

Implications of a Changing China for Brazil: A New Window of Opportunity?

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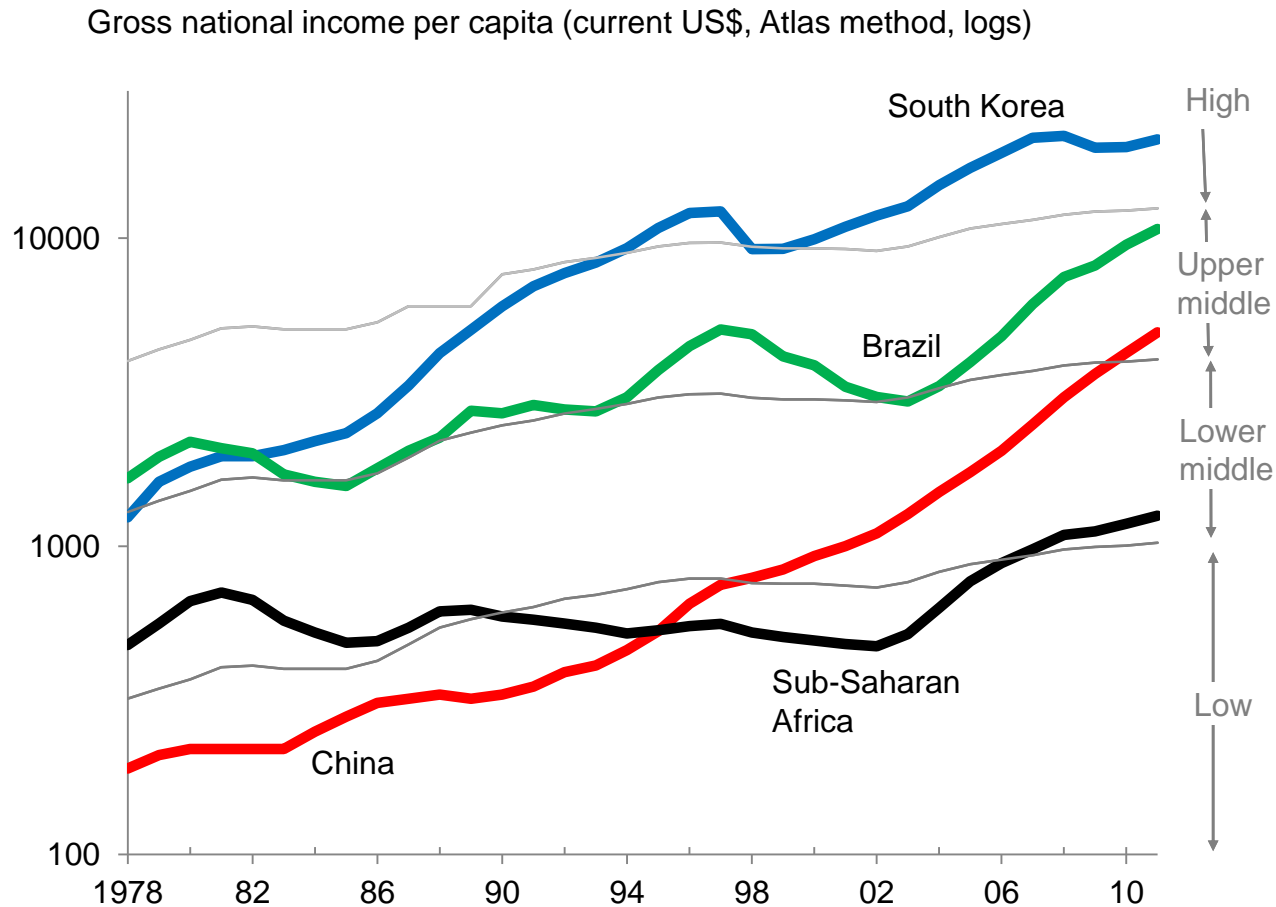
Motivation

- Key questions
 - Where is the Chinese economy heading to over the longer term?
 - What does transformation in China mean for Brazil?
 - Is there scope for Brazil to expand its connections with China?
 - How can Brazil leverage on these connections to boost growth?
- Relevance of China for Brazil?
 - Considerable relevance, yet internal growth engine is key
 - Significant concern about potential impact of changes in China
 - Brazil-China relations put into sharper perspective basic questions about Brazil's broader development agenda



Where is the Chinese economy heading to over the longer term?

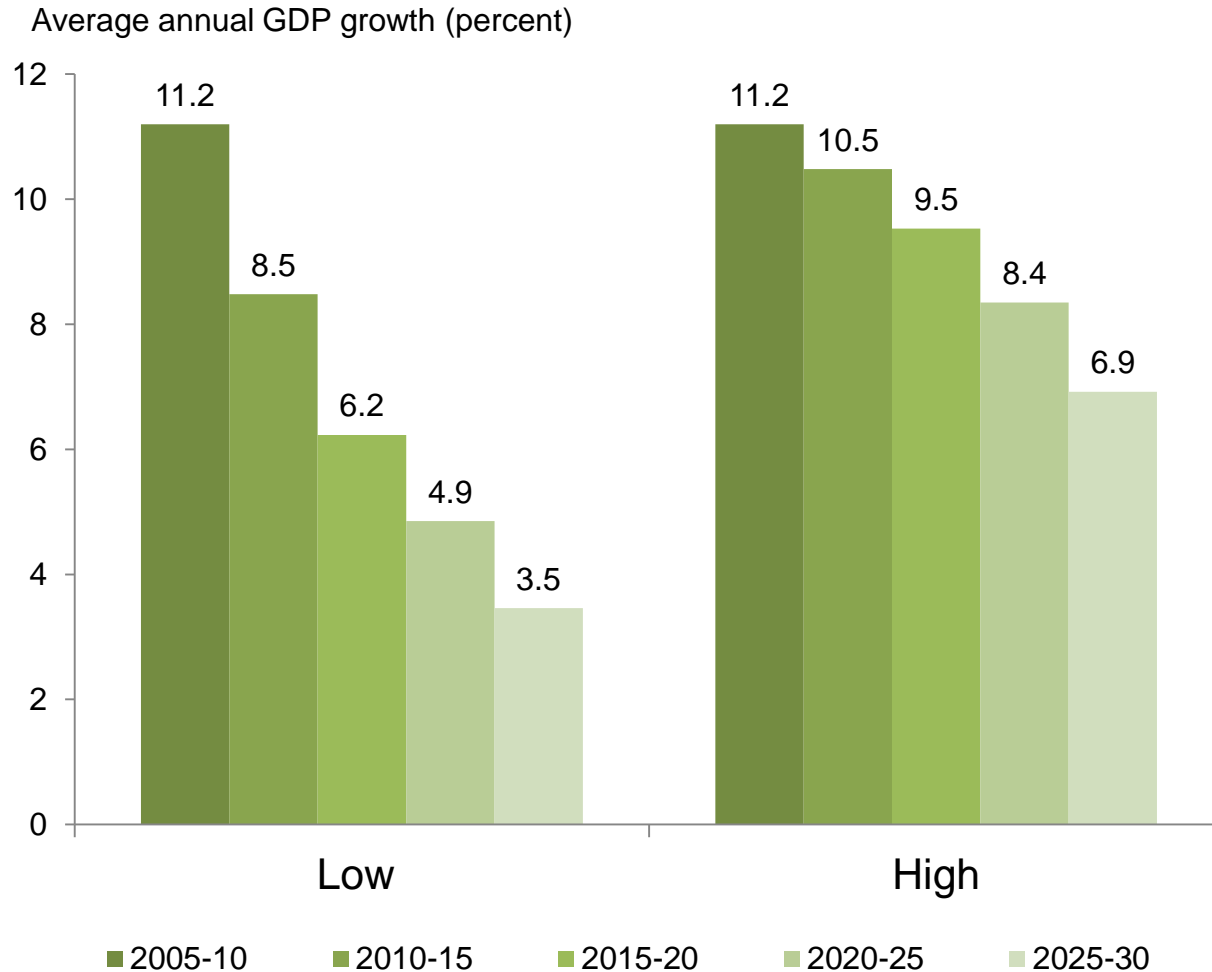
Over the last three decades, China has registered rapid economic growth and structural change



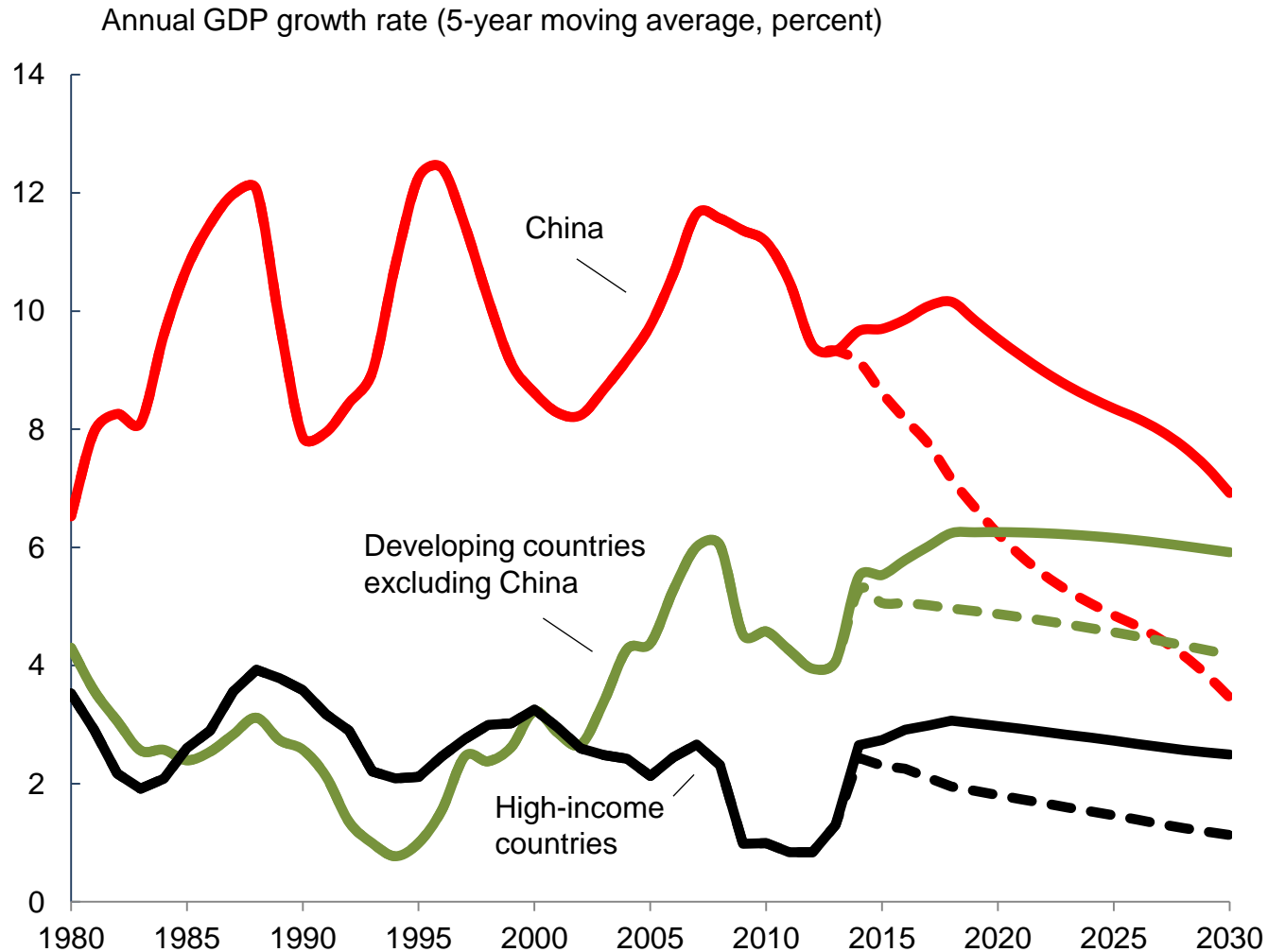
Looking into the next two decades, the continuation of past trends unlikely

- Can past trends continue?
 - Global environment likely supportive but new challenges
 - China's internal growth dynamics will change
 - Policy adjustments needed to avert pressure points
- Key transformations
 - Structural slowdown
 - Rebalancing of patterns of growth
 - Move up the value chain
- Illustrative scenarios (*China 2030*)
 - Global CGE model
 - High and low growth scenarios

