

Edited by Greg Mills
& Natasha Skidmore



TOWARDS CHINA INC?

Assessing the implications for Africa



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Edited by
Greg Mills and Natasha Skidmore

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Introduction and Acknowledgements

The development of 'Greater China' — or China Inc — is possibly the most significant economic development over the past two decades. The combined economies of China, Taiwan and Hong Kong amount to US\$1.437 trillion making 'Greater China' the fourth largest economy in the world. In September 2003, the combined foreign reserves of the People's Republic of China (PRC), Hong Kong and Taiwan amounted to \$686.6 billion; an amount far exceeding any other emerging market. Driven by exports, GDP growth in China over the two decades up to 2000 averaged 9.7%. Average GDP growth was 7.5% in 2001, 8% in 2002, and 9.1% in 2003.

What will be the impact of the growth of China's economy on Africa's development? Will the growth of the Chinese economy crowd Africa out of an increasingly competitive foreign direct investment (FDI) market? Will it prove a competitor to local, African industries; or will these challenges be compensated by the market opportunities on offer in China? These questions necessitate that African leaders develop appropriate diplomatic and business strategies to respond to the challenges presented by the Chinese 'dragon'.

Over the past decade, China has attracted more than \$350 billion in FDI. This is attributed to the size of its market (approximately 1.2 billion people) and the global competitiveness of its cost of production.

In comparison sub-Saharan Africa, with a population of 600 million, has attracted a mere 10% of China's FDI figure. China's GDP per capita growth rate was 9.5% between 1990–99, whilst that of sub-Saharan Africa contracted by 0.4%.

China's past relations with the African continent were driven primarily by political considerations whereas present day relations are driven more by economic realities. China views business opportunities, especially in the commodities sector in Africa, as key to its market expansion. China is seeking to nearly double its trade with Africa to \$30 billion within the next three years. On the political side, China views itself as the leader of the developing world, taking up the rhetoric of the need for a new, more equitable global economic and political order. This is reflected in the establishment of the

China–Africa Forum in 2000, that seeks to engage with African states both on a bilateral and multilateral level in addressing and combating global challenges. China is a member of the G20+ group of developing countries that forced the hand of the EU, the US and Japan on agricultural subsidies at the WTO meeting in Cancun in September 2003. China has also shown an interest in the new India–Brazil–South Africa Forum (IBSA) established late in 2003.

Another driving force behind China's engagement with Africa is Taiwan. China and Taiwan have both been engaged in the so-called 'scramble for Africa,' motivated by a desire to exclude each other from gaining a foothold on the continent. Taiwan is targeting countries in need of financial assistance while China is using its economic and political leverage to discourage such engagement with Taiwan. Ironically, despite the political disengagement, trade and commercial links between the two countries continue to grow. In 2002, China surpassed both Japan and the US to become Taiwan's largest trading partner. Approximately \$30.8 billion (23.6%) of Taiwanese exports were destined for the mainland. Taiwan is the largest single investor in the PRC. Approximately one million Taiwanese now live and work on the mainland and approximately 50,000 Taiwanese companies operate there because of cheaper labour, raw materials and land. The Taiwanese Ministry of Economic Affairs estimates that \$60 billion has been invested in the mainland by Taiwanese business. Observers suggest that the figure could be as high as \$100 billion. It is evident that the status quo is the best deal that Taiwan is likely to get for the foreseeable future. The economic interdependence of the two countries is likely to ensure that this continues unless Taiwan makes a further push for political independence.

China can prove to be a useful ally to both Africa and South Africa in multilateral fora and future engagement should be based on optimising the relationship. Challenges for Africa remain, however, specifically in China's relative attractiveness to foreign investors. Even if the New Partnership for Africa's Development were to realise a best-case scenario, China would most likely be ahead of Africa in the scramble for scarce FDI. This can be attributed to the sheer size of its market, low infrastructure costs and efficiencies, economies of scale, cheap labour, and a stable macro-economic and investment environment.

Bilateral relations between the PRC and South Africa are growing rapidly, boosted by the discussions on a possible free trade area between the two countries. Total trade between the two countries reached R23.3 billion in 2003, with imports totalling R16.6 billion and exports totalling R6.7 billion. However, the trade balance remains in China's favour prompting questions around China's willingness to yield sufficiently to demands for greater

openness of its economy that an FTA would demand. This could potentially strain bilateral relations.

Given the importance and potential of the Chinese market, both South Africa and Africa should develop a more focused diplomatic approach to China (and other Asian countries). Proposed actions include:

- the establishment and tailoring of a strategy linked to a series of country-specific goals which are transmitted beyond the elite of government to the respective departments, business and the public alike;
- identification of trade opportunities;
- the monitoring and offering of ongoing assessments of the impact of 'China Inc' on Africa, both as a market (trade and investment) opportunity, but also as a strategic competitor to FDI flows and African industry; and
- the setting of benchmarks for trade and investment.

This publication is a compilation of papers presented at a conference entitled *Towards China Inc? Assessing the Implications for South Africa and Africa*, held at Jan Smuts House, Johannesburg in November 2003. The conference and this publication form part of the South African Institute of International Affairs' Taiwan Asia-Pacific project, kindly sponsored by the Taipei Liaison Office in Johannesburg.

The objective of the conference was to assess the impact of the integration and growth of China's economy on the Asia region as well as specifically on South Africa and the African continent. It is hoped that this publication will contribute to the debate on these issues.

The editors would like to express their appreciation to the Taipei Liaison Office in South Africa for their sponsorship of this conference, to the authors for their involvement in this project, and to Elizabeth Sidiropoulos, Peter Farlam, Alex Potter and Tracy Seider for their efforts in seeing this publication to fruition.

Greg Mills and Natasha Skidmore
Johannesburg
June 2004

Greater China and Its Neighbours: Economic, Political and Strategic Dynamics and Their Regional Implications

John McKay

Introduction

The rise of China as an industrial and exporting power over the past few years has been remarkable. In 2002, Chinese exports reached \$325 billion, more than twice the 1996 level of \$150 billion. As this growth continues, there is also an expansion of links in East Asia.¹ In particular, the growing ties — trade, technological and investment — among China, Hong Kong, Macao and Taiwan have given rise to much speculation about the emergence of a large economic grouping, or at least a convenient arrangement, that has been variously called 'Greater China',² the 'China Circle'³ or 'China, Hong Kong, Taiwan Inc.'⁴

These concepts have been used principally to describe the growing level of trade and investment among these economies. Essentially this involves informal economic co-operation across political boundaries, but there has also been some speculation about the formalisation of these arrangements to create a large economic bloc. Also, there has been debate about the importance of ethnic and cultural ties in the formation of such regional links, and about the political implications of these growing relationships. In particular, questions have been asked about the role of these trade and investment relationships in ameliorating some of the political tensions that exist across the Taiwan Strait.

My aim in this paper is to present a critical evaluation of the whole concept of Greater China, to try to unravel some of the terminology that has been used, and to attempt to separate ideology and wishful thinking from the realities of the current situation in East Asia. I also want to consider some of the wider regional implications of the current developments in Greater China. The paper is divided into six major sections. I first examine the genesis of the terms used and attempt to evaluate the usefulness of some of the concepts that have been put forward at various times. I also try to

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analyse the distinct ways in which various ideas are viewed in different parts of the region. Secondly, I describe what I see as the most important features of the current economic and political dynamics in China. This is a very complex area, and I can only hope to give the barest outline of what is happening there. Thirdly, I look at the considerable progress that has been made in creating economic links among China, Hong Kong and Macao to create what is becoming known as the Pearl River Delta (PRD) region. This process has now been considerably simplified following the reversion of both Hong Kong and Macao to Chinese rule. But I also want to consider the extent to which this recent experience can provide a blueprint for future relations between China and Taiwan. Certainly the unfolding of events in Hong Kong is being closely watched from Taipei. Fourthly, I consider very briefly some developments in relations between China and Taiwan. Given that another paper in this volume considers this topic in detail, here I will only present some short comments that are essential for my general argument. Fifthly, I analyse the development of the China Circle, and consider in particular the economic dynamics that seem to be at work, especially in key industries such as electronics. Finally, I move on to evaluate the implications for the wider region of these trends, including the political and strategic ramifications. I argue that this is a key turning point for Asia as it seeks to redefine itself in the wake of the 1997 Asian economic crisis, the 2003 Iraq war, and the new relationships that have emerged with the US in particular. I argue that developments involving Greater China are central to these emerging dynamics.

The evolution of Greater China: Concepts, ideologies and realities

To begin this discussion, I want to consider some alternative definitions or mappings of the phenomenon we are considering in this study. As I have already noted, several alternative terms have been discussed in the literature, and it is important to recognise that these represent somewhat different formulations of the key variables that are involved.

Let me begin with the concept of Greater China. As Harding has noted,⁵ the term is used in a variety of ways. Some commentators have focused on the rapidly increasing interaction among a number of Chinese societies around the world. But most have concentrated on purely commercial ties, while a few have explored broader cultural relationships among various ethnic Chinese groups. Still others have reflected on the opportunities for political reunification that are generated by these emerging economic links.⁶ Some have given particular attention to links among China, Taiwan, Hong Kong and Macao, but others have included relationships with Chinese

communities in countries like Singapore. Some formulations have been purely descriptive, identifying the strength of the emerging ties, while others have tried to be more normative, talking about the institutions that should govern these links. Harding also notes that the term 'Greater' is generally used for units that consist of viable economic or cultural regions that span a number of political jurisdictions. However, in the political sphere, the term may have some pejorative connotations, as in the concept of the 'Greater East Asian Co-Prosperty Sphere' put forward by the Japanese in the 1930s. This is perhaps one reason why a number of governments in South-East Asia have reacted badly to the idea of Greater China.

