



There are rumors that China's President Xi Jinping requested the BRICS (Brazil, Russia, India, China, South Africa) summit this year in Fortaleza, Brazil be held in July so he could attend the World Cup final. According to People's Daily, Xi was officially invited to join Brazilian President Dilma Rouseff for the championship match. This year also marks the fortieth anniversary of Brazil's diplomatic relations with the People's Republic of China. While most reports will be celebratory and focused on the benefits of China's demand for commodities, they are likely to leave out a growing sentiment that the Sino-Brazilian relationship is becoming a mixed bag for Brazil.

Between 2000 and 2008, a growing Chinese economy helped fuel a boom in Brazil's commodities, with exports to China rising eightfold. By 2009, China overtook the United States as Brazil's largest trading partner. That same year, China accounted for 12.5 percent of Brazil's total exports. During the financial crises of 2008-2009, Brazil's exports to China increased by 50 percent, which propped up its balance of payments and cemented Brazil's status as a net creditor.

Two thirds of Brazil's exports to China consist of soybeans (64 percent of the total in 2010) and iron ore, with crude petroleum accounting for another 10-12 percent. Iron ore mining and exports are highly concentrated in one company, Vale S.A. (the former CVRD), which has benefitted greatly from exports to China. In 2012, the state-owned petroleum company, Petrobras, eclipsed Vale S.A. as the country's largest commodity exporter shipping 150-200,000 barrels per day to China, in a credit deal worth \$10 billion negotiated in 2009. Raw material and agricultural producers have experienced a significant boon.

Despite the flow of iron ore, soybeans, meat, and other commodities to help feed the Chinese economy, the mood among some economic analysts today is that the strong Sino-Brazilian economic relationship is more of a mixed blessing for Brazil.

These analysts point to Brazil overwhelmingly exporting commodities to China, while imports from the PRC, now accounting for 15.6 percent of Brazil's total, consist almost entirely of manufactured goods, including electronics, machinery, vehicles as well as iron and steel products. This asymmetrical commercial relationship has generated concerns that it may lead to deindustrialization and entrench Brazil's position as a raw material supplier. The long-term concern is that under declining terms of trade a high rate of growth in primary products may prove insufficient as a catalyst for development.

In the last decade, the asymmetric trade relationship between China and Brazil has increasingly shifted in favor of exporting primary over manufactured products. In 2004, for example, 30 percent of Brazil's exports to China consisted of primary products and 55



percent of industrial goods. By 2013, however, the export of primary products had grown to 47 percent, while the percentage of industrial goods exported to China declined to 38 percent.

### **Rising protectionism**

The shift towards greater dependence on primary commodity exports has generated a rising tide of protectionist sentiment among some in Brazil's industrial sector. Brazilian manufacturers point to China's lower labor costs and standards, the existence of state-owned enterprises (SOEs), and subsidies to promote Chinese sales abroad. China's foreign exchange targeting to promote cheaper exports is also perceived as a growing threat by some Brazilian competitors. The perception is leading to punitive measures.

In a move many suggest was directed at Chinese automaker JAC Motors, Brazil slapped a 30 percent tariff on foreign-made automobiles in 2011. According to finance minister Guido Mantega, Brazil "cannot allow our car industry to be taken over by upstarts coming from outside." Brazil's established car manufacturers, including Fiat, Ford, General Motors, and Volkswagen, applauded the measure. Tariffs raised the price of a \$20,000 import to \$26,000 and a \$50,000 vehicle to \$65,000.

Also in 2011, the country's national development bank, BNDES, factored prominently in the removal of Vale S.A.'s boss Roger Agnelli. Agnelli was perceived to be focusing excessively on iron ore exports to China instead of promoting the development of steel manufacturing at home.

A different reaction from Brazil's private sector favors increased pressure on President Dilma Rousseff to pursue free trade agreements with the U.S., the E.U., and the emerging Pacific Alliance countries (Chile, Colombia, Mexico, and Peru). The strategy is to reduce dependence by diversifying exports, especially given China's economic slowdown, as well as securing a larger market for Brazil's higher value goods.

### **Weakened investments**

Perhaps protectionist sentiment would abate if China's investments in Brazil were promoting more industrial development and manufacturing capacity, but both total amounts and the types of investment are moving in other directions.

A study conducted by the China-Brazil Business Council (CBBC), a Rio de Janeiro-based



group, found that Chinese foreign direct investment (FDI) in Brazil had soared from \$95 million in 2009 to a whopping \$13.1 billion in 2010. Since then, though, Chinese FDI in Brazil fell to \$8 billion in 2011 and \$2.8 billion in the first six months of 2012. In the past five to six years while China has invested an estimated \$29 billion in Brazil, by contrast, the United States invested more than \$12 billion in 2012 alone

Since 2005, an estimated 85 percent of all Chinese investment has been concentrated on infrastructure, energy and mining. Meanwhile U.S. and E.U. investment is led by manufacturing, finance, and other higher-value sectors of the Brazilian economy.

The 2013 report also cites the predominance of Chinese investments “that impose new challenges to Brazil’s industrial sector. Chinese entrants compete head-on for the domestic market, combining locally produced and imported Chinese manufactured inputs, giving them a potentially low price advantage.”

Adding to a negative perception is Chinese investors’ insistence on using Chinese workers and equipment rather than native suppliers, while also rejecting competitive bidding on infrastructure projects. Financing from China Development Bank also serves to subsidize most Chinese overseas business development activities.

Of course, lower Chinese investment, like those from other countries, can also be attributed to Brazil’s high taxes, excessive regulations, and slow procedures that hamper all foreign investors.

Another factor in the public debate is the role played by China’s SOEs. For example, in a bid to secure continued soybean exports, Chinese SOEs offered to buy agricultural land. In August 2010, Luís Inácio Adams, Brazil’s attorney general, reinterpreted a 1971 law making it significantly harder for foreigners to buy Brazilian land. The SOEs raise concerns about foreign governments owning strategic resources such as land and minerals.

China and Brazil continue to enjoy a very close, mutually beneficial trading relationship, but as time and trade increase, the terms of trade and investment have become more complex and have given rise to actual or perceived challenges. The decline in commodity prices, the disappearing demand for the region’s exports, and the potential drying up of financing all present potential challenges in Sino-Brazilian economic relations. One key, and difficult, lesson to learn is that there are no shortcuts to eradicating poverty and achieving prosperity.

As Sino-Brazilian relations currently stand, President Xi will have more on his mind than a



## A Second Look at the China-Brazil Relationship

football game, but it might be a good time for his advisers to foster long-term economic terms that do not mirror the old dichotomy between a rich industrial power and a raw material supplier.