(a) Traditional growth drivers are expected to weaken, lowering growth by 4-7 percentage points

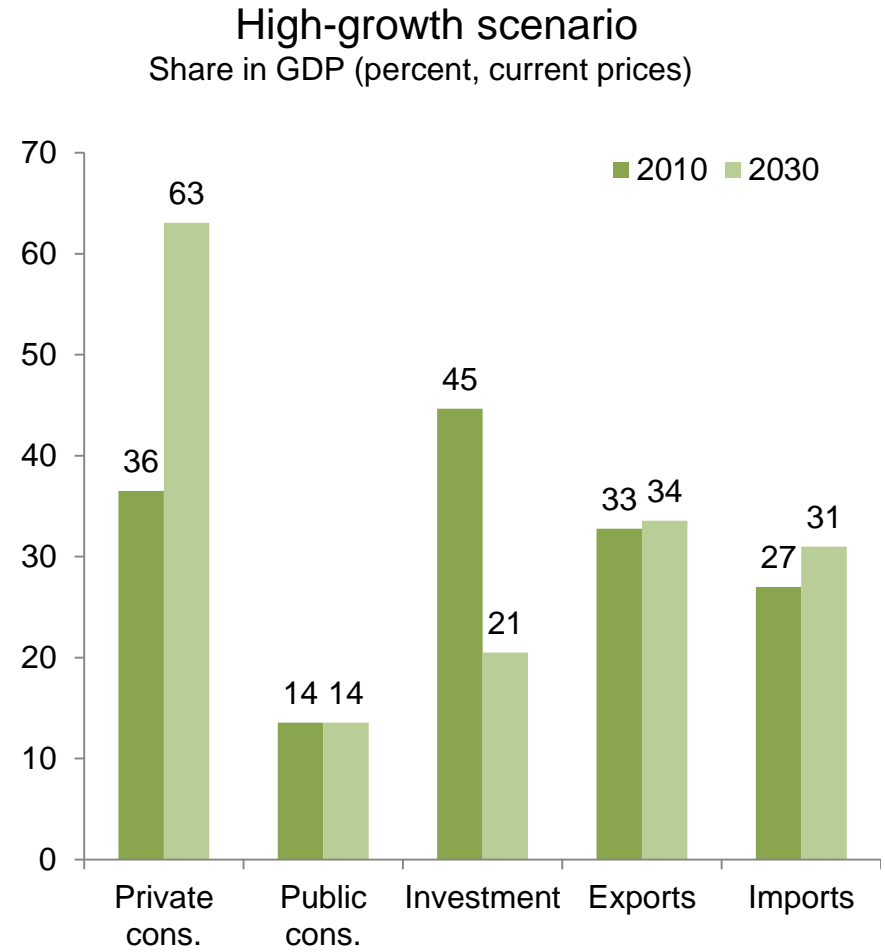
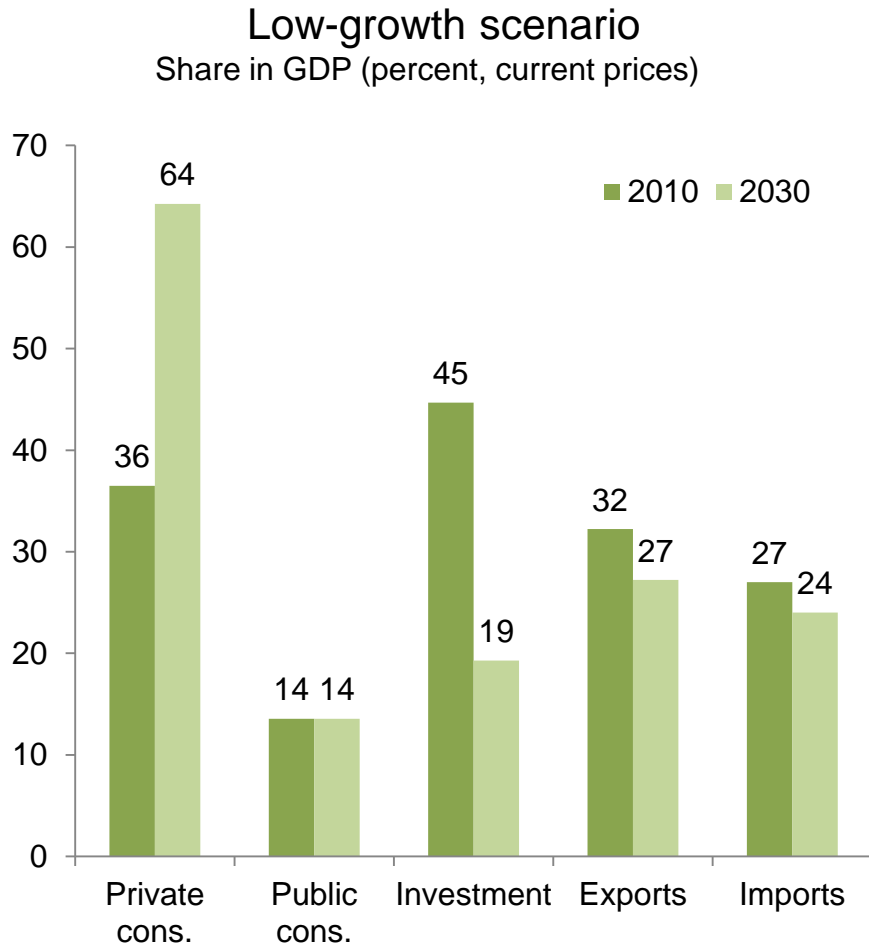


Despite this slowdown, growth would remain high relative to other countries



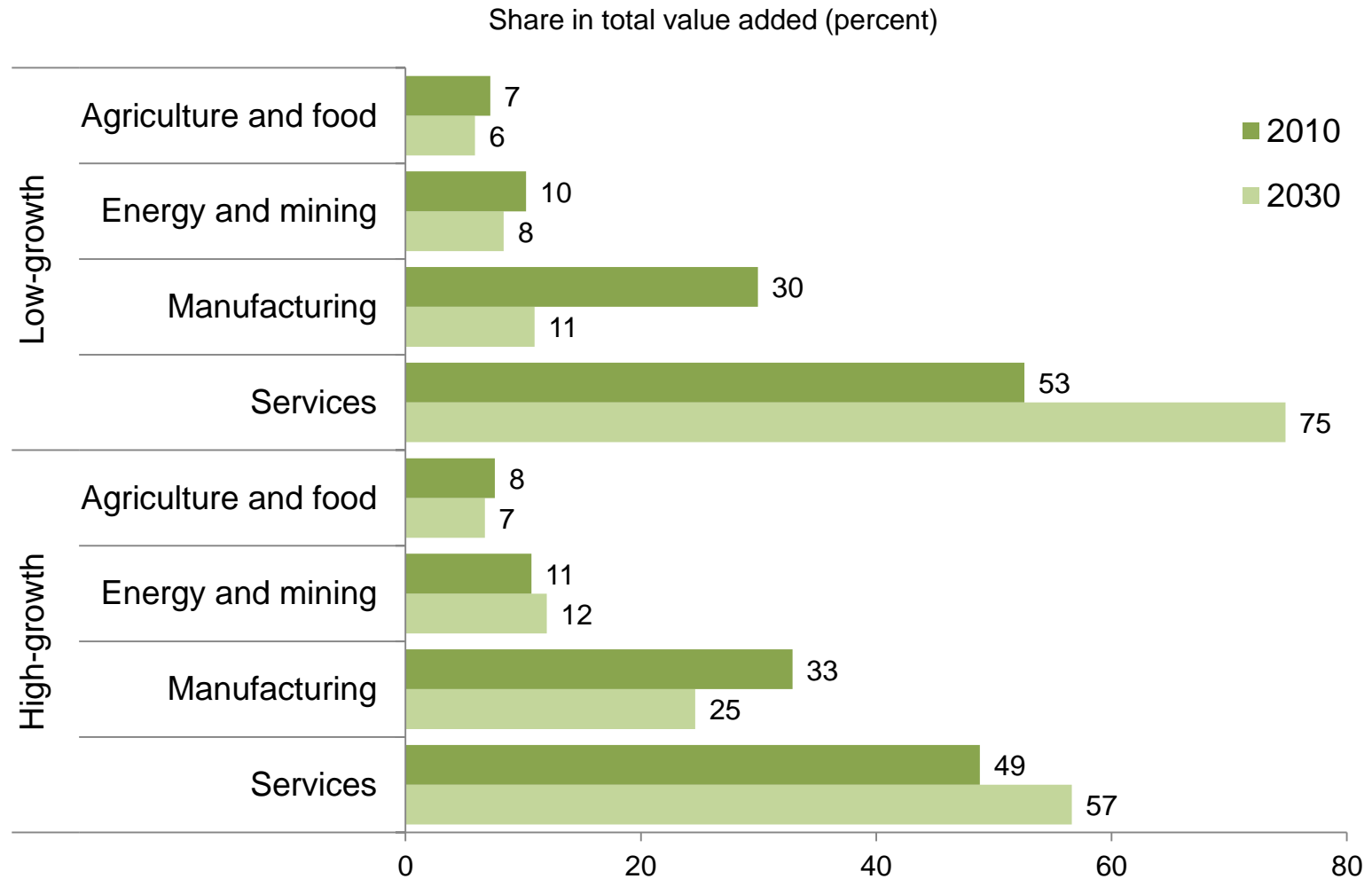
Source: World Bank and Development Research Center of the State Council 2013; World Bank staff projections.
Note: Solid and dotted lines reflect high- and low-growth scenarios simulated with Envisage.

(b) Imbalances are gradually addressed, altering growth patterns, social and environmental outcomes



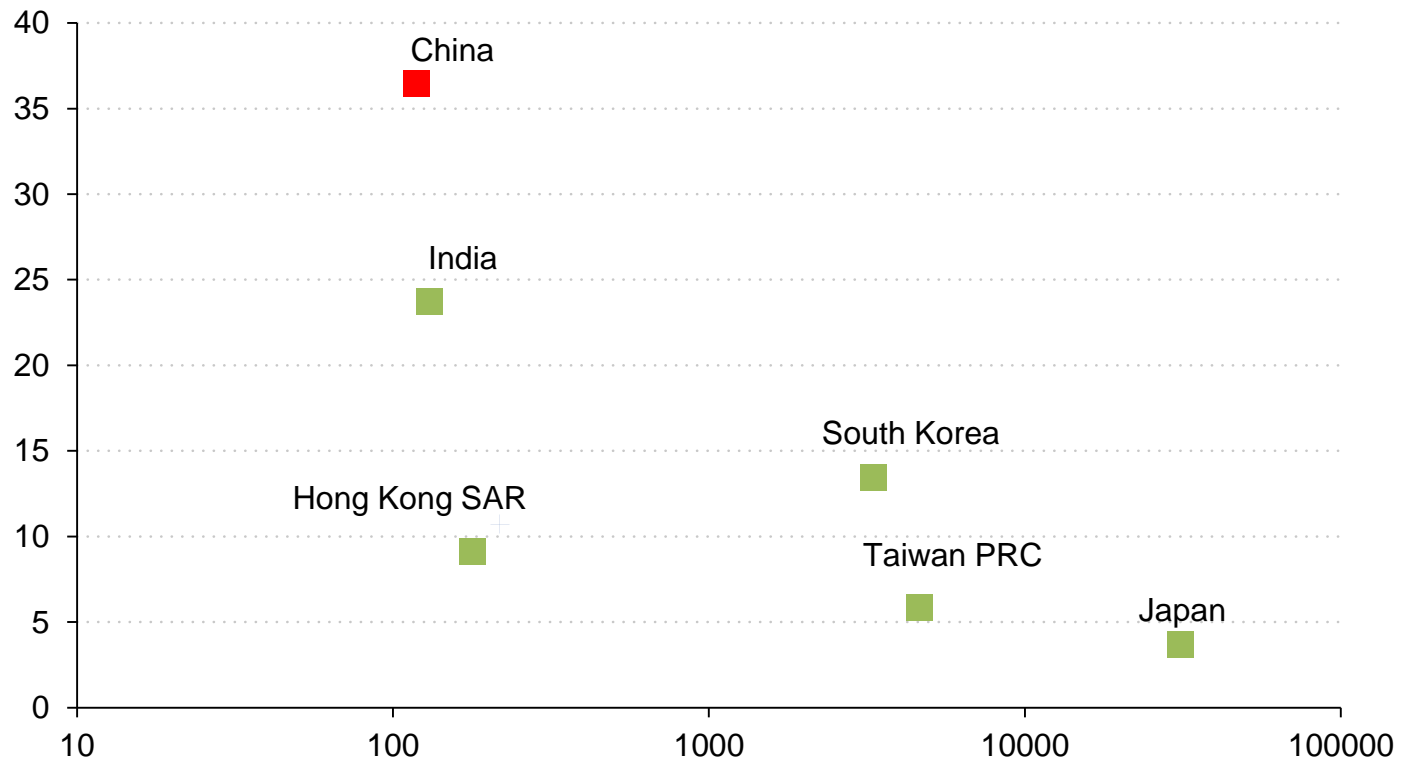
Source: World Bank staff simulations. Note: Actuals for 2005-2010. All other values simulated with Envisage.