Harding also points out that while the specific term is of quite recent origin, the concept is much older.⁷ It can be traced to the traditional distinction, made first by the Chinese themselves and then taken up by many Western geographers, between 'China Proper' and 'Outer China' or 'Chinese dependencies'. The first term referred to the territories directly under political control by the central government, while the outer area consisted of ethnic minorities under the suzerainty of the Chinese state. Such distinctions were also used on later US government maps to designate areas claimed by the Nationalist regime, but not under political control at the time.

More specific usage of the term Greater China, Harding suggests, began in the 1970s in Chinese-language publications examining growing economic links between China and Hong Kong. Slightly later, in a 1979 issue of a Taiwanese journal, the concept was extended to include Taiwan, and the idea of a 'Chinese Common Market' was also raised at this time. Harding claims that the first use in English of the term was in the middle and late 1980s, when journals such as *The Economist* began to speculate about the emergence of a 'greater China confederation' that might eventually include Taiwan. During the 1990s, the use of the phrase became even more common, but mainly in the sense of describing emerging business and trade links. Such networks are not new, of course, as has been explored in a recent historical study by Sugiyama and Grove,⁸ but there is little doubt that the scale of such relationships has expanded dramatically in recent years.

The use of the term Greater China to describe the realities of economic links in this part of East Asia seems to be relatively unproblematic.⁹ However, more intense debate has centred on the desirability and possible design of more formal institutions of economic or political integration.¹⁰ Current work seems to be much more modest in this regard, concentrating on issues of more informal co-ordination or consultation.

The use of the term China Circle is somewhat different, and in some respects rather more sophisticated conceptually. Naughton argues that the development of a functional economic region consisting of China, Taiwan

and Hong Kong 'represents in certain respects the triumph of economics over politics.'¹¹ The core of this conception is the existence of a series of three concentric circles centred on Hong Kong, containing interacting economic activities and crossing political boundaries.¹²

- The smallest circle consists of Hong Kong and its immediate hinterland in China. This is based on the specialised business services located in Hong Kong, with much of the manufacturing activity now relocated to adjacent areas of the PRD region.
- The second circle contains Hong Kong, the Chinese provinces of Guangdong and Fujian, and Taiwan. This area has developed a complex division of labour, resulting in very large flows of trade along well-developed production chains. Trade in intermediate goods is central to the flows of goods. This is now a tightly integrated production region, but there are still firm controls on investment and labour flows. Tariffs are also significant in some cases, and currency-exchange risks remain.
- The third circle is generally in an earlier stage of its formation, and includes all of the rest of China. Particularly important, and now well integrated into the wider system, are the coastal provinces of Shanghai, Jiangsu and Zhejiang.

This definition is very much in economic terms, but is one that is firmly grounded in the dynamics of the emerging regional and global economy. It encompasses explicit theories on the spatial division of labour and on the diffusion of technologies and production networks. It parallels the extensive work that has been done on the production networks established by Japanese companies,¹³ and indeed there is considerable overlap between these Chinese and Japanese production chains although, as we will see later, there are important differences between them.

The notion of China, Hong Kong, Taiwan Inc is somewhat different again. It focuses quite centrally on China and its search for a new model of development, or perhaps a new way of establishing its old role as the dominant power in the East Asian region. Thus the concept is very political, although it is underpinned by the drive to economic maturity in China. The study also examines the ways in which alternative political systems can promote or inhibit economic transformation, and the possibilities for the creation of 'democracy with Chinese characteristics'. The idea of greater integration in the region is thus part of this larger project of economic and political modernisation in China.

It is important to ask whether the whole idea of Greater China, of whatever we may wish to call it, is seen in the same way in different parts of the region. What seems clear is that there are marked differences in

perceptions of the phenomenon, reflecting quite different economic and political priorities.

For Hong Kong, the concept of greater integration is seen predominantly as a way of preserving its own particular economic, cultural and political identity by safeguarding its position as a regional or even global financial centre. Hong Kong is already a major financial centre servicing the local, regional and indeed global markets. This position has been based on a series of important factors and resources. These include a strong financial and corporate services base; a legal system that is regarded as transparent and fair; excellent trade, transport and telecommunications infrastructure; a skilled and well-educated labour force; and intellectual property protections and corporate governance regimes that are superior to others in the immediate region. However, this is an extremely competitive area and Hong Kong is now facing a serious challenge from Singapore, and in the longer term perhaps from Shanghai.¹⁴ The number of regional headquarters and regional offices established in Hong Kong has been increasing steadily. The number of regional headquarters increased from 816 in 1996 to 948 in 2002, while regional offices increased from 1,491 to 2,171 in the same period. However, the government is well aware that in this competitive area it is essential to ensure that infrastructure, legal systems and other key factors are constantly being updated and improved. This then is a real incentive for an ongoing process of reform in a range of areas. The Hong Kong Monetary Authority has been active in the development of international and regional co-operation in issues such as financial stability and in the development of regional bond markets, and this has helped to buttress the role of Hong Kong as an international financial centre.

For Taiwan, the goals are rather different and the stakes are much higher. Taiwan's continued economic health is, of course, a major priority and the key to its relative independence of action. The economic opportunities offered by China as both a market and a source of labour are central to this project. At the same time, some concerns have been expressed about the so-called 'hollowing out' of the island's economy as more and more factories, offices and jobs move to the mainland.¹⁵ Taiwan is also keen to promote cultural and economic ties with China, although these are generally seen as alternatives to political unification rather than as preliminary steps in that direction.

For China, these issues are even more complex. It has been usual to assume that China sees the establishment of economic ties as an important preliminary to wider political unification, and as a way of fostering its own economic development. Certainly, in Chinese eyes, such ties are a way of engendering confidence in the Chinese system, especially in Taiwan. This is

one reason why China has been so careful not to antagonise the citizens of Hong Kong over such issues as the recent Article 23 debate. But there may be other issues that have been less discussed in the literature. Wang has recently raised some of these deeper questions. He argues that they go to the very core of what kind of state China will become in the future.

At the heart of the problem is the question of whether China will continue to have a distinct political culture of its own. For the Chinese elites, their inherited culture is different from what is being offered by the West to China today. In that case, what parts of that culture would still be viable and how much could be preserved in the face of the powerful changes that the whole world is experiencing? Two factors dominate China's political culture. First is the fact that it has had such a long continuous history and has survived all attempts so far to destroy it. The second follows from the first: the fact that its population has grown to 1,300 million people, with over 90 per cent of them sharing that political culture, can be awe-inspiring, even for the Chinese themselves when they know enough to compare that culture with those of other countries. China's history and size do not enable the country to fit easily into the nation-state international system and accept its norms. But the Chinese elites will find that there are unlikely to be alternatives to these norms and, therefore, will have to live with the discomfort of conforming to them for a long time. But they have hopes that the pressures could be eased a little. The various efforts at regional groupings, if not fully developed regionalism, could soften the impact and go some way in diluting the iron boundaries of narrow national concerns.¹⁶

These are key issues, not just for the question of Greater China, but also for a better understanding of the wider links in the future Asian system. They will be discussed in more detail in the next section of the paper, which examines the central role of China in setting the broader regional agenda.

Current economic and political dynamics in China

This is a vast topic, and I can only hope to present here some of the key features of the complex dynamics now at work in this large and rapidly changing nation. As a number of authors have pointed out, Chinese policymaking, especially in the area of foreign relations, is characterised by considerable subtlety and by attention to long-term strategies rather than immediate tactical issues.¹⁷ Chinese policy is usually thought of in terms of long-term hierarchies of goals. This list represents clear priorities, and also provides guidance on shorter-term tactics. The whole process is

sophisticated enough to accommodate the fact that some short- and medium-term priorities may conflict with longer-term goals, and some items on the hierarchy of aims may not work well together.

At present, the overriding aim is for a continuation of rapid rates of economic growth. From this success flows the legitimacy of the regime, and from the fruits of its own growth China will be able to fund those things that it sees as necessary for its ability to extend its own power and influence in the wider region. In particular, the modernisation of its military is dependent on continued economic development.

