

## *Chapter Nine*

# **China and World Trade**

*Valdemar Carneiro Leão*

### **Opening words by Professor Renato Flôres**

This is a Joint Panel<sup>1</sup> with the Brazilian Centre for International Relations CEBRI, another think tank in the city of Rio. FGV believes in co-operation, we have a close relationship with CEBRI and invited them to share a panel with us.

Ambassador Valdemar Carneiro Leão is an outstanding diplomat, an expert on trade, and an expert on China, where he served as Brazilian Ambassador. We shall entertain -in an informal and provocative way- a conversation bringing to the meeting the theme “China”, and we shall end up with consequences (impacts/effects) of China in the Atlantic Basin.

### **The talk**

Thank you for your very kind words. I assume the invitation I received to take part in this panel has to do with my experience as Brazil’s ambassador to China until very recently. So, I suppose the contribution I can give to this debate is to present you with a different perspective, namely by introducing China as an intervening force in the Atlantic dynamics. When I refer to China, I’m not limiting myself to whatever influence China may have on Brazil, as China becomes the largest Brazilian trade partner, but also on Europe itself. In any case, these remarks are more of a provocation than anything close to a scholarly presentation.

I will try to put my thoughts together in a nutshell, by looking at three different aspects: first, China as a trader; second, China as an investor; third—and this is more controversial, China as a rule maker.

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1. The whole event is available at: <https://www.youtube.com/watch?v=yrrnUZST79I&feature=youtu.be>.

*China as a trader*

This is where everything began. You probably recall that as soon as China acceded to the WTO, in 2001, it embarked upon a process of reform, consisting of a profound transformation of its economy. To the external world the reform's most visible traits consisted of an expansion of China's trade relations. However, this process evolved in an unprecedented speed, until China, in a matter of less than two decades, became the world's largest exporter (3 or 4 years ago), and the second largest importer. It was a colossal jump. Suddenly, China could no longer be ignored in whatever international trade topic one would wish to address, either because the country was viewed as a threat, or because it had become an indispensable partner.

In the Atlantic space, China became the elephant in the room.

The case of Brazil is emblematic. Over the past 15 or 20 years, the Brazilian industrial sector went through a "shrinking" process and, today, it accounts for a mere 10% or 12% of the country's GDP. Of course, the loss of competitiveness is at the root of the phenomenon. But this phenomenon could not be fully understood should one fail to take into consideration the big inroads the Chinese industrial goods made in the Brazilian market. Either as a provider of parts and components at far more competitive prices than those produced locally or as supplier of finished products at unmatched prices. Conversely, almost simultaneously, Brazil rose to the position of the world's second exporter of farm products, after the US. And China is also behind this transformation (a positive one in this case), as Chinese demand for food and agricultural commodities used as industrial raw materials skyrocketed. The fact that China became Brazil largest trading partner is of no small significance. Should traditional trade links prevail, this position would be occupied by either the US or Europe, or even Mercosul.

But there is more to it than just China's primacy. China far outweighs its foreign competitors in the Brazilian foreign trade. The bilateral trade between Brazil and Asia (here taking Asia as a whole, though bearing in mind that China is by far the biggest player) is roughly the same as our trade with Europe and the US combined.

To sum up, Brazil is being pulled into Asian rather than into transatlantic trade routes.

*China as an investor*

Three years ago, China became a net overseas investor and it remains the second largest overseas investor in the world. These investments go to Europe, the US, Brazil, Australia, less to Africa, a lot to East Asia.

In Europe, China goes after high tech, brands and market access. In the US, real estate, entertainment, transportation, high tech but also through the purchase of stakes in financial services. In Brazil China comes for natural resources (oil and gas) and infrastructure (power generation and transmission, and ports).

Now, the question is: is Chinese investment in countries of the Atlantic basin contributing to an increase in output? And is it contributing to a more dynamic transatlantic trade? I submit that it's not. In the vast majority of cases, Chinese investments are not greenfield. In 2017 nearly 95% of Chinese investments in Europe were acquisitions, apparently with little effect on trade.

The objective of Chinese investments has to do with technology transfer and market access, neither with increase in production capacity nor with foreign trade.

My point here is that, while China has become a major source of FDI, its targets don't add much (indeed probably very little) to transatlantic trade. In other words, the shift to the Pacific basin finds no counterweight as China expands its economic might to the West.

*China as rule maker*

China is becoming a rule maker (in international trade or in international institutions). Let's focus on what is happening in the WTO. China is strongly attached to the WTO while the US (the Trump administration) doesn't seem to acknowledge its value, to put it mildly.

Now, take two possible scenarios:

i) In an extreme scenario, the US decides to leave the WTO. This would entail, at first, a chaotic situation, as all other countries would have to put something into place in order to organize international trade. In this case, China will take centre stage as the second world trading power and will strongly influence the establishment of a new set of rules that would conform better to its own interests.

ii) Second possibility, Trump decides to remain in the WTO but, then, only in a reformed WTO; a weaker WTO, with a less rule-based and more negotiation-based dispute resolution system, among other reformed features. In such a scenario, even considering all other countries would like to put up resistance, China would inevitably emerge as the strongest voice.