A key feature of rebalancing is the orientation of the Chinese economy towards services



(c) To reinvigorate growth, China is expected to steer its economy further up the value chain

Growth in USPTO utility patents granted, 2000-10, average annual growth in percent



Number of USPTO utility patents granted, 2000, log scale

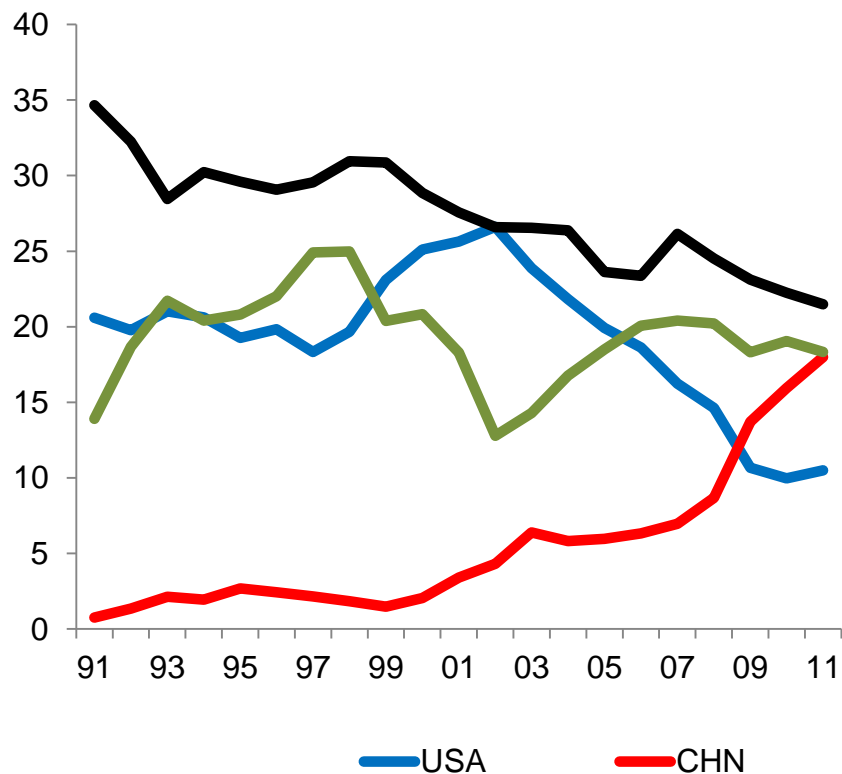


**What does transformation in China
mean for Brazil?**

The importance of China in Brazil's trade accounts has grown both directly and indirectly

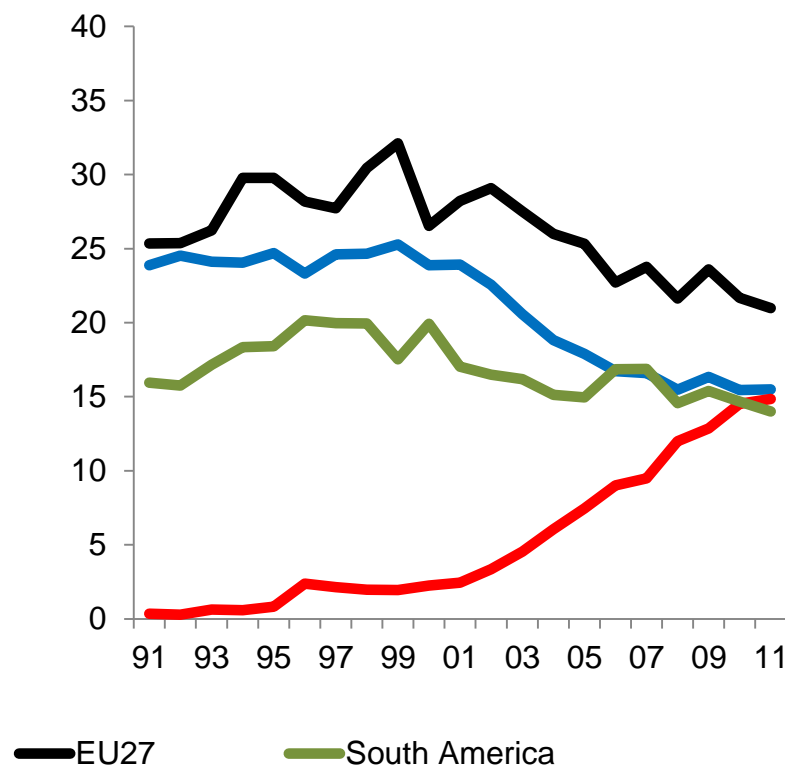
Export destinations

Share in total exports (percent)

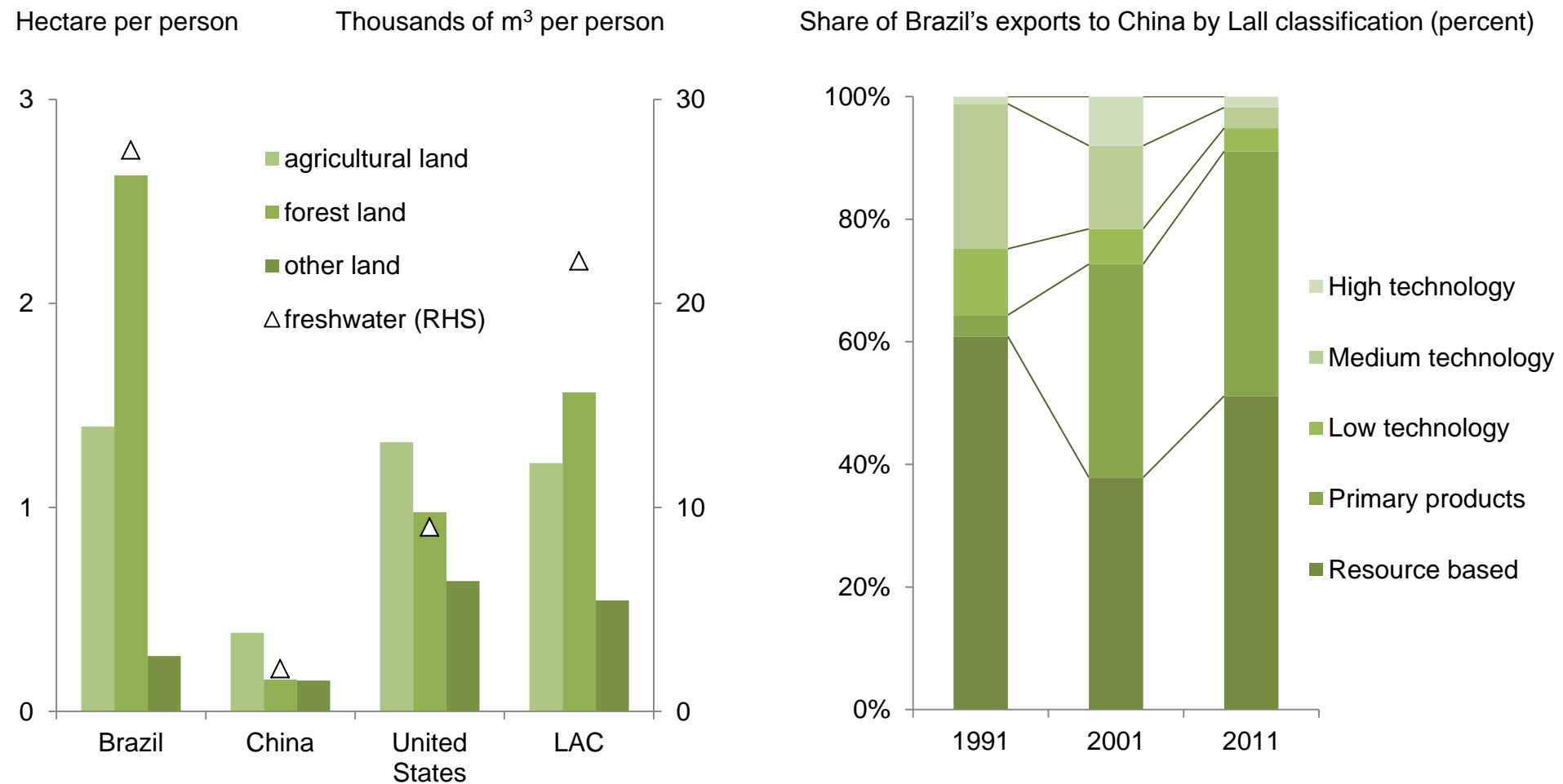


Import sources

Share in total imports (percent)



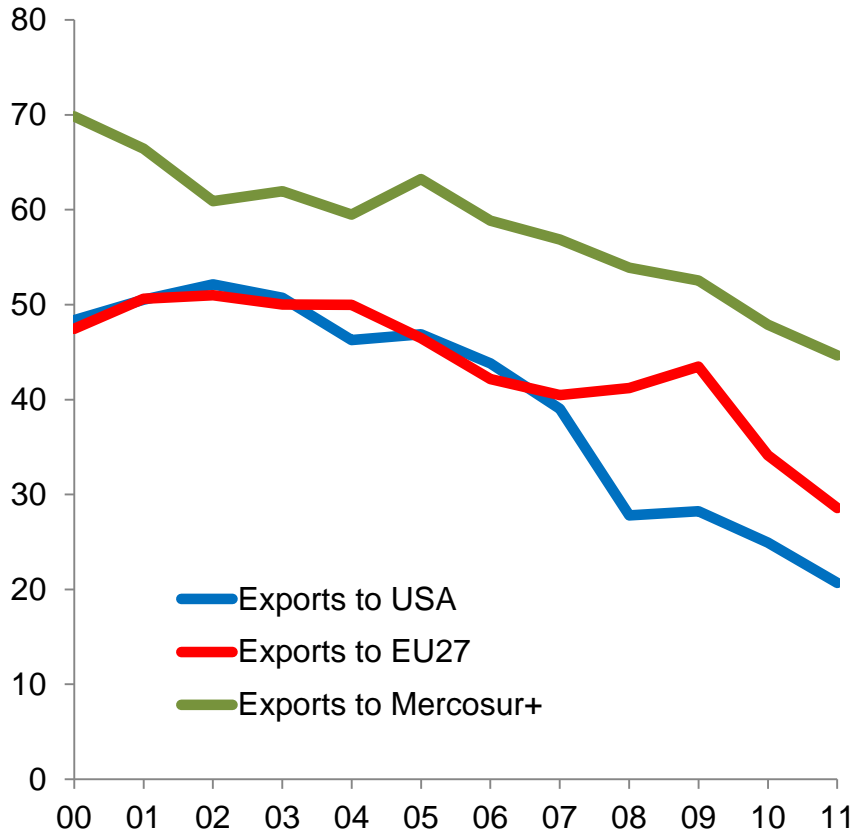
The Brazil-China relationship is characterized by complementarity...