Continued growth depends on several factors. One of them is certainly the continued inflow of foreign investment, and Taiwan is of course a major investor in China. But China is not only attempting to increase the size of its economy, but also to become involved increasingly in more sophisticated manufacturing and other activities. This is not just a matter of investment, but also of access to new technology. To some extent, China has followed the conventional pattern of economic liberalisation to achieve greater innovation, but there are several unique features in this policy that make the country unique. The Chinese leadership is well aware of the contradictions that can arise from a liberalised economic structure coming into daily contact with a more restrictive political system; hence these economic reforms have only been partial and extremely selective. At the same time, China has been attracted by many of the methods adopted earlier in Korea to generate rapid rates of industrial change. These involved intensive state intervention, a nationalistic approach to economic policy, and a strong preference for large-scale business units.¹⁸ In spite of the 1997 Asian crisis, several of these methods still retain favour. Also, China is a very big country, and hence it believes that it can rely on its own resources to a large extent. Perhaps most important of all, China takes for granted the fact that it will in due course assume the status of a great power; hence many decisions about economic and technological policy also have strong strategic and military overtones.¹⁹

The result of all these complex forces is that China is searching for a new model for its development — one that is compatible with its own particular history, institutions and political culture, but is still able to generate rapid growth. I would see its involvement in the China Circle as central to this policy development. Many commentators, especially those writing from a conventional neo-classical economic perspective, argue that China still has some way to go in its economic reforms.²⁰ However, there has been general optimism that China's accession to the World Trade Organisation (WTO) will provide a strong impetus for continued reform.²¹ However, such transitions are not so easy: the opening up and internationalisation of China is a huge and problematic task.²² Some writers²³ have even gone so far as to say that

China will collapse because of the lack of progress in reform of the financial system, state-owned enterprises and other problem areas. It seems that over the past few years, especially since 1997, China has been using Hong Kong as a place close to home where Chinese companies, banks and other institutions can learn about how to operate in the wider international economy. The government of Hong Kong is certainly aware of playing this role.

But it is in the political sphere that most doubts have been expressed about China's transformation. In a recent book, Ross Terrill has argued that Beijing has yet to decide whether it will be a modern industrial state and adopt the policy reforms that are necessary to achieve this, or whether it will continue the legacy of the old Chinese empire.²⁴ In my view, this is stating the problem in too stark a form, but it is certainly true that the current government in Taiwan is very suspicious of the motives and methods being adopted by the Chinese government. Offers of a Hong Kong style 'one nation, two systems' settlement are viewed very sceptically. It is to the development of this Hong Kong model since 1997 that I now turn.

China-Hong Kong integration: The Pearl River Delta region as a model?

Hong Kong has for long played an important role as a gateway for trade and other links both into and out of China, but particularly for the southern part of the country. This still continues, but a number of commentators have suggested that this traditional function is now under some pressure. Lo, for example, argues that as China opens up further to the rest of the world, and in particular with its accession to the WTO, Hong Kong is bound to lose its traditional role as a conduit for trade and investment.²⁵ This will include, it is suggested, trade and investment to and from Taiwan. Since 1987, when trade through Hong Kong was first allowed, annual indirect cross-strait trade has grown to over \$10 billion per year. With the entry of both China and Taiwan to the WTO, many commentators are arguing that direct trade will only be a matter of time, thus removing some 6% of Hong Kong's annual total exports. Similarly, Hong Kong may lose the benefits of passenger flows from Taiwan to China, which currently account for some 6.9% of all tourist arrivals. There may be similar losses of banking and other financial services.

Others have suggested that any such loss will be offset by Hong Kong's continued role in the re-export of increased volumes of Chinese goods, as China's trade expands in response to WTO entry. This re-export business amounted to \$111 billion in 2002, or 69% of Hong Kong's gross domestic product (GDP). But it may be that in future far more of this trade will move

through ports and airports in China itself. For example, as new airport services develop in Baiyun and Shenzhen, some of the air traffic originating in the Guangdong area that currently moves through Hong Kong's Chek Lap Kok Airport may fly directly.²⁶

However, a recent survey by the Hong Kong Trade Development Council of 906 enterprises in the Guangdong, Jiangsu and Zhejiang provinces — the three most economically developed areas of China — suggests that no other city can replace Hong Kong as an international commercial and financial centre. Some 82% of respondents placed particular value on the transparent legal system, and 53% reported that they had raised funds there.²⁷ Based on this sort of evidence, the Hong Kong government argues that Hong Kong still maintains its important advantages as a gateway, and is in the process of redefining and expanding its economic and trade relationships with China. The Closer Economic Partnership Arrangement (CEPA) signed between China and Hong Kong China (HKC) on 29 June 2003 freed up trade in goods and services and facilitated trade and investment. This will be followed up with further discussions leading to progressive liberalisation. This is likely to attract to Hong Kong manufacturing of brand-name products and the production of goods with higher levels of technology input and intellectual property requirements. The government of Hong Kong expects that these 'WTO-plus' liberalisations will give important 'first mover' advantages to companies in Hong Kong, especially in the service industries.

Hong Kong is now playing a crucial role in one of China's most rapidly expanding regions, the PRD, which comprises Guangdong, Hong Kong and Macao. A major part of Hong Kong's economic activity is now linked to manufacturing activities across the border. It is estimated that some 500,000 workers in Hong Kong are employed in companies that are involved in manufacturing or import-export activities on the mainland.²⁸ Another one million workers are indirectly employed in producer-service activities related to cross-border manufacturing. This partnership has transformed Guangdong into the most rapidly growing region of China, with some 13% of all value-added industry in 2002. The PRD has been called the Fifth Asian Dragon and now receives more foreign direct investment (FDI) than any country in South-East Asia. Total exports from the region are around \$283 billion, or 4.69% of world exports. It is estimated that some 63,000 HKC companies are engaged in manufacturing activities across the border in the mainland. Of these, 7,000 are directly involved in production, while 56,000 are engaged in import-export activities. Hong Kong-based companies operate some 59,000 factory facilities on the mainland, with 53,000 of these being in Guangdong. Thus the level of linkage in this region is truly enormous.

Hong Kong is also marketing itself as the best base for foreign companies

planning to open operations in the PRD. For example, a recent survey of Korean companies investing in the PRD has suggested that most were motivated by the proximity of Hong Kong, and some 80% have offices in Hong Kong for easy access to financial services, business support and logistics.²⁹ Other surveys by the Hong Kong Trade Development Council suggest that companies from a range of countries are now using Hong Kong as a service platform in the PRD.

Hong Kong companies have generally moved to Guangdong in search of cheaper labour and larger tracts of cheaper land. However, it appears that most Hong Kong companies continue to carry out overall management of their activities in Hong Kong, along with much of their financial control, marketing, and research and development. Thus there appears to be a clear division of labour emerging in the PRD region; one that is very beneficial to the economy of Hong Kong. Once again, these developments are having a clear impact on the trade and investment liberalisation and facilitation programmes of the government.

The discussion so far has been broadly centred on Hong Kong's crucial relationship with China and how this is evolving with the new political arrangements since 1997. Crucial for the future of Hong Kong will be the precise form of the wider relationship that emerges between the two economies. There seem to be several alternative scenarios here. Hong Kong has done very well so far as a partner in export industries, especially in the PRD region, and as a provider of logistical, financial, technological and other services. However, there seem to be real limits to this role. Most importantly, China is developing its own service industries, although the gap in skills and regulatory frameworks is quite large at the moment. Continuous upgrading of skills thus becomes essential for Hong Kong if this function is to be maintained.

However, in the longer term, it appears to be necessary for Hong Kong to move beyond this traditional role. The danger seen by a number of commentators³⁰ is that China will attempt to box Hong Kong into a purely regional role to service the needs of the PRD region. This is an important and rapidly growing region, as was noted earlier, but the possibilities here fall far short of the ambitions that the government of Hong Kong holds for the future. These involve a drive to become a truly world city, operating at the level of a New York or a London. Hong Kong is already being marketed as 'Asia's World City', but the achievement of such a status will require a huge effort, and an equal amount of investment. Ambitious government efforts are already under way in information technology (IT) and in the training of IT staff, and a new programme has been launched to attract investment to Hong Kong.

These growing economic links within southern China are important, but the extent to which Hong Kong integration into China can be regarded as a successful model for Taiwan will depend much more on the degree to which cultural and political links develop satisfactorily. As Steve Tsang has noted, Chinese identity in Hong Kong is deeply ambiguous.

On the one hand, as Hong Kong citizens, they want to preserve their own way of life under the principle of 'one country, two systems', which requires non-intervention in each other's affairs by both the PRC [People's Republic of China] and Hong Kong. On the other hand, feeling that they are PRC nationals too, they believe they have the right to have a say in vital matters affecting the future of the nation, which inevitably involves PRC politics. Few among the Chinese of Hong Kong can see that there is in fact an inherent contradiction between asserting their right to have a say in the politics of the PRC and their demand that the PRC should not interfere into Hong Kong's domestic affairs.³¹

This ambiguous identity was already being formed at the time of the traumatic putting down of the pro-democracy movement in Tian'anmen Square, Beijing, in 1989. Many in Hong Kong feared for their future after the handover of Hong Kong to Chinese rule in 1997. Many chose to leave the country, while others stayed to mount a campaign for greater democratic freedoms in China. Since 1997, Tsang argues, the removal of British protection has resulted in a greater degree of pragmatism, but this dual identity still survives. Hong Kong residents still regard themselves primarily as belonging to Hong Kong, but they also accept that they are now Chinese nationals as well. However, they see themselves as a distinct group, quite different from the rest of the population of the mainland. As we will see, profound ambiguities also characterise identities in Taiwan, although the manifestations are rather different.

China-Taiwan relations: Integration or conflagration?

