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Brazil x China Trade Frictions: Overview and a brief case analysis

Conflitos Comerciais Brasil x China: Visão geral e uma breve análise de caso

Omar Rodrigo Ribeiro e Silva

Student in a Double Degree Master Program, MBA in International Business - Technische Universität Bergakademie Freiberg (Freiberg/Germany); and Master in Political Economics - Wuhan University of Science and Technology (Wuhan/China).

rodrigo07@hotmail.com

Zheng Yueming

PhD in Quantitative Economics at Huzhong University of Science and Technology - HUST (Wuhan/China). Associate Professor at Wuhan University of Science and Technology (Wuhan/China).

austin78@126.com

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Abstract

The present article aims to describe the current market and economical reality regarding international trade and its imperfections (frictions) confronting China, specially those originated in one of its largest commercial partners, Brazil. Through an empirical research, this paper displays, under a brief descriptive perspective, the historical constructs that formed today's economical reality of both countries and, in a quantitative manner, the existing frictions between the former.

Key-Words: Trade frictions; Brazil x China; Trade barriers; Cellulose industry.

Resumo

O presente artigo tem por objetivo descrever a presente realidade econômica e de mercado no que tange ao comércio internacional e suas imperfeições (conflitos) que confrontam a China, especialmente aqueles originados em um de seus maiores parceiros comerciais, o Brasil. Através de uma pesquisa empírica, este trabalho demonstra, de forma breve e descritiva, as construções históricas que formaram a realidade econômica de ambos os países e, de uma forma quantitativa, os conflitos existentes entre os últimos.

Palavras-Chaves: Conflitos comerciais; Brasil x China; barreiras comerciais; indústria da celulose.

As international trade grows constantly, so does the friction among the various parties that operate in the world economical scenario. China, as it is widely known, is the one of the countries that possesses the largest trade volume in merchandises in the world. It presents strong comparative advantages in production, such as low cost for labor and capital, making its products extremely price competitive in the international trade scenario. Hence, numerous trade measures are taken into effect by third parties against China and its rapid economical growth.

Among those, Brazil proposes numerous measures against its largest trade partner, partially to deem the large inflow of cheap manufactures from China, and for other reasons further on discussed. A notorious case took place in 2013, as it represents China's first action against its emerging partners, by the initiative to investigate and appreciate tariffs on Brazilian cellulose producers. Such case will be briefly analyzed further on.

Objectively, it is not the goal of this paper to deepen into economical analysis, that also requires reference to political conjectures, and would demand huge research efforts and cooperation, as the thematic itself is vast and as extremely relevant as it is controversial. However, the aim is solely to provide an overview on the matter and one specific case, with a structured criticism over the intelligence on levying trade barriers.

Historical Background

As it is widely known, China is the largest market (in numbers) for industrial and consumer goods in the world, and a growing one for the *third sector* (services and commerce). However, such definition would only see its effects on the world market after the systemic political changes of 1949 and the so called “economical opening”, a series of economic reforms that began in 1978, which procedural steps last up to date. From it, the main characteristics we can quote are: the opening up to foreign trade, the reduction of governmental control over the market (prices), the establishment of TVEs (Township Village Enterprises) and the *dual track system* - allowing households and SOEs (State Owned Enterprises) to operate directly in the market with a secondary price (CSIS 2014).

Since the economical opening, China has been experiencing a huge economical growth (in GDP scale, *Gross Domestic Product*), with yearly averages of around 10% until 2013, a growth that was not matched by an improvement in living standards, environmental protection and other key institutional mechanisms (Morrison 2014). The economical reforms, introduced by Deng Xiaoping, have changed the economical scenario in China, focusing on economical growth by *an export led industrialization* and, later, the massive attraction of *FDI* (Foreign Direct Investment) and other forms of investment into the domestic economy by a series of benefits and favorable policies (Morrison 2014). Low production costs, favorable policies and readiness for goods exports transformed China into the favorite manufacturing pole for the secondary sector industry, which would install production or assembly lines in the country, later exporting finished goods to third or home markets.