... and competition

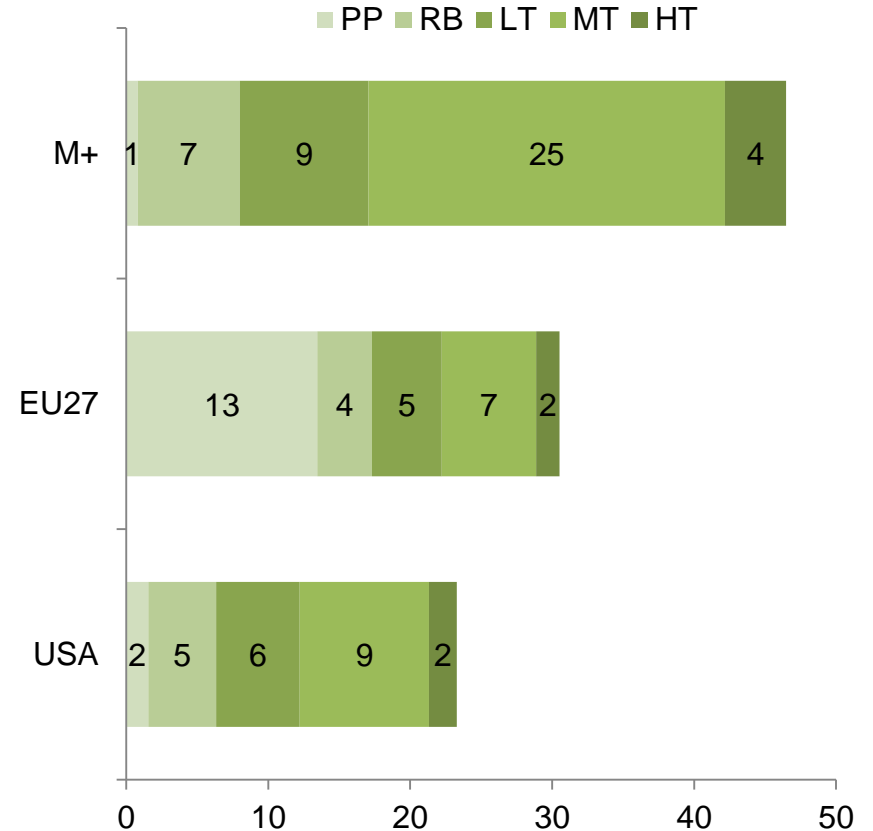
Evolution of competitive pressure

Share of Brazil's exports under competitive pressure from China 2000-2011, by market (percent)



Decomposition of competitive pressure

Share of Brazil's exports under competitive pressure from China in 2011, by market and Lall classification (percent)



How would ties between both countries be affected given China's transformations?

- Two concerns
 - The slowdown and rebalancing of the Chinese economy could reduce the growth of the demand for natural resources
 - The increasing sophistication of Chinese exports could unleash a fresh wave of competition towards manufacturing
- This report argues
 - The structural transformations in China do not necessarily represent a threat for Brazil
 - To the contrary, Brazil could gain considerably from China's changes, particularly over the longer term

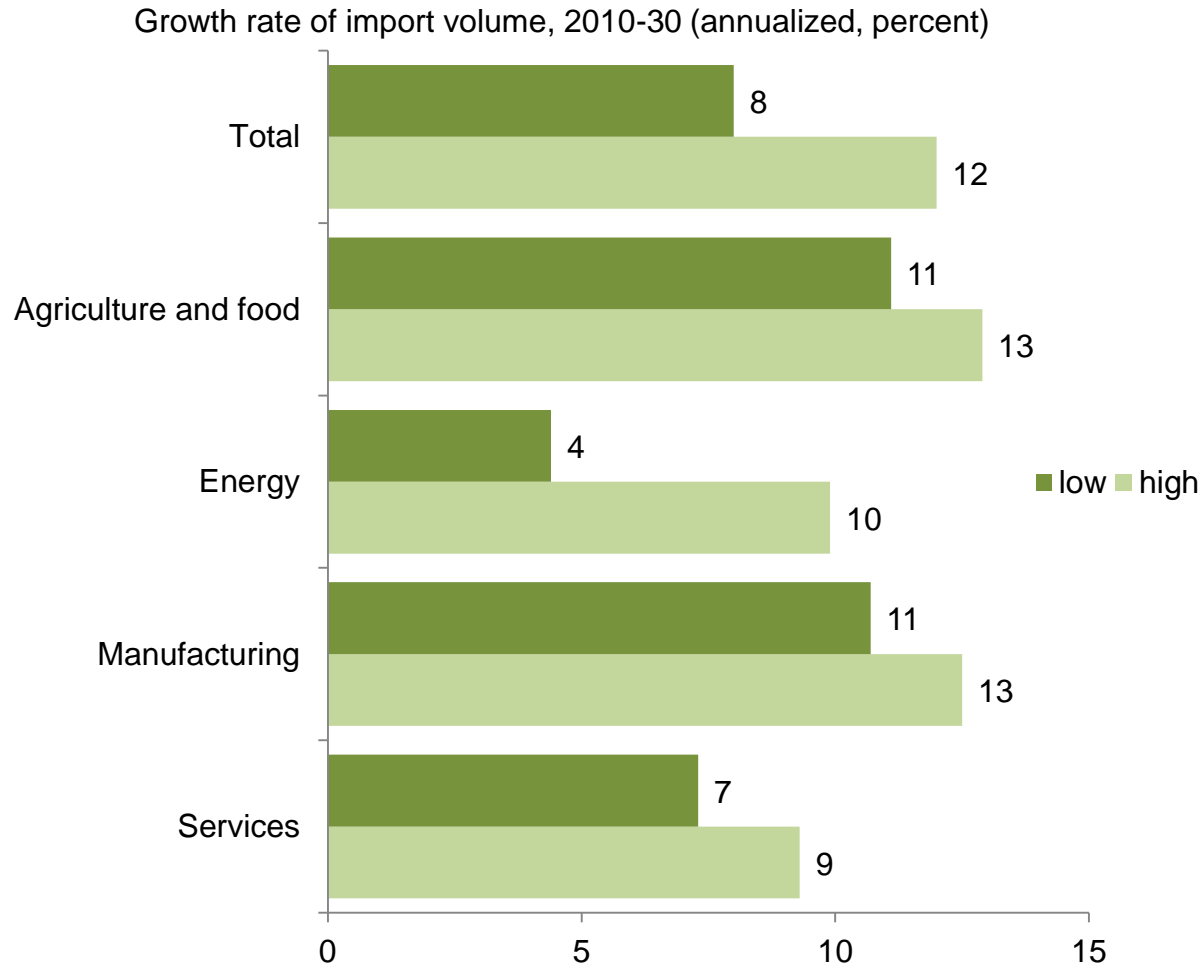
Brazil will likely be among the countries that would benefit most from future Chinese imports

Growth rate of China's import value, 2010-30, by geographical source (annualized, percent)

	Low-growth scenario	High-growth scenario
World	6.2	8.7
High-income countries	5.9	8.1
United States	8.0	12.9
EU27 & EFTA	7.5	8.0
Japan	2.2	4.4
Rest of high-income	5.0	6.6
Developing countries	7.0	10.0
Latin America excluding Brazil	6.2	9.8
Brazil	8.0	12.0
East Asia	6.9	10.0
South Asia, excl India	7.7	10.2
India	7.5	10.0
Europe & Central Asia, ex Russia	5.8	9.3
Russia	3.1	6.1
Middle East & North Africa	6.9	9.6
Sub-Saharan Africa	9.8	12.5



New opportunities are expected to arise for all sectors of the Brazilian economy...



... but competitive pressure is expected to change

- New competitive pressures are likely to emerge with respect to the manufacturing industry
 - A fresh wave of competitive pressure is expected for products that are technologically sophisticated or intensive in human capital
 - At the same time, new opportunities are expected to emerge given the continued expansion of China's internal market



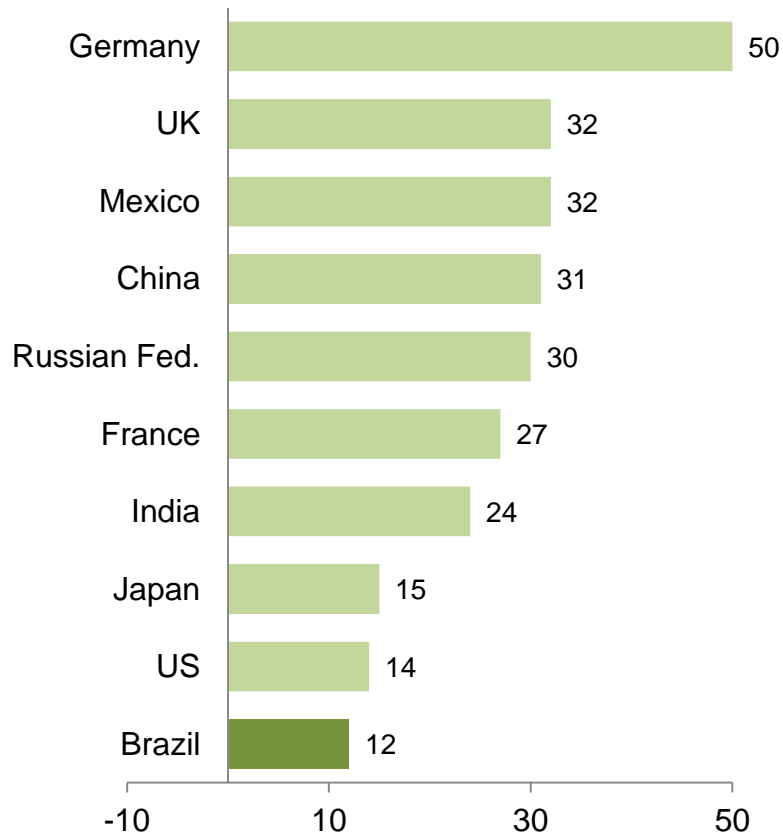
Is there scope for Brazil to expand its connections with China?

Three potential concerns

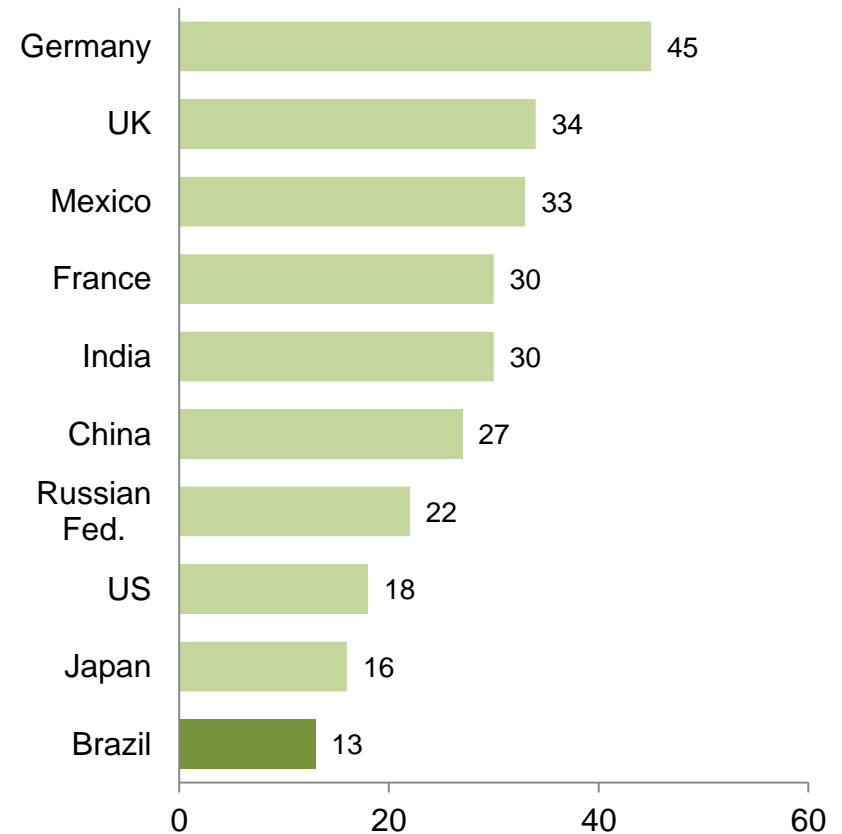
- New opportunities may emerge for Brazil to broaden and deepen its connections with China
- Yet, concerns have emerged about extent and nature of dependence of Brazil's economy on Chinese demand
- The question arises what scope remains for Brazil to leverage on the evolving connections with China
 - Have growing connections with China made Brazil's economic structure too outward oriented?
 - Has the trade with China made Brazil's trade structure too concentrated either in terms of markets or products?
 - Does the commodity orientation of trade with China reflect negatively on future opportunities for growth?