As noted in my introduction, I do not want to say much here, since another paper in this volume is devoted specifically to this issue. I just want to make a couple of specific points about the development of the Taiwanese economy that are, I think, essential to my later argument. In spite of its success in weathering the Asian crisis of 1997, Taiwan has been going through some serious questioning about future directions for the economy. Much of this debate, as in Korea, has revolved around two questions — the so-called 'hollowing out' of the economy, and the difficulties in navigating change

towards higher technology in the manufacturing sector. I also want to make some brief points about Taiwanese identity and the ambiguities involved in its current formulation.

The large-scale relocation of more traditional and labour-intensive manufacturing activities to the mainland, as well as to other countries in South-East Asia, has been criticised by some commentators as giving away Taiwanese jobs and handing power over the future of the Taiwanese economy to the rulers on the mainland. Ironically, some critics in China have suggested that these arrangements are in fact handing power over the future of the Chinese economy to companies in Taiwan! Kao and Wu assess these arguments and conclude that there is little evidence so far of a hollowing out phenomenon.³² Rather, Taiwan has benefited from this division of labour across the Taiwan Strait. However, they do urge caution in the further development of this relationship, arguing that companies in Taiwan need to look at their possible investments very carefully and realise that their own future prosperity is closely tied to the future health and vitality of the local economy. A recent Australian government publication also tends to dismiss the hollowing-out argument.³³ It argues that China's core competitiveness still lies in labour-intensive production, and much of its move into higher technology has simply involved the assembly of imported components from more advanced neighbours in East Asia. Thus, economies such as Korea or Taiwan have much to gain from continued expansion of their links with China.

The future direction of this debate will hinge very heavily on Taiwan's success in its continued push towards high-technology development. In areas such as electronics, success will depend on the viability of the joint ventures that have been negotiated with a number of foreign companies. But the role of the state will also continue to be crucial, although in precise ways that are quite different from those of the past, when Taiwan was seeking to develop its early phases of industrialisation. As Linda Weiss has noted,

[t]he experience of Taiwan demonstrates that in spite of extensive liberalisation (not to mention full-fledged democratisation), developmentalism remains relatively robust at the turn of the century. International and domestic constraints notwithstanding, the state centred on Taipei retains both the key role in defining financial and industrial strategy and a capacity for effective implementation.³⁴

Increasingly, these new strategies for technological development may include co-operation with China, which, as was noted above, has embarked on a high-technology industry of its own. Thus, it may be that the China Circle may move to a new phase of technological co-operation.

The logic for increased economic co-operation with China seems to be generally accepted in Taiwan, but the cultural, political and strategic dimensions of the relationship are, of course, much more problematic. After reviewing a range of evidence on the dimensions of Taiwanese identity, Chu and Lin argue that more than anything else, the memories of China's many threats and acts of intimidation, especially at the time of the 1996 presidential election, have created a sense of shared identity and destiny among the people of Taiwan.³⁵ They now regard with horror the possibility of becoming another Hong Kong, and look for support from the international community. The move towards democracy in particular has created a security dilemma for Taiwan. On the one hand, democracy has generated a strong sense of national solidarity, enhanced the island's international legitimacy and done much to discredit China's claim to sovereignty. However, most people realise that democratisation has increased the chances of military intervention by China. The desire for a separate national identity has been enhanced by the growth of democracy, but it has also increased the external threat.³⁶ Thus, moves towards the further consolidation of democracy may be more difficult than might be imagined. All of these considerations suggest a profound mismatch between economic and political factors, making a peaceful settlement increasingly difficult.

The China Circle and regional co-operation

There is some evidence to suggest that the China Circle is now at the very centre of change in the global economy, especially in key industries such as electronics. Borrus has argued that investment in the China Circle has been central in the reinvigoration of US electronics companies, which have utilised the production network possibilities in the region to regain technological dominance over their Japanese competitors.³⁷ These US companies have established quite new kinds of production: open to outsiders, fast, flexible, but formal (i.e. structured through legal relationships) and disposable.

These networks are quite different from those set up earlier by Japanese companies. These tend to be closed to outsiders, more cautious in creation, long-term and stable. The role of the dynamic and technologically sophisticated companies in Taiwan is clearly central to these processes. Yet it has been argued that the sheer size and dynamism of the Chinese economy will ensure that the China Circle will be increasingly absorbed into the mainland economy, with Hong Kong and Taiwan as mere outliers. Naughton, for example, has suggested that the China Circle will 'merge into a broader and more integrated East Asia, involving more of the PRC

mainland economy.³⁸ But, as Naughton also acknowledges, it is political rather than economic considerations that are the most problematic in predicting such a future. The unpredictability of political developments in Beijing, he suggests, is particularly problematic, but it is the China–Taiwan relationship that is the most important unknown. Since Naughton wrote this opinion, there has been far greater predictability in Chinese policymaking, but his point about Taiwan still stands.

The recent Australian government report mentioned earlier gives a rather different view of likely future economic scenarios, and in particular questions the chances of China controlling the future economic system.³⁹ The authors argue that China's export specialisation is not becoming more similar to those of other East Asian nations. Rather, China is becoming more embedded in the region's production chains. Each economy is becoming more specialised in the particular items that reflect local strengths and experience. These chains still for the most part involve the production of more sophisticated components in Korea, Japan and Taiwan, and these are assembled in low-cost facilities in China and South-East Asia. Thus, the region is becoming more integrated, but there appears to be little sign of the Chinese dominance predicted by some commentators.

Given that the economic links in Greater China are relatively well-developed, and seem to be in the interests of all of the players, what can we say about the role of this regional relationship in terms of the fostering of political change and the creation of more harmonious international relations? In a new compilation of various studies of political change and the possible emergence of a new political consciousness in Greater China, a number of authors have speculated about the ways in which new social and political ideas, notably those surrounding democracy, are being diffused as economic ties increase.⁴⁰ Copper argues that while the notion of Greater China emerged as a result of economic reform in China and the consequent creation of economic links, the idea did have a historical basis.

It was also a concept that as it developed was in many respects in consonance with how most Chinese view their culture and, in some ways, how Beijing and other Chinese entities view the world. The notion of an economic community of Chinese 'participants' became widely heralded in the early 1980s after it began to garner strong support from various Chinese political actors and the overseas Chinese Subsequently, Greater China came to have very salient political implications, especially as the 'Taiwan issue' became more heated and difficult with rapid democratisation on the island. However, a political Greater China did not win such broad and enthusiastic support as an economic Greater China.⁴¹

For Beijing, there is no problem in defining a 'united' or 'Greater' China that would include Taiwan, but this would only be on the basis of complete control by China on terms that are not currently acceptable to Taiwan. Renwick argues that it would be better for China if ideas and norms from Hong Kong and Taiwan were to acquire greater importance in China.⁴² This would allow the resolution of the current problem of the state in China and allow the completion of some fundamental processes of societal and political transformation. Indeed, he argues, the very future of China, as well as of Greater China, may hinge on the success of these changes.

In the final section, I want to examine the broader regional consequences of the changes and uncertainties that I have been describing, especially in terms of their wider ramifications and foreign policy implications.

Some regional implications

The economies of East Asia, having put the 1997 crisis behind them, are on the move again in a very aggressive way. In many ways, the reforms that were necessitated by the crisis have made them much stronger, and certainly more determined. Asia has vowed that never again will it allow itself to be so vulnerable to outside forces. This resolve is at the heart of many of the current developments that are redefining the architecture of the region. Plans for an Asian Monetary Fund, initiated in response to criticisms of the International Monetary Fund (IMF) at the time of the crisis, are moving ahead quickly, in spite of opposition from the US. Regional economic integration plans are being put forward at a rapid pace, although the precise details of the final form of this are not yet clear. The most likely result will be an Association of South-East Asian Nations (ASEAN) + 3, consisting of the ASEAN-10, plus China, Japan and South Korea. This system, if it does come to fruition, will have a central role for Greater China; indeed, that will be its dominant core. This will cement relationships within the China Circle, plus extend its role into the rest of East and South-East Asia. Thus, the economic future of Greater China seems assured.

But what of the political and strategic implications? China-Taiwan relations are likely to be fraught for the foreseeable future. Rivalry between Japan and China for domination of Asia will also continue, and this is likely to have a major impact on the future shape of Greater China. China is very important to the future economic growth of Japan, and investments there have been very large. But Taylor has argued that Japan fears giving economic assistance and technology to China, lest it assist in the creation of a superpower that can threaten its own future.⁴³ Thus, the easy diffusion processes of the 'flying geese' model may be at an end. But it may be that the

two leading powers in the region may come to some arrangement eventually. As Austin and Harris have argued, both nations, despite their rivalry, have Asian starting points, with different assumptions from those of the West.⁴⁴ Both share a belief in the distinctiveness of Asia and in the need to create a new Asian order. Once again, the role of Greater China in the achievement of a new relationship will be central.

Finally, what are the implications for relations with the US? At various times there have been suggestions that China and Japan might combine to limit US influence in the Asian region, but few commentators seem to give this idea much credibility.

Both Japan and China will continue to rely, each in its own way, on the role of the US in the region.⁴⁵ Given the strong relationship that exists at the moment between Taiwan and the Bush administration, there is no sign that Greater China has any place as a unit of analysis in US foreign policy formulation. Rather, the US has clear policy distinctions among China, Taiwan, Hong Kong and Macao. In this sense, Greater China has no meaning in strategic formulations.