In effect, such model of growth drove China into becoming one of the world's largest trading nation, specially after its ascension to the WTO (World Trade Organization) in 2001. In 2009, it surpassed Germany as the world's largest merchandise exporter and the second largest importer, after the United States (Morrison 2014). As follows, despite the fact that industry sectors from most countries benefit from the favorable Chinese market reality, China suffers from most of all trade friction measures from its recent trading partners. According to the official data, since its accession to the WTO, China suffered a total of 31 official trade complaints and was involved in other 105 as a third party, being the US and the European Union the responsible for most complaints (WTO 2014), among other hundreds of measures and investigations to be later screened.

Brazil has a relatively different economical development when compared to the Chinese model. From a basically primary economy (agriculture) focused on commodities export in the early XX century, Brazil shifted its production core model to suffice the domestic market, after periods of low exports demand due to financial crisis worldwide (a true *import substitution industrialization* period) (Schatzmann 2014). A second period of development, from 1950 until 1980, can be characterized by a strong planning and State interventionism, due to the fact that Brazil was submitted to a military dictatorship until 1985. In such period the key aspects are a strong focus on infrastructure development, long-term planning focused on savings stimulation and foreign capital flows regulation (Schatzmann 2014). It is worth a mention that the military revolution was carried out by the burgeouis class allied with the military against a liberal government, which took some actions against the interests of the economically ruling class and those of the United States. After a first period of political instability, and hence a low economic growth, Brazil experienced a period of huge growth, due to the high productive capacity created in the previous times and not used by then. Such period is known in Brazilian history as the *Brazilian economic miracle*.

From 1990 on, we can perceive a neo-liberal economical development approach: the exchange rate was, to a large extent, controlled by the State, favoring the establishment of domestic enterprises and attracting foreign investment. Brazil has been gaining the world economical scenario, evolving from a basic agricultural export economy, to a manufacturing, technology and commodities one, despite the fact that commodities and resources, such as minerals, still account for most of the Brazilian exports (Schatzmann 2014).

Brazil has strengthened economical relations with its major partners, by taking part in the formation of the *Mercosul* (South American Common Market Agreement), in which it plays a leadership role, and joining new emerging nations in trade agreements, such as the G-20 and the so called BRICS countries (Brazil, Russia, India, China and South Africa). As for today, China is the largest trade partner Brazil possesses, as 19% of all Brazilian exports are directed towards that market, we have the US in second place, with 10,3% of the total share. When it comes to imports, the figures are, respectively, 15,6% and 15,1% (MDIC, 2014). As follows, such a huge trade and commercial relation is also tempered with trade frictions and consequent measures.

Trade Frictions Brazil x China: Overview

Despite all favorable aspects different countries obtain by trading and operating in China, the latter is currently one of the countries that most suffers from trade frictions, such as antidumping measures, what yield huge tariff and non-tariff barriers against the so preached *Ricardian* free trade. The protectionism of domestic enterprises, international competition, political discrepancies, environmental protection and even a fear of the rapid Chinese growth are the main reasons for the large number of measures imposed against China, both official and non-officially stated. Following that trend, the Brazilian government also proposes many measures and, naturally, against its largest trade partner, China. Trade frictions between those two countries may occur not only due to imports and exports among themselves, however also due to disputes for third markets shares.

General Information

As seen before, Brazil and China play a leadership role in their inserted regional markets and have a history of good trade and diplomatic relations. Both countries signed, in 2010, a treaty reaffirming the cooperation in various different levels, from agribusiness, to research and development and aerospace technology (MRE 2014). Brazil sees in a China a huge importer market for its mineral ores, transportation material, agricultural products (such as soy beans, meat, ethanol) and other commodities (such as paper cellulose) (Tachinardi 2005). Such high level of exports kept the Brazilian economy ongoing during the international financial crisis with little effect. On the other hand, data analysis from the Brazilian Central Bank shows that China is responsible for a huge share of the total FDI inflows into the country, accounting for $17 billion USD, from a total of $48,46 billion USD in 2010 (FTChinese 2011).