(a) External trade orientation remains low, even among large economies, as reflected in trade shares

Share of exports in GDP, in 2011 (percent)



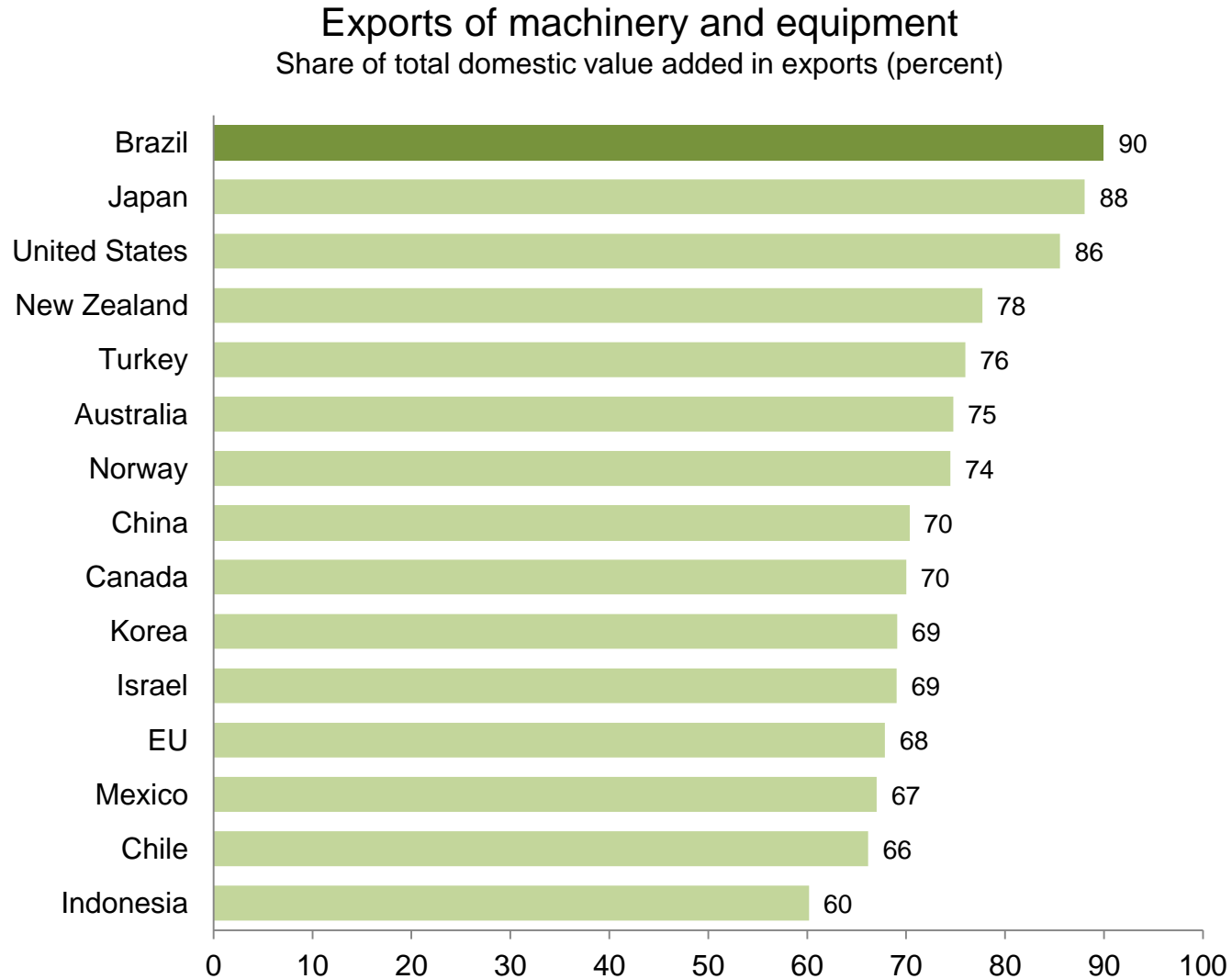
Share of imports in GDP, in 2011 (percent)



Source: WDI; World Bank staff calculations.

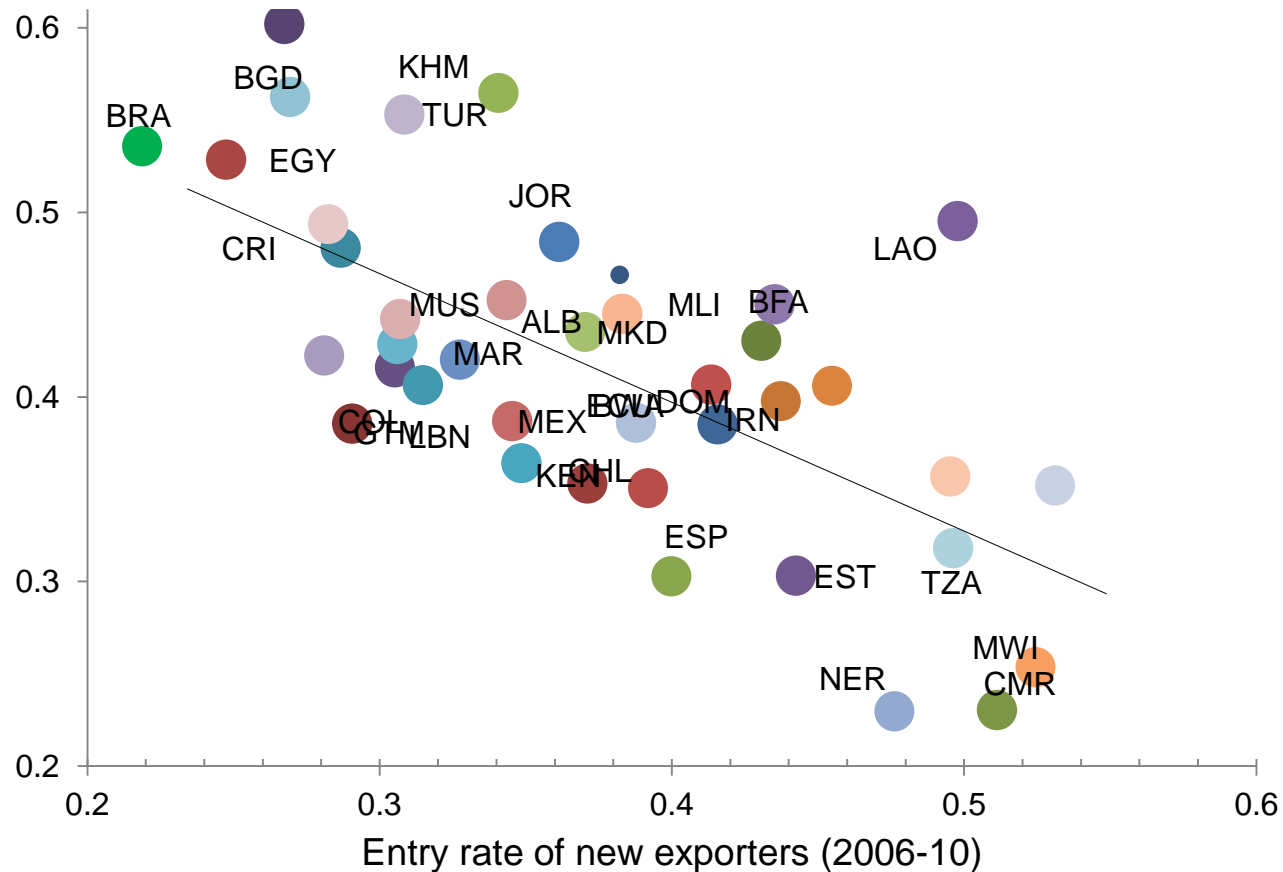
Note: Largest 10 economies were chosen in terms of 2011 GDP (PPP-adjusted current international dollars).

Participation in global production networks is relatively low, as reflected in value added shares



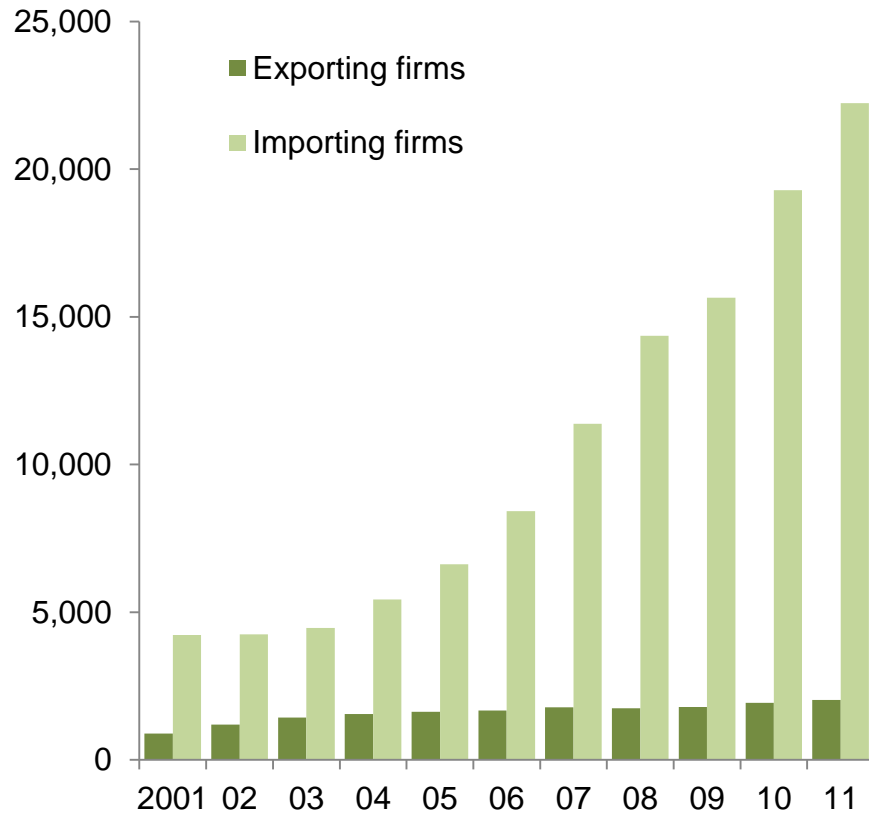
Firm-level participation in export activities is low, with low entry rates and high survival rates

Survival rate (2006-10)

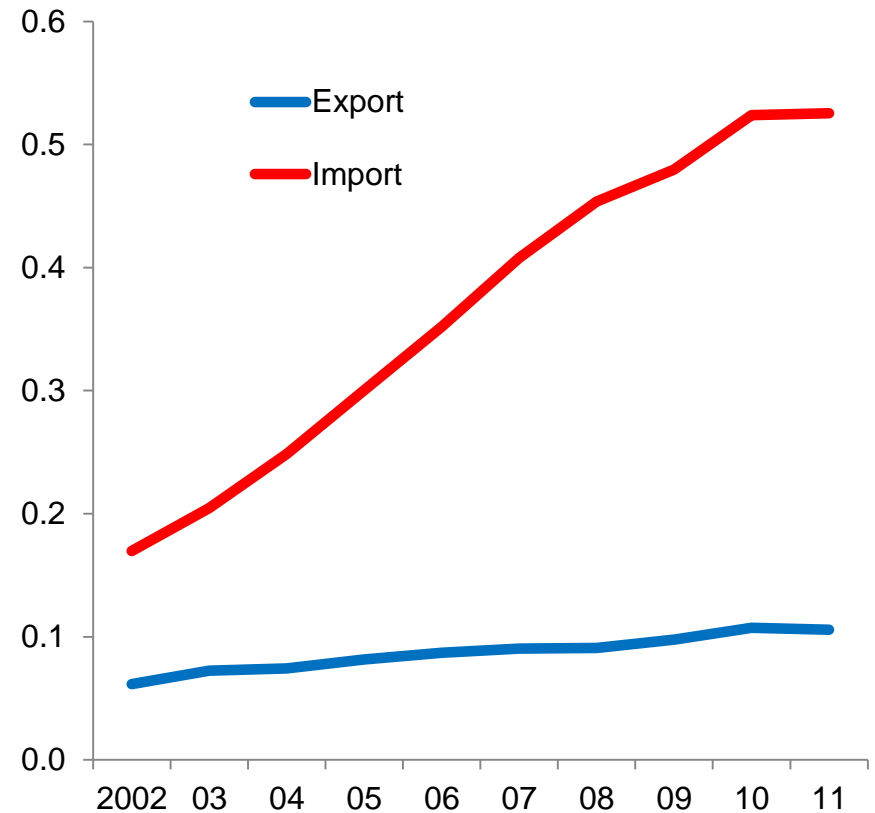


Firm-level participation in trade with China is much more pronounced on the import than export side