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China–Taiwan Inc? Assessing the Impact of Economic Integration Across the Taiwan Strait

Chen-shen Yen

Introduction

For outside observers, political and economic relations between Taiwan and mainland China present a series of paradoxes. These paradoxes include political divergence and economic convergence,¹ political independence and economic dependence/interdependence,² political impasse and economic dynamism,³ political disengagement and economic engagement, political conflict and economic co-operation,⁴ political coercion and economic co-optation, and political deadlock and economic great leaps forward.⁵ Cross-strait relations in the past 15 years are a testimony to these paradoxes.

When President Jiang Jinguo of Taiwan lifted martial law and allowed visits by Taiwanese nationals to China in 1987, he opened the door for economic and political cross-strait interactions that had been forbidden since 1949. Economically, Taiwanese manufacturing industries began to invest in China and to relocate their production facilities across the Taiwan Strait to take advantage of China's cheap labour, land and raw materials, as well as its favourable, pro-business environment. Mainland China also became an important export market for Taiwanese businesses, as demand for machinery, parts and semi-processed goods increased. In fact, China and Hong Kong have become the largest Taiwanese export market. Moreover, Taiwan maintains a favourable balance of trade with the mainland, without which it would have a deficit in its foreign trade.

Politically, China has been developing a peaceful offensive for unification since 1979, when the proposal for establishing the 'Three Links'⁶ was made. Two years later, Chairman Ye Jianying issued his famous 'Ye's Nine Points'.⁷ This was followed by Deng Xiaoping's call for 'one country, two systems'.⁸ Taiwan's initial response to these proposals was the so-called 'Three Nos'.⁹ With economic interactions on the rise, both sides were forced to set up quasi-official institutions to deal with the problems that resulted from these interactions. Taipei's Strait Exchange Foundation (SEF)¹⁰ and Beijing's

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Association of Relations across the Taiwan Strait (ARATS)¹¹ actually held several rounds of talks in the early 1990s, culminating in the signing of an unprecedented agreement in Singapore in 1993 by Koo Cheng-fu and Wang Daohan, the heads of SEF and ARATS respectively.¹²

In early 1995, in his New Year speech to his Taiwanese compatriots, Chinese Prime Minister Jiang Zemin outlined an eight-point proposal for reunification. Taiwanese President Lee Teng-hui responded to this 'friendly' gesture with a six-point proposal of his own. These positive developments nevertheless stalled in 1995–96 when China fired missiles across the Taiwan Strait as a response to Lee's visit to the US and when the two sides could not agree on the thorny issue of 'One China'.

The missile crisis in the mid-1990s is a vivid reminder that Beijing has never ruled out the military option in its approach to the unification issue. This threat, even though it prevented Taiwan from declaring official secession and *de jure* independence, also led Taiwan to reject further Chinese unification initiatives.

In sharp contrast to the political impasse and military threat, there are ever-growing economic ties across the Taiwan Strait. As China attracts more and more Taiwanese investments and exports, policymakers in Taiwan have become increasingly concerned. This paper will look at this process and responses to it. We will examine the effectiveness of these responses and evaluate the role in China–Taiwan relations of the Taiwanese business community and its investments, as well as the implications for Taiwan's economic and political security.

The rise of China and cross-strait economic interactions

China emerged from isolation in the late 1970s after a decade of chaos created by the Cultural Revolution and began to open itself up to the world. It also introduced a reform programme under the tutelage of Deng Xiaoping. With its abundant cheap labour and other incentives, China was able to attract a tremendous amount of foreign direct investment (FDI), which fueled its export-oriented industrialisation programme.

With an economic growth rate in the past two decades that has averaged more than 8%, China soon overtook the East Asian newly industrialised countries (NICs) of South Korea, Taiwan, Hong Kong and Singapore, and became one of the largest exporters of consumer goods in the global market. Excluding Japan, China's share of East Asian exports to the North American Free Trade Area (NAFTA) and the European Union (EU) increased from 25% to 45% from 1985 to 2000.¹³ Its share of US merchandise imports rose to about 11% in 2003, up from about 3% a dozen years before. During the same

period, the rest of Asia's share of total US merchandise imports fell from about 17% to 13%.

Not only has China become a formidable exporter, it has also turned into a major importer of the goods of its neighbours in East Asia. China took about 7% of Thai exports in 2000 (up from 1% in 1996), about 14% of Singapore's exports in 2001 (up from 2–3% in 1997), about 7% of the Philippines' exports in 2001 (up from about 1% in 1997), about 6% of Indonesian exports in 1998 (up from around 3% in 1996), and about 18% of South Korea's exports in 2001 (up from about 8% in 1996).

Compared to China's economic ties with these East Asian countries, those across the Taiwan Strait are even more substantial. Since the mid-1980s, economic liberalisation, readjustment and recession in Taiwan have caused growing numbers of the island's entrepreneurs to look to the mainland as an alternative site for their investments and manufacturing operations. Last year, Taiwanese investment on the mainland reached \$67 billion and the value of cross-strait trade topped \$40 billion in 2002, with Taiwan enjoying a surplus of \$25 billion. Taiwanese enterprises produced around 14–16% of China's overall exports and about 20% of its exports to the US.¹⁴ They have also made significant contributions in other areas, including technological upgrading, managerial training and training in marketing skills.

Some concerns about the impact of Taiwan's economic activities on China

In the mid-1990s, recognising the rapid increase in trade volume with and investment in China, President Lee Teng-hui of Taiwan began to promote *nanxiang zhengce* (the 'Go South' policy). In 1994, the Executive Yuan approved the 'Outline for Strengthening Economic and Trade Efforts in the Southeast Asian Region' — a three-year programme that identified Thailand, Malaysia, the Philippines, Indonesia, Singapore and Vietnam as targets for investment and trade.¹⁵ A second three-year programme that extended the target area to include Myanmar, Australia and New Zealand was approved in 1997.

In addition to *nanxiang zhengce*, President Lee also introduced the idea of *jieji yongren* (patience over haste) as advice for Taiwan's businesses that were eager to go west (i.e. to China), not south. In his address to the National Convention of Entrepreneurs, Lee suggested that they should adopt a cautious approach when investing in China.¹⁶

It was because of this two-pronged approach of active promotion of alternative targets for investment (*nanxiang zhengce*) and passive restraint with regard to investment on the mainland (*jieji yongren*) that Taipei

continued to slow down its talk with Beijing on the issue of the Three Links. This made investment and trade flow, as well as individuals' travel to China, cumbersome ventures. The end results of these two policies were mixed. The Go South policy was thwarted not only because of the less favourable investment climate in the region when compared with China, but also because of the negative impact of the Asian financial crisis in 1997. Many businesses that responded to *nanxiang zhengce* withdrew their investments, vacated their manufacturing facilities and came home. For example, the number of Taiwanese businesses investing in Penang, Malaysia, reached a high of 300 before it was reduced to 16 after the financial crisis. Similar flights from the Subic Bay area of the Philippines and the Bataan Peninsula were also evident.

As for the policy of *jieji yongren*, with the exception of the high-tech sector, which is still heavily regulated, other sectors have not heeded President Lee's call, and the flow of investment and trade continues to surpass previous levels each year. The only 'accomplishment' so far has been the Taiwanese government's success in opposing the establishment of direct air links across the Taiwan Strait. These links have been strongly advocated by the business community and travel industry.

Why is the 'no direct air links' policy, an aspect of *jieji yongren*, still in place? What are some of the concerns behind the implementation of this policy? According to Chen-yuan Tung, assistant research fellow of the Institute of International Relations at the National Chengchi University, Taipei, there are at least five major concerns in Taiwan about the impact of Taiwan's economic activities in China.¹⁷ These are: 1) whether Taiwan's investment in China will lead to an imbalance in the China-Taiwan balance of payments; 2) whether Taiwan's investment in China will make Taiwanese enterprises reluctant to invest in Taiwan; 3) whether Taiwan's investment in China will slow the pace of upgrading in Taiwan's industrial sector; 4) the way in which the upgrading and hollowing out of the Taiwanese industrial sector are related; and 5) whether Taiwan's investment in China will lead to higher unemployment in Taiwan and greater economic risk.

In his analysis, Tung finds that Taiwan's investment in China actually helps the island's balance of payments.¹⁸ He also cites statistical data to show that most businesses investing in China have not cut back their investment in Taiwan.¹⁹ As to the question of whether investment in China would slow the pace of upgrading in Taiwan's industrial sector, he believes that such investment actually facilitates upgrading.²⁰

Fourthly, the hollowing-out effect has not been proven, in Tung's opinion, as Taiwan's industries remain very competitive in the global market.²¹ Finally, at the time that Tung wrote, Taiwan's unemployment rate

was constant, fluctuating around 2.5%, which allowed him to claim that no correlation existed between Taiwan's investment in China and unemployment at home.²² However, such a claim is now being questioned, as the unemployment rate in the past three years has climbed above 4.5%. Still, it is hard to tell whether the rise is related to the generally unfavourable international economic environment or to Taiwan's investments in China. As to the risk factor, Tung indicates that for small enterprises, China has become their only choice and the possible gains in profit probably outweigh the risks involved. For big business, to invest in China is only one part of a general process of going global and spreading risk.