However, China is also considered a threat among Brazilian businessmen, when it comes to its large scale and low cost production of electronic devices, textiles and toys, among other industrial materials (such as paper), which flood the South American market and jeopardizes both the Brazilian domestic and foreign markets (FTChinese 2011). Hence, we can identify two main reasons that raise concerns among the Brazilian domestic industry and, consequently, Government: the inflow of cheaper Chinese manufactures into the Brazilian domestic market; and the international competition Chinese products and firms are placing against markets that were originally predominantly Brazilian, such as Mexico, the US and Argentina (Thorstensen 2011). The attractiveness of the Chinese market to FDI is also in direct competition to that of the Brazilian; however, due to differences on growth models, it plays a secondary role when it comes to generating frictions between those two nations.

As a matter of exemplification, we can perceive the increase in the participation of Chinese products in the total Argentinian imports (a market that was previously largely dominated by the Brazilian exporting sector), from roughly 5,2%, in 2003, to 12,8%, in 2010 (Thorstensen 2011). When it comes to the share of Chinese products in total American imports, the figure grew from a rough 12%, in 2003, to 19% in 2010, summing up to $ 368 billion USD in 2013 (MORRISON, 2013).

In effect, measures against the Chinese market strength have taken different forms, not only attaining themselves to the official *tariff* and *non-tariff barriers* (tariffs levying, import and export taxes, restriction quotas, import licensing, technical requirements in products and packaging, among others). In recent times, we can quote the public bidding of the first *fast-train line* in Brazil, which projects the connection of São Paulo and Rio de Janeiro's metropolitan zone. On the announcement regulations, Chinese enterprises were explicitly forbidden to participate in the bidding for the project, which will be carried out as a *Public-Private Partnership* (PPP) (ANTT 2013). To a large extent, such prohibition is non-sense, as it forbids one of the nations with the highest know-how in railway technology, which railroads extension covers more than 80% of the network. News channels state that the Brazilian government was considering further restrictions on Chinese originated FDI on energy sectors and mining, imposing minimum domestic supply quotas and analyzing transactions through the investor's profile (FTChinese 2011).

Quantitative Data

In a quantitative analysis, from the creation of the WTO until June of 2012, Brazil had already filed 55 antidumping investigations with the application of 33 tariff appreciation measures against China (Landim 2013). The latter, on the other hand, never applied measures or initiated investigations against its emerging partners, until 2013, focusing its actions on the US, Canada and the European Union (EU). China had always presented a *non-litigation culture*, inherent to its socio-cultural background and development. Hence, as preached by Chinese lecturers, China had suffered numerous measures against its *comparative advantages* (such as cheap labor force), however it had not adapted itself to a proper level of defense or countervailing such economical losses.

Up to June of 2010, China was the country that most suffered from trade frictions, with 613 antidumping investigations initiated and 436 measures applied (Thorstensen 2011). That accounts for 21% of the total number of investigations initiated under the WTO, and 23% for all measures, three times as much as the measures applied against the runner-up, Korea (Thorstensen 2011). It is worth a mention, around 28,57% of all antidumping measures applied by Brazil are destined to Chinese exports.

According to official WTO data, as far as 2010, the average tariff rates applied by Brazil against Chinese products are as follows (Thorstensen 2011): 35,4% for agricultural and 30,7% for non-agricultural goods. China, on the other hand, utilized a low tariff portfolium when dealing with Brazilian imports, with an average of 15,7% for agricultural products and 9,2% for non-agricultural goods (Thorstensen 2011). However, some other key Brazilian exports faced higher tariff rates, such as: industrialized food, oil, textiles, shoes and transportation equipment.

China had always utilized tariff, quotas and trading rights restrictions as forms of imports control into the domestic market. Since its accession to the WTO in 2001, the nation has reduced its former barriers and is developing its learning curve on utilizing the permitted *antidumping, countervailing* and *safeguard measures*. Up to 2012, China had already launched 107 antidumping measures, against imports from 17 countries, and other 12 investigations in progress; its first three countervailing duty investigations were launched in 2009, all against US products (China 2014).