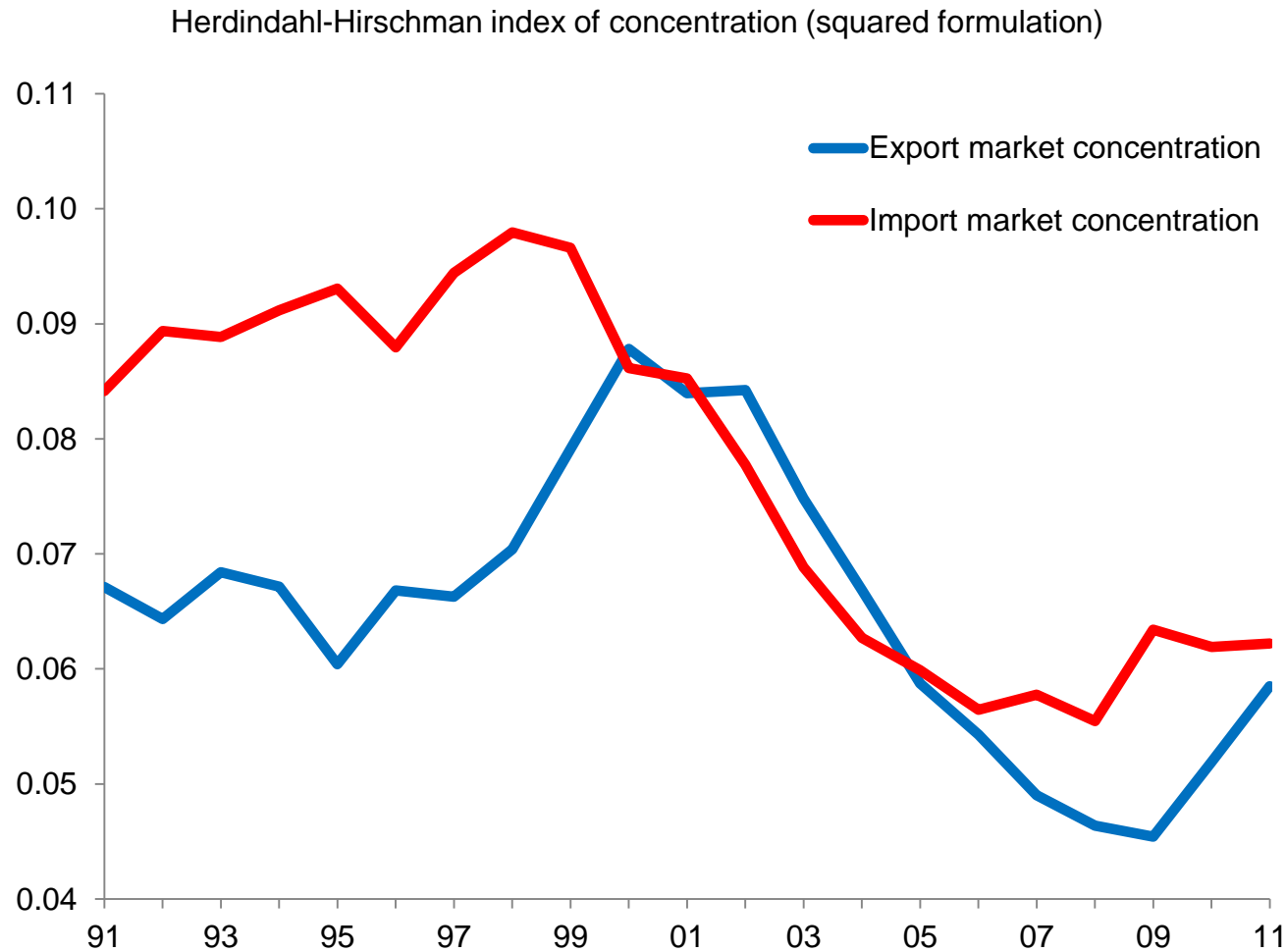
Number of Brazilian firms trading with China



Share of Brazilian firms trading with China

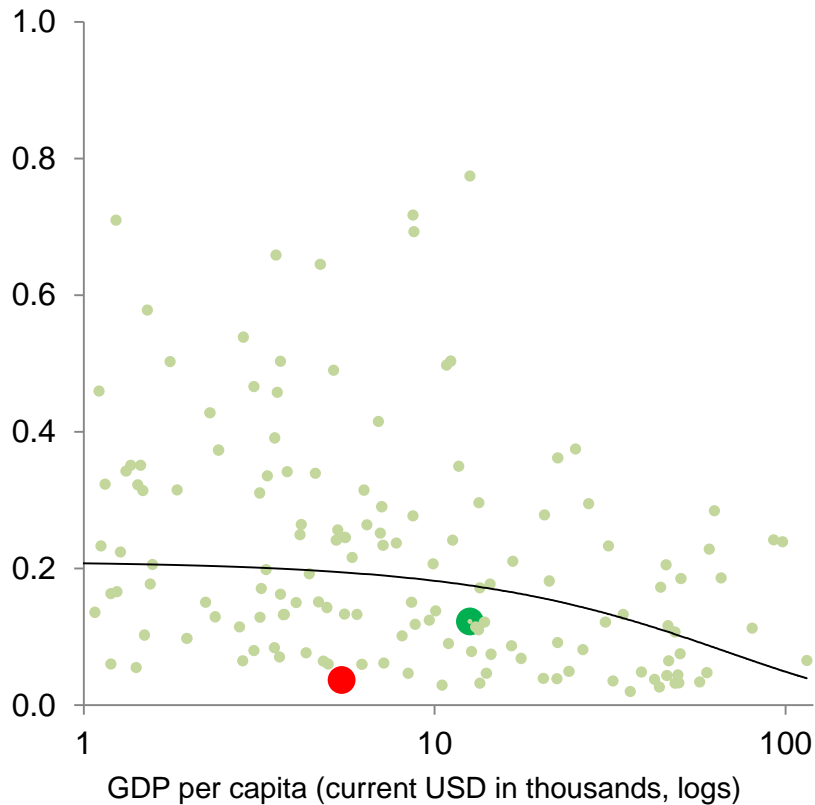


(b) Rising trade with China has made Brazil more market-diversified on both export and import side

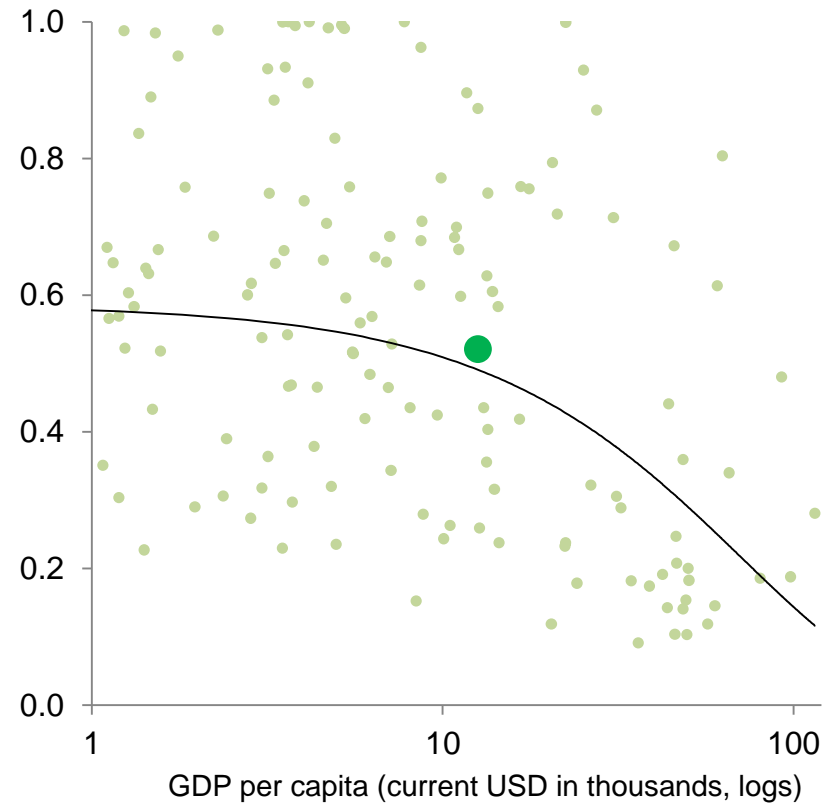


Brazil's product diversification is strong, except for exports to China (as is the case for most countries)

Product concentration of exports to anywhere
Herfindahl-Hirschman, 2011 (square root formulation)

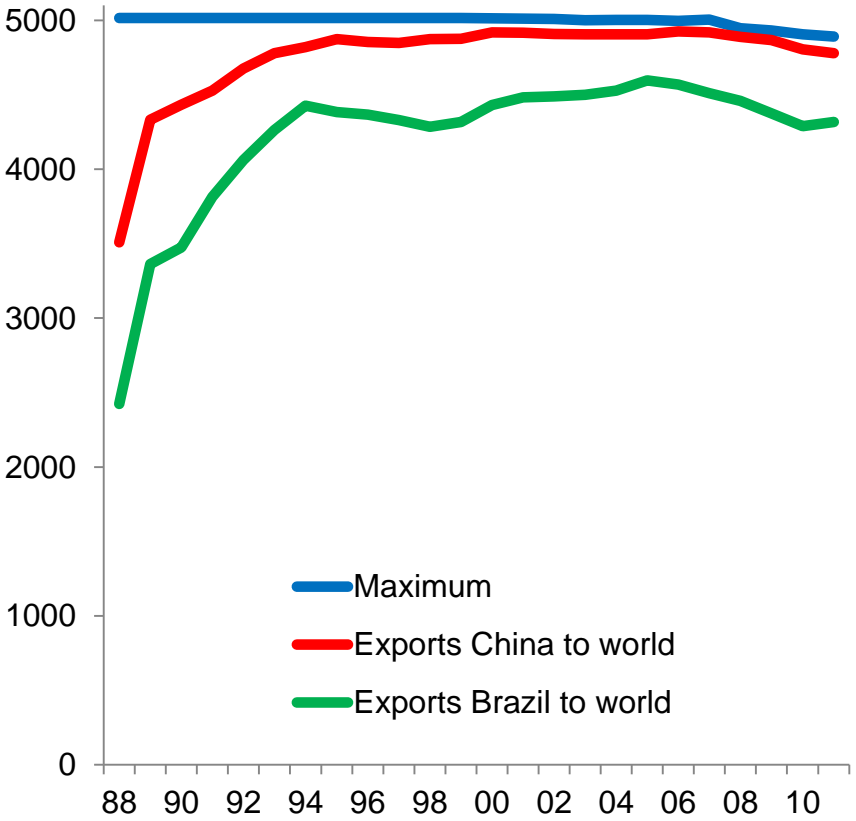


Product concentration of exports to China
Herfindahl-Hirschman, 2011 (square root formulation)

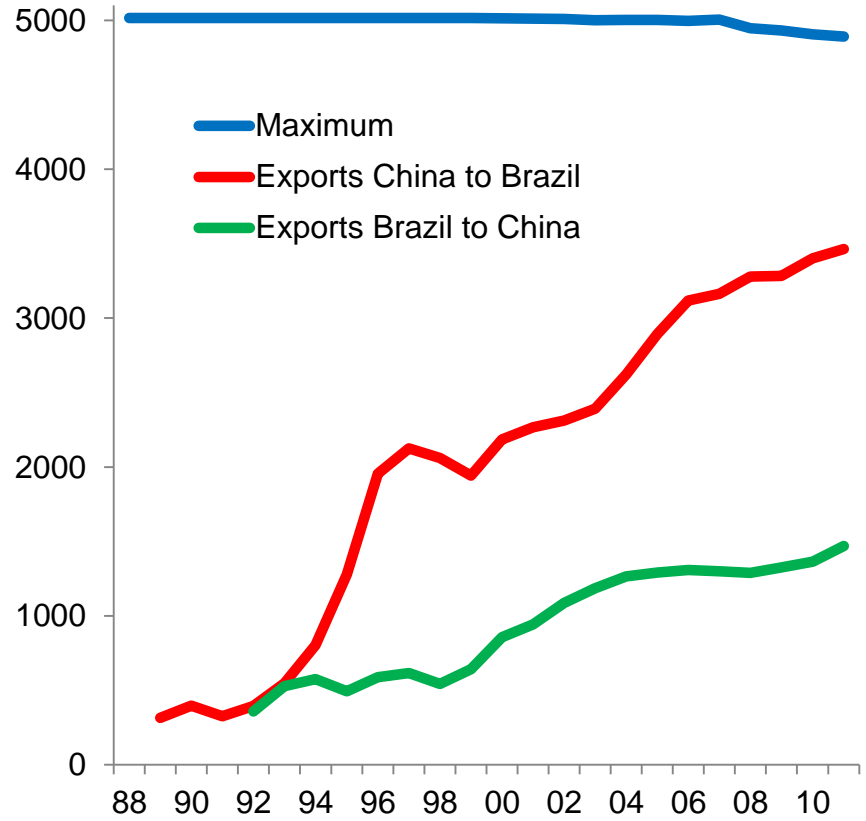


With the world, Brazil and China trade a wide range of products; between them, there is an asymmetry