In short, in Tung's view, while all these concerns are genuine, he concludes that Taiwan's investment in China has not led to negative effects in these areas. Even though risk is involved in individual businesses investing across the Taiwan Strait, the overall risk for Taiwan is not a concern.²³ These findings seem to be consistent with my earlier description of cross-strait economic relations, i.e. as being characterised by convergence, co-operation, engagement, interdependence and co-optation.

Tung also examines the issue of Taiwan's security in the context of increasing cross-strait economic interaction. On this issue, he raises two levels of concern. One is the impact of Beijing's fundamental policy towards Taipei; the other is the operational aspect of the policy.²⁴ Tung's view of the former is that Taiwan's investment and the activities of Taiwanese businesspeople are positive forces that can help China evolve into a more open, prosperous and stable society and become a more responsible member of the international community. The implication here is that China's policy towards Taiwan is likely to become more pragmatic over time.

As to the operational aspect, the role of Taiwanese businesspeople is a major concern. Beijing has tried very hard to enlist the support of Taiwan's business elite for unification. Such a co-optation has been interpreted in Taiwan as a policy of *yimin biguan; yishang weizheng* (using people to force the hands of officials; using businessmen to surround politicians). They then could become advocates for Chinese interests in Taiwan. Tung analyses some of their advocacies, such as stable cross-strait relations and the Three Links, and finds them to be consistent with the national interests of Taiwan.

Another concern about the operational aspect is that the increasing volume of Taiwan's investment in China gives the latter the capacity to adopt an effective policy of economic sanctions against Taiwan. Again, Tung seems not to be persuaded. His analysis is that economic sanctions may well be damaging to Taiwan's economy, but they will be more damaging to that of China. Pragmatic leaders in Beijing will probably not resort to such drastic tactics.²⁵

Geng Shu, another assistant research fellow at the Institute of International Relations, uses the role of Taiwan's businessmen (*Taishang*) in China to explore the investment and trade impacts of closer economic relations across the Taiwan Strait.²⁶ Geng argues that the biggest worry in Taiwan concerning the exodus of *Taishang* to China is that this will allow China to use these people to exercise political leverage over Taiwan.

Again, like Tung, Geng's assessment is not pessimistic. He comes to this conclusion by looking at the influence of *Taishang* on two-way relations between Taiwan and China and assessing whether their involvement is voluntary or involuntary. He identifies four types of *Taishang*, as indicated in the table below.

Table 1. Geng's four types of *Taishang*

<i>Political roles of Taishang</i> <i>Direction of influence</i>	<i>Nature of involvement</i>	
	<i>Involuntarily involved</i>	<i>Voluntarily involved</i>
China to Taiwan	<i>Taishang as hostages</i>	<i>Taishang as pawns</i>
Taiwan to China	<i>Taishang as partners</i>	<i>Taishang as lobbyists</i>

Source: Geng, *op cit*, p.2

When their investment reaches a certain level and their business in China becomes their major or only source of revenue, *Taishang* are likely to be held 'hostage' if Beijing were to enforce a policy of economic sanctions against Taiwan. Such a policy — or even the threat of its implementation — would be very effective when there is an asymmetry in trade dependence and when Taiwan is vulnerable in a different way to that at present. Geng nevertheless doubts if Beijing will introduce economic sanctions, because they are merely a deterrent. In addition, economic sanctions would hurt China as well and would not be as effective as the military option.²⁷

The hostage scenario can be seen as the 'stick' approach. The 'carrot' approach for Beijing would be to favour those *Taishang* who are more likely to push Taipei to defer to Beijing's demands or influence the direction of cross-strait policy in the mainland's favour. Such selective incentives as special privileges, additional favourable terms or tax breaks would be hard to resist and could prompt *Taishang* to become the pawns of Beijing. If they were to put pressure on Taipei to improve cross-strait relations, they would make *yimin biguan*; *yishang weizheng* a reality.

Again, Geng claims that this approach is not likely to last long. He gives three reasons for this. Firstly, as China extends its commitment to the

principle of the market, there would be fewer resources its government could use as selective incentives. Secondly, even if Beijing wanted to use such incentives, to do so would be against the general principles of the World Trade Organisation (WTO), which China joined three years ago. Finally, selective incentives would arouse the jealousy of and lead to protests by other *Taishang*, or by local entrepreneurs who had not received such favours. For these reasons, Geng argues that this approach would be progressively weakened and become increasingly less effective.²⁸

Taishang should not be considered only as liabilities to Taiwan: they could be assets as well. Even if they were not voluntarily involved in directly influencing China, the fact that *Taishang* and most Chinese local government officials who champion venture capital maintain a symbiotic relationship cannot be denied. Venture capital is the most likely source for China of capital, modern technology, efficient management systems and creative thinking. Such a symbiosis therefore allows *Taishang* to exert a certain measure of influence at the local and provincial levels.²⁹

On occasions when *Taishang* did try to influence policymaking in China more aggressively, they became lobbyists to protect their interests and those of Taiwan. An example of this occurred in 1998, when Beijing tried to levy a 17% export duty and was eventually persuaded to give it up after *Taishang* organisations all over China mobilised their members to petition against this measure. Another example was the success of *Taishang* in diffusing the pressure put on them during the crisis of the 'special state-to-state relations' advocated by President Lee Teng-hui in the summer of 1999. Beijing considered such a policy as an attempt to separate Taiwan from China and urged *Taishang* to condemn it. However, *Taishang* seemed to ignore the call, appealing instead to Chinese leaders not to take military action against Taiwan. Even though their plea may not have had much influence on Beijing's subsequent decisions, it proved that they could become advocates for Taiwan.³⁰

Conclusion: Moths flying to the light or to the fire?

Increasing economic integration between Taiwan and China has not led to a more relaxed political environment across the Taiwan Strait. More Taiwanese businesses are relocating to China despite Taipei's efforts to discourage this trend. In recent years, even with the inconvenience caused by the lack of direct flights between the two sides, the number of Taiwanese entrepreneurs and their families living in China has continued to climb.³¹

For those, including Lee Teng-hui, the former president, who considered such an economic engagement as a 'fatal attraction' and worried about its

ramifications for Taiwan's economic security, the policies of *nanxiang zhengce* and *jieji yongren* appeared to be the appropriate prescriptions. The fact that *nanxiang zhengce* did not go anywhere and *jieji yongren* failed to prevent *Taishang* from flooding to China suggests their fallacious natures. The proponents of *jieji yongren* see *Taishang* as moths attracted to a deadly flame; others see *Taishang* as moths flying towards the light.

Unless China's economy collapses, it will remain a light to the Taiwanese moths that find it so attractive. With such a large number of *Taishang* and their families in China, will they shift their allegiance from Taipei to Beijing in the future? If the ban on direct flights is lifted to make the cross-strait flow of goods and people less costly and time-consuming, *Taishang* are more likely to maintain ties with Taiwan. They could also play a positive role in moderating Beijing's policy towards Taiwan.

However, if more and more *Taishang* were attracted to China, Beijing would be able to strengthen its political leverage over Taiwan, especially when an asymmetrical dependence and vulnerability exist to the latter's detriment. With greater numbers of *Taishang* and their families becoming possible 'hostages', a confident China would have more options when dealing with Taiwan. President Chen Shui-bian and the Taiwan independence fundamentalists are still calling for separation from China in the next few years. Rising Taiwanese nationalism in the last decade seems to offer some hope for the success of this endeavour. However, without a self-sufficient economy and with an export-oriented manufacturing sector heavily dependent on the Chinese market, Taiwan is likely to remain involved in Greater China, even if does not actually become a province of China, for the foreseeable future.

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East Asian Economic Perspectives: Recent Developments, Challenges and Opportunities

Tan Khee Giap

Introduction: A post-11 September update on three major world economies

There is clear consensus that the US economy has bottomed out and that the worst is over. It is also apparent that the strength of the recovery and the extent of the techno-sector upturn are sustainable. Since early 2002, we have seen 12 consecutive reductions in the benchmark overnight bank lending rate to its current 40-year low of 1.25%, with a recent productivity surge of 5.2% and the first decline of unit labour costs in two years by 2.7%. I believe that these developments indicate a significantly milder downturn and potentially a moderate rebound in the US business cycle. However, the large and growing US budget deficit, the biggest since the 1980s, is a cause for concern.

The decade-long stagnation of the Japanese economy does not look too promising, despite a fiscal pump-priming of \$1 trillion since the 1990s. Japanese government bonds were downgraded, deepening deflation, while pension funds attempted futilely to support the Nikkei index, which set yet another 19-year low of 8700 in 2002. Looming systemic financial failures due to mounting non-performing loans, lack of new capital infusions and failed banking reform initiatives in September 2002 reduced Japan to a pitiful state, its \$1.1 trillion worth of overseas assets notwithstanding. Although some economists seem to believe that the worst for the Japanese economy is over, we have not yet seen the light at the end of the tunnel.

As the European Central Bank keeps interest rates on hold, the fiscal positions of EU members, including the major economies of Germany and France, have weakened considerably, which could lead to their breaching the stability and growth pact. In the medium term, the EU will continue to be a significant global capital exporter, especially to the growing region of East Asia. But as Eastern European economies start entering the EU, the

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requirements and demand of the euro-zone economies will soak up some of the EU's capital outflows.

