's debt repayment prospects. According to former Deputy Minister of Finance Bernard Appy:

> In Brazil, the market has more strength in controlling what the government can do than in other countries...You had to have a strong fiscal policy -- otherwise, you would lose the confidence of the markets."[75]

As a result, Brazilian presidents have employed two policy measures to assuage such market concerns: targeting inflation to keep rising prices at bay[76] and pledging to maintain healthy state finances through primary budget surpluses.[77]

This market-imposed discipline can create an unenviable balancing act for sitting Brazilian presidents. Current Brazilian President Dilma Rousseff has sought to preserve Brazil's hard-won macroeconomic stability, while struggling to overcome economic headwinds and reignite growth. To achieve these twin goals, she has 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. Within a balanced budget framework, President Rousseff has also provided subsidies ranging from electricity to education. On top of these measures, she has targeted poverty by

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[73] In the wake of the 2008 global financial crisis, the Brazilian government took a countercylical policy stance, halving its primary budgetary surplus to 1.24 percent of GDP in 2009 to help offset the downturn.

[74] Brazil borrowed US$15.2 billion in new funds from global bond markets between 2009 and 2011, while Argentina borrowed a paltry US$193 million.

[75] Author's interview, October 27, 2014.

[76] Brazil's National Monetary Council currently has a 4.5 percent midpoint target for inflation through 2014 and 2015.

[77] In highly-indebted countries, market investors tend to closely monitor primary budget balances (net of interest payments on public debt) because it measures a country's ability to service its debt with incoming tax receipts.

increasing monthly cash allowances under the *Bolsa Familia* program,[78] which grants cash stipends to 48 million poor Brazilians, or one quarter of the country's population.

Controversially, however, Rousseff's balancing act has reached the boundaries of her political safety net. Such social spending programs and corporate subsidies are politically difficult to trim, and have contributed to a narrowing of Brazil's targeted primary budget surplus – a key gauge of debt service capacity – to 1.9 percent of GDP from a recent high of 2.5 percent of GDP in 2008. Consequently, both budgetary management and inflation control had featured prominently in this year's presidential campaign, with Dilma repeatedly declaring "her profound commitment to fiscal responsibility." The Brazilian president also pledged to replace her current finance minister, Guido Mantega, who has been heavily criticized for fiscal mismanagement.

Ironically, such a political chorus underscores the key structural constraint on Brazilian spending. The Brazilian government borrows from global markets that demand sound budgetary management, even when government accounts are in surplus. Notwithstanding the electoral debate about budgetary drift, Brazil has maintained its primary budget surplus and exhibited far greater fiscal restraint than Argentina or Venezuela. For example, notwithstanding this year's election debate, Brazil has left its primary budget surplus relatively intact since the 2008 financial crisis,[79] while Argentina and Venezuela have swung their budget surpluses into considerable deficits.[80]

But, will Brazil be tempted to find new alternatives to market finance? After securing her re-election in October, President Dilma Rousseff must reconcile the seemingly irreconcilable. She must persuade global markets that Brazil is committed to sound economic management, while simultaneously becoming more socially responsive to the Brazilian people. Confronted with a series

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[78] These conditional cash transfers (CCTs) provide money directly to poor families via a social contract, mandating that the beneficiaries send their children to school regularly or bring them to health centers.

[79] Notably, Brazil decreased its primary budget surplus by about 1.1 percentage point of GDP in 2009, but quickly reversed these actions the following year (CEPAL).

of protests the last two summers, for example, the government is grappling with how to maintain this balance between economic and social stability. Catalyzed by an increase in public bus fares[81] and the sky-high price tag for World Cup and Olympic stadiums,[82] millions of people first took to the streets to voice their discontent with the quality of public services in the summer of 2013. Facing plummeting approval ratings,[83] President 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 public education, health care, and transportation is no small feat, however, and likely necessitates massive new spending commitments. Hence, placating the growing demands of Brazil's middle class could simultaneously threaten the government's budget discipline, and in turn undermine Brazil's investment climate.

In searching for an exit from this political quagmire, the Brazilian government might be tempted to tap Chinese income streams either through trade taxation or direct borrowing from Chinese banks. Similarly to Argentina, for instance, the Central Bank of Brazil completed a US$30 billion currency swap agreement with the People's Bank of China in 2013.[84] In contrast to Argentina, however, the bilateral agreement explicitly states that the swap is intended to facilitate bilateral trade and will not impact Brazil's international reserves. The current director of the Central Bank of Brazil's international affairs department, Bruno Coelho Saraiva, explains that the Brazilian government did not want to have direct access to Chinese funds.