Variety of products exported to the world
Number of products traded at 6-digit HS level

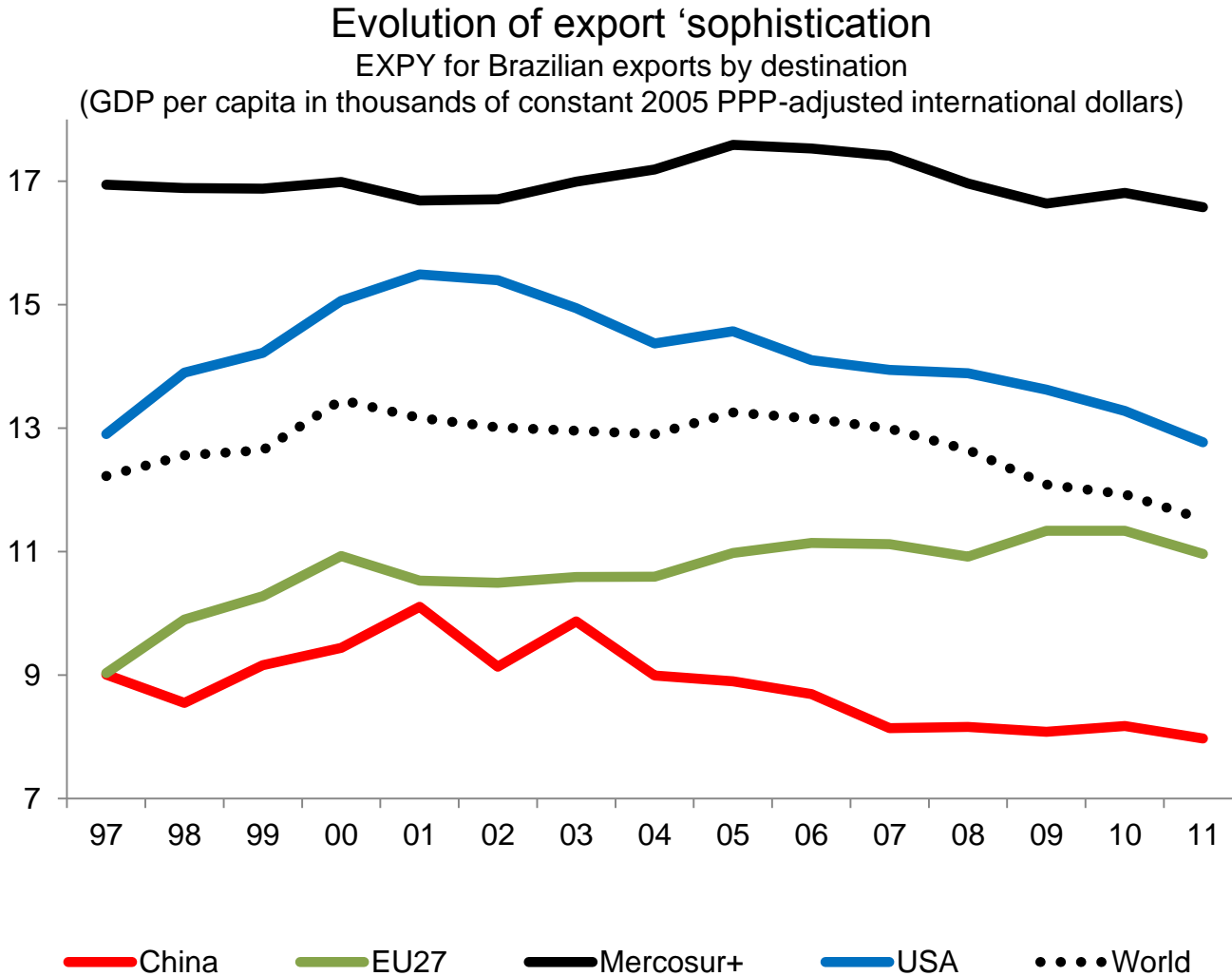


Variety of exports exported to each other
Number of products traded at 6-digit HS level



Source: UN Comtrade; World Bank staff calculations.

(c) The 'sophistication' (or export similarity to rich countries) of Brazilian trade has declined....



... but declining 'sophistication' need not be negative and is secondary to the pursuit of productivity growth

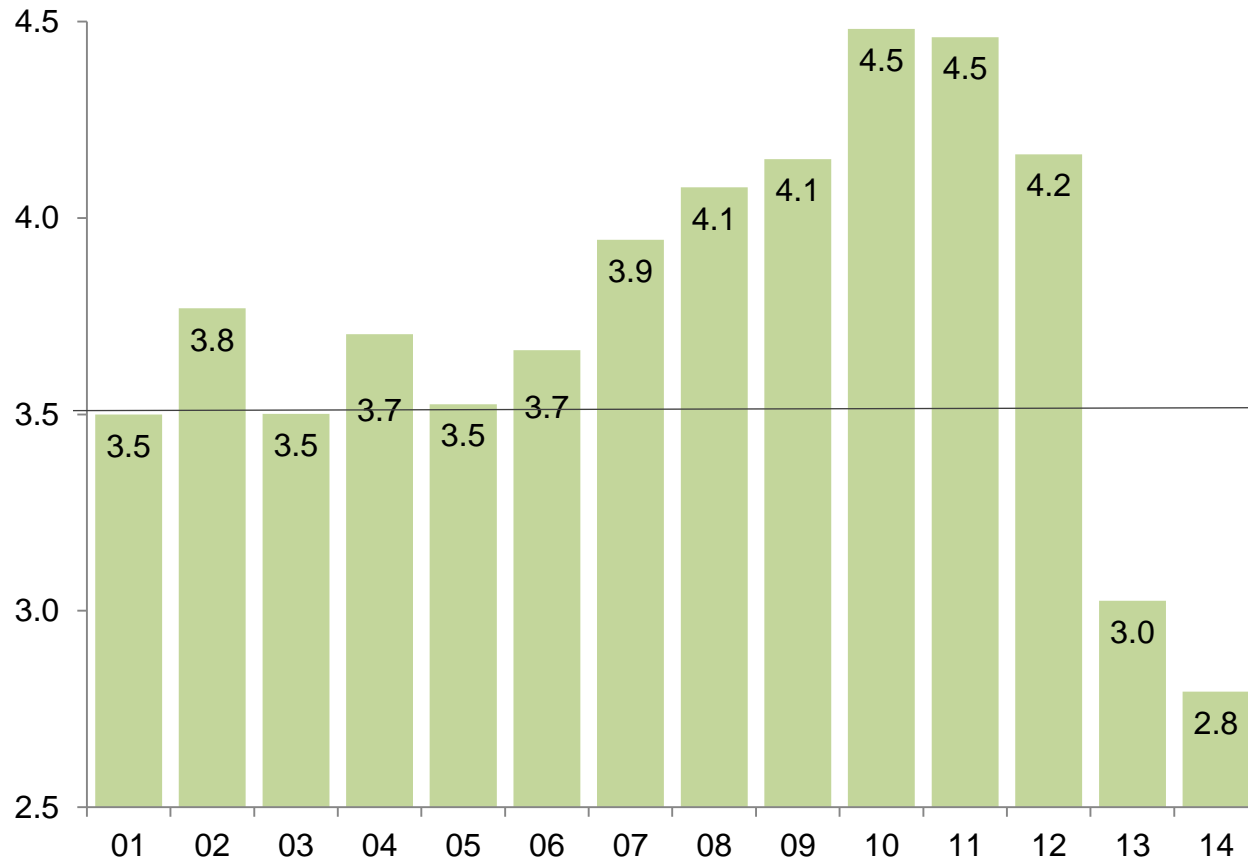
- Declining 'sophistication' (or bearing less resemblance to rich-country export baskets) need not be negative
 - The exports of Brazilian commodities are not 'unsophisticated', technologically
 - Moreover, Brazil's comparative advantages in the natural resource sector have been well established
- What matters more for development than 'sophistication' is the capacity to generate value added and sustain its growth
 - Brazil's strong commodity base does not imply it cannot or should not develop a competitive edge in other sectors
 - From a supply-side perspective, opportunities exist to enhance productivity growth in all sectors of Brazil's economy



How can Brazil leverage on its connections with China to boost growth?

Growth expectations have diminished considerably in recent years

Diminishing growth expectations
Evolution of growth forecasts for two years later
(daily median GDP forecast averaged over the year, percent)



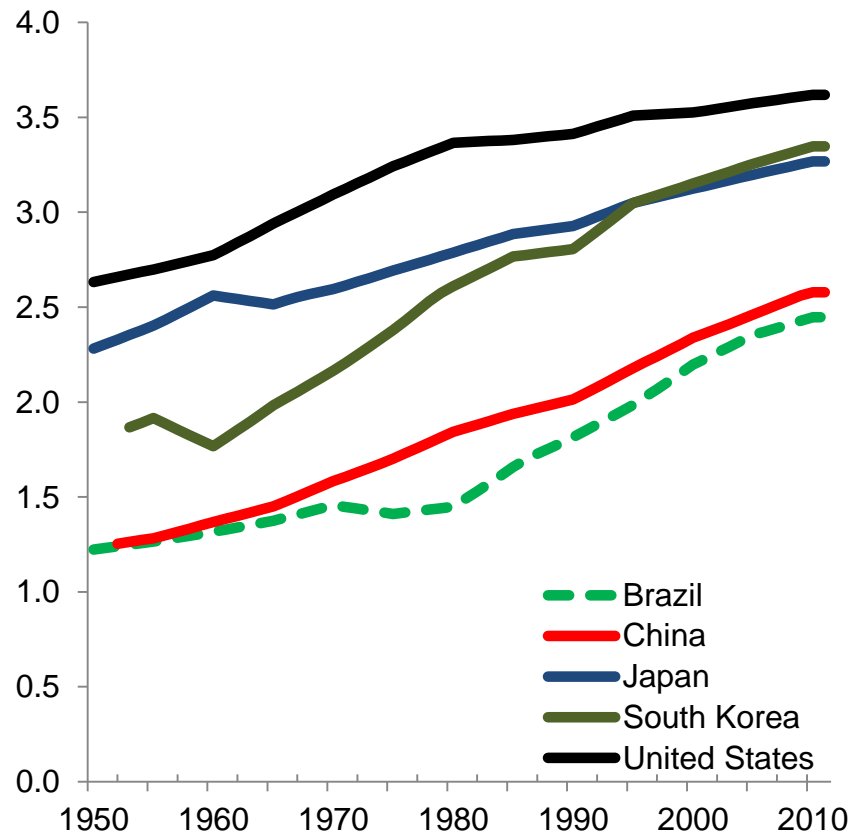
China's transformations present a policy opportunity for Brazil to boost economic growth

- To take advantage of the transformations in China, continued efforts are needed for Brazil to address internal productivity constraints
 - Strengthening business environment
 - Accelerating investment in physical capital
 - Enhancing the formation of human capital
- Such cross-cutting efforts could help improve a number of *trade-offs*
 - Improving domestic growth
 - Taking advantage of opportunities emerging externally
 - Boosting capabilities to face external competition
- In addition to advancing the domestic reform agenda, the external environment for trade and investment could be strengthened
 - Various bottlenecks dampen trade and investment flows
 - Efforts are needed in both countries

Human capital levels remain relatively low, and physical capital accumulation has lost momentum