This short policy paper attempts to briefly update assessments of the major world economies and their strategic shifts. It also assesses market liberalisation and capital flows in East Asia since 1997. It summarises the drive to globalisation and recent trade liberalisation initiatives in East Asia and scrutinises the implications of Chinese membership of the World Trade Organisation (WTO). It highlights some worrisome trends in and challenges to the East Asia region, and also translates the impact of East Asian trade and investment trends into challenges and opportunities for South Africa in particular. The paper ends with a forecast of the performance of East Asian economies in the early years of the new millennium.

From the Atlantic to the Pacific: President Bush's strategic shift in the new millennium

Several developments and events have fundamentally influenced the current US strategic focus to shift from the Atlantic to the Pacific, particularly in the early days of the Bush administration, and to recognise China as a competitor rather than a strategic partner. (However, a reversal of the latter position was adopted after the 11 September terrorist attacks.) These are as follows.

Firstly, the post-Cold War emergence of a united Europe and its further integration since the middle of the 1980s resulted in Europe's combined economic power surpassing that of the US. Secondly, the spectacular post-war economic revival of Japan, starting in the 1960s and lasting for three decades, resulted in it becoming currently the second-largest economy in the world, despite even the decade-long economic stagnation of its economy in the 1990s. Thirdly, there was the emergence of newly industrialised economies, namely South Korea, Taiwan, Hong Kong and Singapore, during the 1980s. Fourthly, there was the rapid rise of the Association of South-East Asian Nations (ASEAN)¹ emerging market economies, including Malaysia, Thailand, Indonesia and the Philippines, until the 1997 financial crisis. And last but not least, there was the meteoric rise of China as a global economic powerhouse from the middle of the 1990s.

The gradual shift of America's economic epicentre, with trans-Pacific trade exceeding trans-Atlantic trade for the first time since 1982, and President Bush's recent announcement of the dawn of a Pacific century, further underpinned the importance of Japanese economic recovery and the 'revitalising' of the US-Taiwan defence pact to 'contain' China. In short, the US strategy in the Asia-Pacific region, based on bilateral military alliances,

will change as circumstances change, and economic power — the ultimate source of national influence — has become an indispensable part of strategic international alliances.

Market liberalisation, capital flows and trade liberalisation initiatives in East Asia: Trends and assessment

Progress in market liberalisation in East Asian economies in the aftermath of the 1997 financial turmoil is not as good as expected. Regional financial centres are manifesting policy contradictions and making retrogressive moves, while governments are fighting hard to preserve their, at times unsustainable, economic aspirations. More regulations may still temper market competition, and interventionist authorities still try to control international financial activities. Restraints on information flows and transparency still hamper market efficiency. Market accessibility is being curtailed as momentum for greater opening slows down for reasons of prudence and stability. Some crisis-affected governments are still questioning the benefits of globalisation and slowing down the pace of trade liberalisation, although some countries are pushing ahead with bilateral trade agreements.

Trends of capital flows from major world economies to East Asia since the 1997 financial crisis are rather mixed. Persistent political uncertainty, social upheaval and reform inertia within ASEAN render its members' already fragile economies more precarious. This was made worse by the Bali bomb blast. Trends are emerging that, increasingly, foreign direct investment (FDI) flows to Greater China have overtaken those to ASEAN, and will continue to do so unless its members revitalise economic co-operation and co-ordination. In 2000, of the total of \$145 billion in FDI to East Asia, \$38 billion and \$64 billion went to China and Hong Kong respectively, while the others together only received \$14 billion. A worrisome development is that global FDI suffered the biggest fall in three decades in 2001, plunging by 53% from the previous year's \$695 billion, and looked set to fall again in 2002. A recent study of competitiveness amongst ASEAN-10 + 3² based on economic, social, political and business environment factors, ranked China third after Singapore and Malaysia.³ More FDI flows to China are expected as it continues to record spectacular figures for economic success; for example, it moved from being the world's ninth-largest trading nation in 2000 to the sixth-largest in 2001.

I would like to briefly review recent trade liberalisation initiatives and assess their implications. The ASEAN Free Trade Area (AFTA) — an emerging market of more than 500 million people — is to achieve full implementation

by 2002 through closer co-operation and co-ordination, which appeared to have deteriorated somewhat since the 1997 financial crisis. The China–ASEAN Free Trade Area (FTA), proposed in November 2001 and to be completed by 2012, is essentially more of a politically motivated intent than an economically driven effort, and is aimed at calming slow-growing ASEAN countries. The Japan–ASEAN FTA proposed in January 2002 could be perceived as the expression of a long-standing desire by Japan to provide economic leadership in Asia to counter Chinese influence in the region. Enthusiasm for this project may well have dwindled as FDI in ASEAN in the 1990s dropped because of the stagnant Japanese economy, and the outcome of the renewed attempt in December 2003 to revitalise interest amongst ASEAN members has yet to be seen.

The US–ASEAN FTA proposed in March 2002 is a serious strategy by the US to stay engaged with ASEAN, made more urgent by the 11 September attacks and the global terrorist threat. It is also a conscious effort to ‘balance’ the US strategic position in East Asia. After the EU–ASEAN ministerial meeting in December 2000, there is potential for an EU–ASEAN FTA in the near term. EU members must cultivate new markets in the growing Asian region to help overcome their worsening fiscal positions, and it is therefore vital to continue engaging ASEAN through more contacts, interests and understandings. At the 2003 Bali meeting, ASEAN members endorsed the vision of establishing an ASEAN Economic Community by 2020, as first envisaged in November 2002 by Prime Minister Goh Chok Tong of Singapore. In the longer term, Dr Thaksin, prime minister of Thailand, proposed in February 2002 to establish an Asian Co-operation Dialogue, which would be a pan-Asian economic forum.

Chinese accession to the WTO and worrisome trends in East Asian economies

A recent study has shown that market size and an abundant, cheap, high-quality labour force are crucial factors for China in attracting investments from multinational companies (MNCs).⁴ While ASEAN may have lost out to China and newly industrialised economies (NIEs) on FDI flows, the opening up of Chinese markets presents new opportunities, and Chinese investment flows into ASEAN can be expected, possibly in the medium term. With rational discussion, so as to minimise conflicts of interest and expand the scope for co-operation between ASEAN-10 and China, the former should strategically recognise the latter’s economic dominance and work on resolving disputes over territory and resources. At the same time, they should co-ordinate efforts directed at economic development, especially of

the ASEAN transitional economies, such as Vietnam, Myanmar, Cambodia and Laos.

The negotiation of the so-called 'Three Links' (i.e. transportation, postal and trade linkages) between China and Taiwan, once activated, would also have significant economic implications for East Asian economies, especially Hong Kong, Singapore, Malaysia and ASEAN in general. Studies have shown that direct China-Taiwan transport links would reduce transport costs by between 15% and 42%. Transportation services in Hong Kong and Singapore would be most affected. This would result in a 0.14% and 0.36% gross domestic product (GDP) gain for China and Taiwan respectively. Direct transport links would also expand trade by 0.39% and 0.58% for China and Taiwan respectively. Hong Kong's trade would contract by 0.06% and ASEAN members' trade would be adversely affected too. A 2001 study by the Singapore Ministry of Trade and Industry concluded that both Hong Kong and Singapore would lose their competitive edges in terms of logistics support, financial services and serving as regional headquarters for Taiwanese MNCs.

There are some worrisome trends in and challenges confronting East Asian economies that warrant close attention. Firstly, there is the elevation of Taiwan in the overall strategic paradigm, where it becomes an important player in the overall US Asia-Pacific framework, instead of just a factor in Sino-American relations. If not properly handled, this could seriously upset China's growth momentum and East Asian stability. Secondly, East Asian economies need swiftly to further reduce the role of state-owned enterprises and give a greater role to private-sector entrepreneurs. Thirdly, in the aftermath of the 1997 East Asian financial crisis, political and economic reform inertia due to cronyism, nepotism, poor corporate governance, high indebtedness and weak budgetary discipline has yet to be significantly tackled.⁵ Fourthly, given the history of enmity, rivalry and uneven distribution of power among them, East Asian economies are not yet ready for an integrated Asian Economic Community (AEC), nor are they prepared to make the concrete adjustments and policy changes required for successful implementation of regional arrangements. Finally, an ASEAN-10 + 3 framework and regional financial arrangements are crucial for East Asia's economic stability, but the ultimate issue remains of who is to pay for these facilities.⁶

Recent East Asian trade and investment trends: Challenges and opportunities for South Africa

With China emerging as the global manufacturing house, the challenge to South Africa is to position itself to attract multinational enterprises that may

be adopting a diversified investment strategy for business and political reasons. Given the relatively lower costs of production and its abundant raw materials compared to most East Asian economies, South Africa is well-positioned to do this.

Under the WTO agreement, and with the opening up of the huge Chinese market and the emergence of a sizeable (and growing) Chinese middle class, the supply by Africa of agricultural products and processed food products to China is a new opportunity, as the latter's resources are increasingly being diverted to manufacturing.

The implication of Africa's not plugging itself into the loop of the globalised trade and investment network is that it risks being further marginalised and becoming irrelevant. A comprehensive and consistent export-oriented strategy for Africa would be a useful complement to existing internal growth policies, with the aim of longer-term economic, political and social stability.