In both cases China is bound to be the key player in the shaping of any multilateral trade framework succeeding the WTO current rules. These were made essentially by Atlantic powers (Japan was always a player of little weight in the GATT/WTO treaty negotiations) for use by Atlantic powers. A future set of rules—if it materializes—will bear China’s fingerprint and the Pacific basin trade will probably be the reality that those new rules will aim to regulate.

Countries around the Atlantic Basin will have to learn how best to cope with this giant that is pulling trade and investments to Eurasia and East-Asia rather than to the Atlantic. And that will gradually make international rules reflect its core interests.

Thank you.

## The debate

**Professor Renato Flôres:** I fully agree that the WTO is a very serious issue, I myself don’t see the US quitting the organization (it would be a catastrophe!). Let’s assume that this scenario doesn’t take place. But your last scenario is rather feasible. There is a movement, not by all, but by some members, to progressively weaken the WTO. It will provoke a reaction from China, and at the same time, US will put barriers to Chinese investment. China will fight the US within the WTO. A kind of fight will start within the WTO, specially within the Atlantic Basin. So, there are two very serious points of attrition.

How would you see this in terms of the future, if this were the scenario? So, there are internal disputes in the WTO, which eventually be damaging anyway, and suddenly, Trump becomes more aggressive with the Chinese presence in the Atlantic. What are your views about this?

Second, it’s very understandable why China became so important from trader to rule maker, if you look at the evolution of international trade. Since 2012, it has been decreasing, for many reasons: international deflation after 2008/ 2009 crisis, volatile growth in the US, problems in the Ar-

izona, and so forth. Anyhow, the main cause is the decrease of the Chinese trade.

China is growing at 8% or less. My guess is that they will stabilize around 6% to 8% in terms of GDP growth. This represents a fall in the international trade. With the decrease of China as a trader, in the other hand, they will lose power, dependency of China will decrease, and exporters will be obliged to diversify, in terms of partners.

So, there are two different moves here, one movement of conflict at the WTO, here in the origin, and another of decreasing importance of China, as a trader. And a China that will be needing ever more expertise, as for instance, for creating China brands. Could you exploit a bit this scenario?

**Ambassador Carneiro Leão:** First of all, I don't necessarily dismiss the possibility that Trump decides to leave the WTO. First because Trump is a very unrepressed man, extremely ignorant of world affairs but convinced he can always win because of his wit and his power. His vision of the world is aligned with the US strategic interests in a very narrow and short-sighted way.

As to China fighting the US within the WTO, my view is that it will do it all the time., particularly when the US decides to act unilaterally. China will try to show the world that it abides the rules, that the US are the one that is trying to destroy the multilateral trading system. "The emerging power likes the rules"—that's the image that China likes to show.

China has a number of tools it can use to cause some damage to US trade interests, basically in agriculture and in aerospace sales. China can use those weapons without infringing the rules; China's state owned enterprises can simply cancel contracts.

On the decline of China, I agree with you in that China will probably stabilize around 6.5 percent or 7 percent growth rate. It will be unsustainable to go on and on and, as a result, trade will come down. But still, China will continue to be the largest exporter, and the second largest importer, at least. Its importance in trade will continue to be extremely significant, regardless of what it might lose in terms of trade growth rate.

Besides, at the same time, China is increasing investments, offering credit, creating international financial institutions, so its expanding its influence in different fields that will more than compensate possible loss in trade.

**Professor Flôres:** Just two things, first I'm obliged to come back to Trump, the US is in decline, it's not something that Trump invented. It's a very slow and continuous decline, and it has effects. At the same time, China is becoming more dependent of the world. Particularly as they want to show themselves as a fair rule maker. These two effects imply that it's not in the interest of any partner to create a great damage to the relationship; in the end, there must be a kind of balance. Neither China, nor the US will have an interest to pursue further drastic measures. Maybe, this can create opportunities in this area. In the end, we will live a funny equilibrium, a kind of balance, that will both manage the US decline and the US and the rise of the China dependence.

**Ambassador Carneiro Leão:** The US is so far ahead, particularly in technology and financial power; it will take a long time to happen.

**Answer by the Ambassador to questions from the audience:** Brazil doesn't see China as an economic rival. Among East and Southeast Asia countries, China dependency is a reality, but, apart from North Korea, no one looks at China as a model to be followed.

As far as the EU is concerned, what I saw in Beijing was an European complaint that China would always try to divide member countries, while the EU delegation did what it could to avoid this kind of game. But the reality is that China has a number of bilateral commissions with different European countries (Germany being by far the most important).

In the energy sector, I have no doubt that China will increase its efforts to get away from coal and to develop advanced energy technology in different directions. I am not familiar with this topic, but I believe that, among renewables, solar is where they have made more progress. They are now the largest producers of solar panels. They have already an overcapacity. In nuclear, they continue to build reactors at an amazing pace. China needs all the energy it can get: the demand is huge.