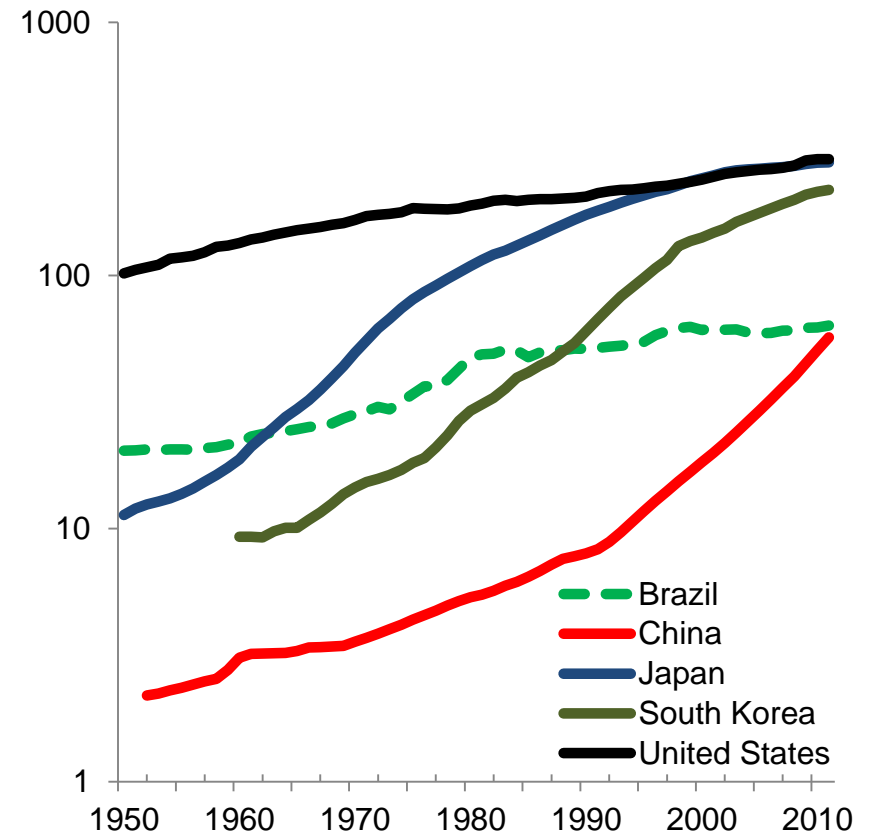
Human capital accumulation

Index of human capital per person,
based on years of schooling and returns to education

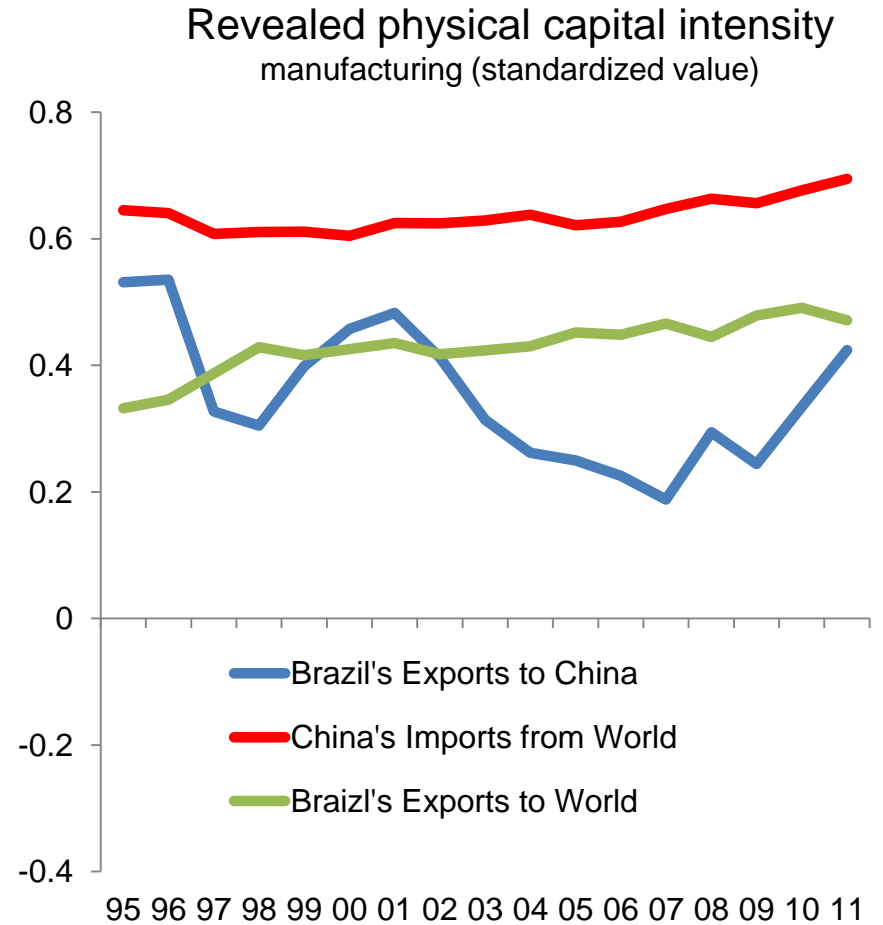
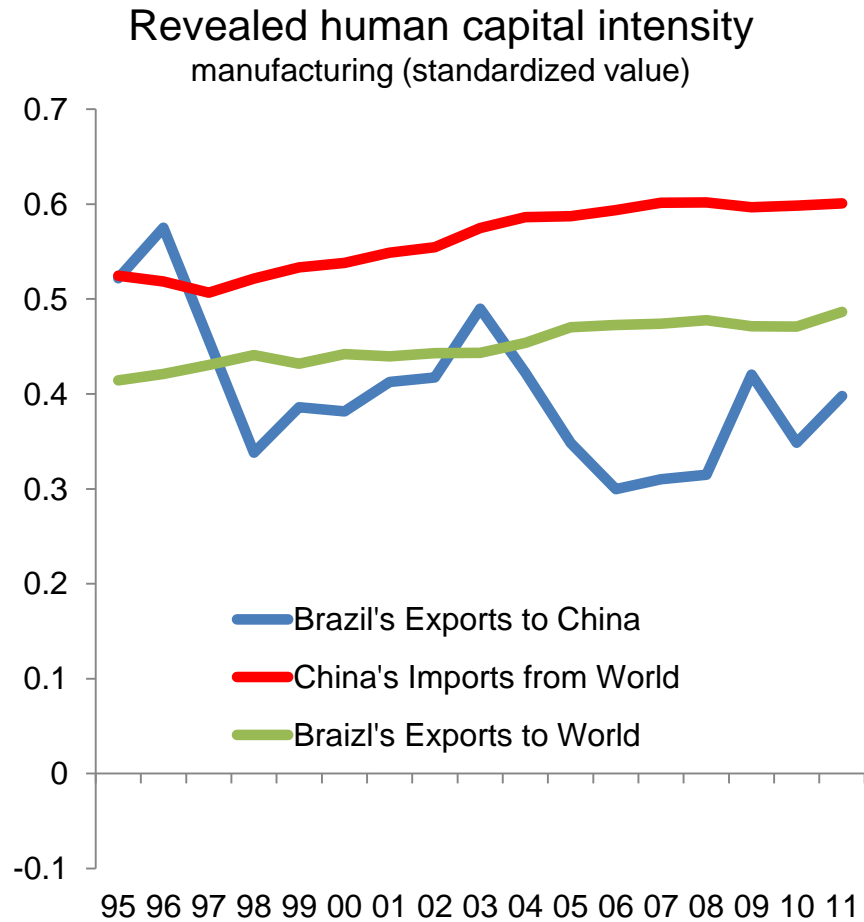


Physical capital accumulation

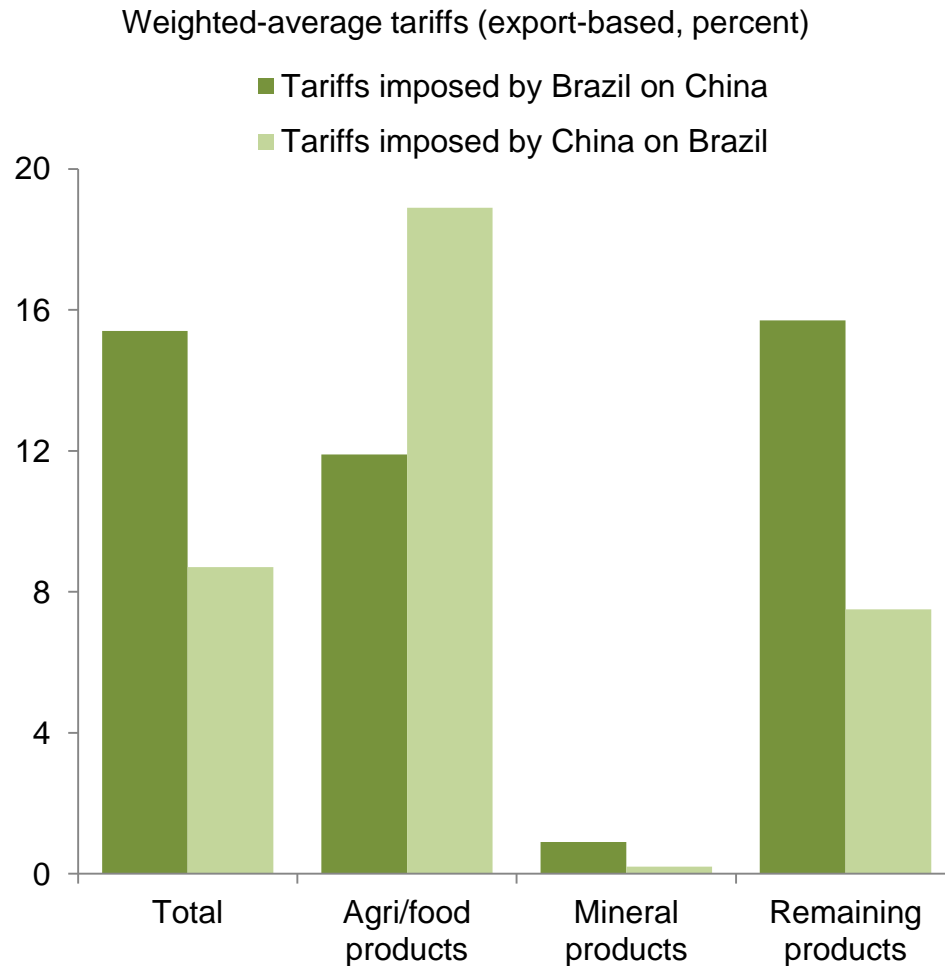
Capital stock at constant 2005 national
prices per worker (2005 US\$ thousands)



Faster capital accumulation would help Brazil's manufacturing sector access opportunities in China



Further efforts are needed, in both countries, to reduce tariff and non-tariff barriers to trade



Scope exists for improvement of the trade environment in both countries

- Brazil and China maintain relatively high tariff rates
- The tariffs are higher on each other's comparative advantages
- Tariff escalation is an important constraint to enhancing value added
- Non-tariff measures are important trade barriers in both countries

Brazil permits a higher share of foreign equity ownership than China across a range of sectors

Permitted foreign equity ownership share by sector (percent)

	Brazil	China
Agriculture and forestry	100	100
Mining, oil and gas	100	100
Manufacturing	100	100
Electricity	100	80
Waste management & water supply	100	75
Transportation	87	75
Tourism	100	100
Media	30	0
Telecom	100	49
Financial services	100	67
Accounting	100	99
Education	100	99

While setting up shop in Brazil is de jure highly liberal, it is de facto relatively cumbersome

	Investing across sectors	Starting a foreign business		Arbitrating and mediating disputes	
	Average foreign equity ownership permitted (percent)	Number of procedures	Number of days	Length of arbitration proceedings (days)	Length of recognition and enforcement proceedings (days)
Brazil	93	16	152	560	2325
China	75	17	63	164	420
India	81	15	35	569	1654
Russia	94	9	19	119	138
South Africa	88	8	57	528	1178

Conclusion

- The changes in China are expected to bring opportunities and challenges for Brazil
 - The scale and patterns of commercial relations are bound to be affected
 - New competitive challenges are on the horizon
- The anticipated changes are on balance expected to play out positively for Brazil, even if it responds to them passively
- Yet, to extract maximum benefit, a proactive response is needed
 - Pressing ahead with structural reform would make it easier to tap into nascent opportunities in China and to address competitive challenges
 - Structural reform would also help boost external competitiveness with respect to other countries and energize the internal growth engine of the economy
- The changes in China offer a window of opportunity to accelerate the pace of structural reform and enhance the capacity of the Brazilian economy to produce sustainable and non-inflationary growth



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**IMPLICAÇÕES DE UMA CHINA EM TRANSFORMAÇÃO:
OPORTUNIDADES PARA O BRASIL?**