> "The purpose [of the swap] was different from the one China made with Argentina - Argentina was interested in announcing it had a swap and making everyone believe that the swap would be an additional line of defense if they reached the point that they would need resources, especially with no access to international markets. But,

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80 Figure 1 shows the change in budgetary balances for these countries since the beginning of Chinese lending.
81 The bus fare increase was equivalent to about 9 cents.
82 To date, the Brazilian government has spent US$3.2 billion on these stadiums for the 2014 World Cup and 2016 Olympics, a greater public outlay than first envisioned (Campos 2013).
83 Rousseff's approval ratings fell by more than 20 percentage points following July's protests (Datafohla 2013).
84 This pattern is in line with recent research finding that we should be more likely to observe Chinese currency swap

in the case of Brazil, we wanted to make it clear that we were not interested in getting an additional line of defense in general terms, like something that could be added to international reserves...we had made it clear that we had a sufficient level of international reserves."[85]

Rather than tapping such Chinese resources to help calm investor concern over government finances, the Rousseff administration is more likely to pursue an intermediate solution. It can outsource public services, like infrastructure, to the Brazilian private sector through government concessions. To date, China has mostly lent money to Brazil's energy sector, helping finance its pre-salt[86] oil development and operations, but the government is also increasingly likely to procure Chinese investment in infrastructure. Witnessing China's shiny new investments in neighboring Argentina's public transportation, Brazilian local companies have already courted potential Chinese partners to bid on government projects that are likely to amount to as much as US$60 or US$70 billion. According to Fernando Alves, Price Waterhouse and Coopers' Senior Partner for Brazil:

"Chinese firms are prepositioning themselves to finance infrastructure in Brazil. They will be ready to finance major capital projects. 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 relay on third parties. We need to invite foreign players through bids for airports, highways, and ports."[87]

In short, Chinese capital is likely to be channeled through the Brazilian private sector. Such procurement strategies could allow the Brazilian government to simultaneously meet its twin goals of economic and social stability. The government can maintain budget discipline by using private-public partnerships to defray the cost of big-ticket capital projects, while still quieting the growing chorus of demands for better Brazilian public services.

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agreements in countries with strong trade and investment ties with China (McDowell and Liao 2015).

[85] Author's interview, Brasilia, Brazil, September 27, 2014.

Conclusion

After excessive borrowing led to financial booms and busts, many countries have sought to insulate themselves from market volatility, and to varying degrees, diversify away from neoliberal governance. In this regard, China's rapid economic expansion in the Western Hemisphere has presented regional governments with an important opportunity. The availability of non-Western financing sources, derived from these new trade and investment ties, provides governments with an income stream that is independent of global financial markets.

In this comparative case study analysis, we examined three mixed-market South American economies, Argentina, Brazil, and Venezuela, to test whether this non-conditional funding has the potential to enhance national budgetary autonomy. We found considerable variation within these mixed-market economies. The Brazilian government, which predominately relies on market financing and has not directly borrowed from China, has maintained budget discipline, notwithstanding its microeconomic tendency to subsidize credit to consumers and businesses. By contrast, Argentina and Venezuela have attempted to directly tap Chinese income streams to finance their expenditures. Argentina's government opted to tax trade, which provided a temporary but not sustainable boost to its budgetary flexibility. The Venezuelan authorities, on the other hand, 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.

These patterns appear to hold beyond the borders of these three countries. For example, if we briefly extend our analysis to two of Venezuela's Andean neighbors, Colombia and Ecuador, we observe a similar set of outcomes. The Colombia government, which relies on global market financing and has borrowed a mere US$75 million from China (0.02 percent of its annual GDP),

[86] Part of the Brazilian continental shelf where an estimated 50 billion barrels of oil reserves was recently discovered.

has maintained a primary budget surplus since China's lending began to the region in the late 2000s. Like Brazil, Colombia prefers to finance its infrastructure needs through private sector procurement, which heightens its focus on using good governance to promote a favorable business environment. The country has even enshrined its commitment to fiscal responsibility into Article 334 of its constitution, declaring that "fiscal sustainability is a criterion that should guide the branches and institutions of government."[88]

By comparison, Ecuador has borrowed about US$10 billion directly from China (or about 20 percent of its annual GDP) during this same period, and even explicitly used a Chinese credit line to cover its budgetary shortfalls. Following its 2008 default on its international debt, China has also directly padded Ecuador's government coffers with additional funds in exchange for future oil delivery, becoming Ecuador's biggest global creditor in the process.

Without being subject to global market pressures, Ecuador has simultaneously moved its government budget sharply into the red from a primary surplus in 2008 into a sizeable and sustained deficit today. During this time, the country also negotiated a multi-billion dollar deal with the Chinese Development Bank to drill for oil under Yasuni National Park in order to "obtain access to a favorable line of credit to finance priority projects," despite having a U.N. backed-trust that was set up to collect donations to deter oil development in the Amazon rain forest.[89] In other words, it appears as though Chinese financing can amplify a country's political and economic trajectory, by providing countries like Ecuador and Venezuela with greater fiscal space to pursue their political agendas without the scrutiny of international investors or global governance norms.

In this regard, these findings offer important new insights for both the international relations

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[87] Author's Interview, Sao Paulo, Brazil, September 29, 2014.
[88] Ministerio de Hacienda y Crédito Público de Colombia.
[89] *The Guardian*, February 14, 2009.

and political economy literature, providing a systematic explanation for how the shifting economic power balance between the United States and China affects national ideological and 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 Western governance models. This analysis also demonstrates that China's economic engagement in the Hemisphere may have some unintended political consequences. Chinese financing might help enhance the policy autonomy and sustain the longevity of political leaders like Hugo Chávez, Rafael Correa, and Nicolas Maduro that challenge the Western liberal order. Moving forward, developing a more precise understanding of the comparative political economy across nations will be crucial to better understanding how China's global emergence affects state behavior.

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