The recent paper cellulose antidumping investigation, initiated by China against Brazil in 2013, was the first measure taken against this important commercial partner, as we shall briefly analyze further.

A Brief Case Analysis: The Cellulose Industry

Recently, China initiated the first measure against one of its emerging and/or developing trade partners. The Brazilian producers of paper basic paste, cellulose, were submitted to an internal investigation by the Chinese Ministry of Commerce, by the alleged practice of dumping in its cellulose exports to China (Landim 2013). The preliminary dumping measures are as follows: 49,4% against Brazilian; 50,9% against Canadian; and 29,9% against American producers.

In the previous commercial exercise (2012), China imported an amount equivalent to $4,7 billion USD in cellulose, utilized by its large manufacturing sector in the production of paper and textiles, among others (Dow Jones Newswires 2013). From that total amount, 26%, or US$ 1,2 billion, are from Brazilian exports, being the fourth largest exported commodity by the latter to China (Landim 2013).

Experts accredit the Chinese maneuver as a retaliation against the appreciation of tariffs against Chinese imported paper, action taken into effect in 2011 after a long pressure by local Brazilian producers against a wave of Chinese cheaper paper into the domestic market, deemed to harm the domestic economy due to an unfair exchange rate and dumping practices by China. In the year of 2010, Brazil imported 1,5 million tons of paper from China, an increase of 40% over the previous year, what, according to producers, greatly jeopardized the domestic industry stability (Brito 2010).

In reality, despite criticisms carried out by Brazilian experts, the industries of both countries are strongly interrelated. The exports of a commodity or resources will be transformed and later reinserted into one's territory, in a true cyclical business relation. In a rough analysis, by levying tariffs, both sides only manage to increase average industry market price (market distortion), in a “no-winner war”. The affected parties are, naturally, intermediate and final consumers of the manufactured product, and the whole production and services chain that utilizes such resource.

Conclusion

Regardless the discussion whether China's growth model is sustainable or not (the need for a shift in the production model into a technology based one, less dependency on exports and FDI by the development of the domestic market, environmental issues and further demands), the country is facing an increasing number of commercial disputes and trade frictions measures from various trade partners. As seen, China is the country that most suffers from frictions (both formal and informal barriers) in the world, against its price competitive goods. Even considering the fact that most industrialized nations profit from the Chinese consumer and, specially, the production environment (with its “flexible” regulations, low cost and developed distribution channel). However, after a long period, referenced as a learning curve, China is learning how to deal with and countervail such measures.

As it is widely known, a shift in the Chinese production model to a more technology focused one, a higher investment on the services sector and the development of a domestic market for demand (arousing the dormant huge consumer market) are measures that should be taken into consideration by Chinese policy makers for the following years. By doing so, China will reduce its extremely high dependence on exports and market fluctuations for its economical growth and the need to purchase such huge amounts of foreign currency.

Despite the close relationship, both political and economical, between China and Brazil, the previous has been target of numerous trade barriers from the latter. As seen, China is the focus of the majority of all Brazilian antidumping measures, what is deemed natural, as that is the biggest commercial partner such nation possesses. Strong inflow of Chinese goods into the Brazilian domestic market, with cheaper prices, and the dispute for third markets are reasons that arouse the concerns of Brazilian businessmen and politicians, leading to further litigation between the two countries.

In effect, as seen on the case shown, the first measure ever taken by China against its strong emerging commercial partners was not until 2013, against the cellulose industry in Brazil. That either shows us the development in China of a better litigation system, or a change in political culture, due to a learning curve, to better position itself in the international scenario, defending its economical interests.

In conclusion, the litigation shown, with the imposition of measures that increased barriers for free trade by Brazil against China, and the consequent retaliation of the latter, only managed to increase the final industry price to secondary and final consumers. This consists of a real market distortion, in the pure sense of its concept, as both industries are close linked and interrelated. Criticisms put aside, the whole economical welfare is harmed by such lobbyist and politico-economical disputes.

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