Since Singapore is among the pioneers and initiators of the various bilateral free trade agreements, it would be wise for South Africa to follow the former's leadership in extending its international trade linkages by forging more bilateral FTA partnerships in order to plug into globalisation. A particular emphasis should be placed on agreements with East Asia.

Conclusion

Can business proceed as usual with the current tension across the Taiwan Strait, given the impending Taiwanese presidential election on 20 March 2004? Intense political tension among Taiwan's ruling and opposition parties has paralysed effective economic policy formulation. Recent statements by the US and Chinese governments on the issue of a public referendum in Taiwan added further uncertainty to an already precarious cross-strait relationship and threaten to internationalise what was originally supposed to be an internal affair between mainland China and Taiwan. Increased tension in the area would undermine economic recovery in East Asia, which seemed to have started in October 2003.

Given the recent terrorist threats and the terrorist networks recently exposed in several ASEAN countries, international and regional co-operation is crucial, as the globalisation of security follows the globalisation of the economy. With greater political unity and improved corporate governance, ASEAN must forge joint FDI promotion packages. Exchange rate realignment and macro-policy co-ordination among the governing authorities of East Asian economies must be the *sine qua non* for currency stability in East Asia.

Assuming no further widespread outbreaks of severe acute respiratory syndrome (SARS) in East Asia, a forecast of shorter- and longer-term GDP growth of the various East Asian economies is given in the following table.

Table 1: East Asian GDP growth forecast

	2001 / 2002 / 2003	2001–2010
China	7% / 8% / 7.5%	6–8%
Indonesia	4.5% / 2.5% / 4.5%	2–4%
Hong Kong	–0.3% / 1.5% / 3%	2–4%
Malaysia	0.4% / 4% / 5%	5–7%
Taiwan	–2.7% / 3% / 4%	2–5%
Philippines	3.5% / 4% / 4%	2–4%
Japan	–0.5% / 0% / 1%	0%
Singapore	–2.2% / 2% / 1%	4%
Korea	7.5% / 6% / 6%	5–7%
Thailand	4% / 5% / 6%	5–7%

Endnotes

- 1 Countries belonging to ASEAN include Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.
- 2 The +3 grouping includes China, Japan and Korea.
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South African Trade and Investment Trends in East Asia

Isaac Matshego

Background information

South Africa's relations with the East Asian bloc have evolved in line with the country's relations with the rest of the world. They were characterised by an absence of formal diplomatic relations or the existence of 'restricted relations'¹ before 1994, due to the country's socio-political policies before that date. Following the transition to a new dispensation in 1994, formal diplomatic and economic relations were established or existing ones strengthened. Relations with East Asian countries were established mainly in terms of bilateral trade agreements and treaties aimed at avoiding double taxation, with the most significant event being the termination of formal relations with Taiwan in favour of formal relations with China in 1998.

South Africa's trade profile has changed over the past few years as economic sanctions against the country were lifted. The country's trade policies were also reoriented towards production rather than consumption. While overall trade expanded, trade with some economic blocs increased at a faster pace. Notably, total trade with East Asia expanded by around 260% over the 10-year period to 2001 and it became South Africa's second-largest regional trading partner after the EU. This expansion was driven mainly by exponential growth in trade with China since 1998. For the purposes of this paper, the East Asian bloc will include China, Hong Kong, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand. These were South Africa's top trading partners in East Asia in 2001, with their individual shares in South Africa's total trade ranging from 8% for Japan to 0.2% in the case of the Philippines. In 2001, these 10 countries had a combined population of 1.8 billion and their combined gross domestic product (GDP) amounted to \$6,700 billion. This compared with South Africa's population of 44 million and GDP of \$114 billion in the same year.

Differences in economic growth and the level of development between South Africa and the East Asian economies have defined the patterns of trade

and fixed investment between them. While South Africa is classified as a developing economy, the East Asian region consists of a diversity of economies across the development continuum. This includes the highly industrialised economies of Japan and Hong Kong (based on manufacturing and trading), the newly industrialised economies (NIEs) of Malaysia, Singapore, Taiwan and South Korea, and the developing economies of China, Indonesia, the Philippines and Thailand. Although South Africa has diversified its exports, it still exports mainly raw materials and semi-processed minerals and metals (iron, steel and gold) to these countries, while imports consist of high-value-added goods (electronic equipment and textiles).

In the case of fixed investments, capital flows are mainly from East Asian countries to South Africa, with East Asian firms investing primarily in the automotive and telecommunications sectors. South African investments in East Asia are rising, but the size of the capital flows remains negligible.

This paper will review developments in goods-only trade between South Africa and the East Asian bloc between 1992 and 2001. It will assume a largely static approach, as opposed to a dynamic analysis of the developments in trade. In other words, the trade situations in 1992 and 2001 will be compared without investigating the developments that occurred between these dates. South African fixed investment trends in East Asia and investment opportunities in the region, particularly in China, will then be discussed. The focus will be mainly on China, as it has established itself as the regional economic hub in recent years.

Trade with East Asia

East Asia's significance in terms of South African exports

The East Asian bloc remains significant as a market for South African exports, absorbing goods worth R9,241 million in 1992, equivalent to 13.3% of total South African exports. The market share remained steady at 13.3% of total exports in 2001, amounting to a total of R31,739 million in nominal terms. This suggests that the nominal value of exports to East Asia increased in line with the nominal value of total South African exports over the period. The East Asian financial market crisis of 1997, which dampened global economic growth, had an adverse effect on South African exports to East Asia. In constant terms, exports to Hong Kong were down by 24.0% in 1997 and by 18.1% in 1998, while those to Singapore plunged by 30.9% in 1998, following the 36.6% decline in 1997. The performance of South African exports to other countries in the East Asian bloc experienced similar weaknesses, but exports to these countries recovered significantly in subsequent years.

Changes in the shares of individual countries in South African exports were characterised by a significant increase in China's share in both total and regional terms, which increased to 1.7% of total South African exports in 2001 from 0.7% in 1992. On a regional basis, China's share increased to 13.2% of exports to East Asia in 2001 from 5.5% in 1992, becoming the second-largest market in the region after Japan, whose regional share was virtually unchanged at 34.5% in 2001 from 34.3% in 1992. (Japan's share in total South African exports remained unchanged at 4.6% over the period.) Taiwan's and Hong Kong's shares in trade with East Asia were halved to 12.4% and 8.3% in 2001 from 23.3% and 16.2% in 1992 respectively, while their shares also fell significantly on a total basis.

In terms of goods exported, in 1992, South Africa's export basket to Asia (this includes the East Asian bloc, India, Turkey and the rest of Asia)² was made up of mainly iron and steel products (27.8%); mineral fuels, oil, etc. (13.7%); and ores, slag and ash (9.2%). In 2001, the basket was still dominated by iron and steel (16.3%), and ores, slag and ash (10.0%). Aluminium (12.0%) and vehicles (8.4%) had become significant in the export basket to Asia, while the share of mineral fuels, oil, etc. had dropped to 4.9%. The higher importance of aluminium and vehicles in the export basket demonstrated the relative success of South Africa's policy of reorienting its policies towards promoting manufactured goods in trade during the 1990s.

Table 1: South Africa's exports to East Asia

	<i>R million</i>		<i>% of total SA exports</i>		<i>% of SA exports to East Asia</i>	
	1992	2001	1992	2001	1992	2001
China	508	4,177	0.7	1.7	5.5	13.2
Hong Kong	1,493	2,623	2.2	1.1	16.2	8.3
Indonesia	128	952	0.2	0.4	1.4	3.0
Japan	3,166	10,974	4.6	4.6	34.3	34.5
Malaysia	9	1,352	0.0	0.6	0.1	4.3
Philippines	130	374	0.2	0.2	1.4	1.2
S. Korea	1,006	3,845	1.5	1.6	10.9	12.1
Singapore	310	1,996	0.4	0.9	3.3	6.3
Taiwan	2,150	3,938	3.1	1.6	23.3	12.4
Thailand	339	1,508	0.4	0.6	3.7	4.8

Source: Commissioner of Customs and Excise, South African Revenue Service and author's calculations

East Asia's significance in terms of South African imports

In terms of imports, the East Asian bloc remains significant as a source of imported goods for South Africa. Although East Asia's share of South Africa's total imports declined slightly, it still remained significant at 19.3% in 2001 from 21.3% in 1992. In nominal terms, total imports from East Asia were up three-fold to R42,465 million in 2001 from R11,251 million in 1992.

A sharp increase in imports from China — as was the case with exports — was behind the strong increase in total imports from East Asia. China's share rose to 4.2% of South Africa's total imports in 2001 from 1.2% in 1992, while in the East Asian bloc, China's share increased to 21.6% from 5.8% over the period. Japan recorded the largest decline in its share of South Africa's imports from the East Asian bloc, which dropped to 34.9% from 49.4%, while Taiwan's share was down to 10.8% from 15.6% over the period. Hong Kong and Singapore also lost market share on a regional basis, while South Korea, Thailand, Malaysia, Indonesia and the Philippines each accounted for a larger share of South Africa's imports from East Asia than they did in 1992.

In 1992, vehicles, parts and accessories (22.1%); machinery and appliances (18.9%); and electrical machinery (12.7%) dominated South Africa's import basket from the East Asian bloc. By 2001, machinery and appliances, and electrical machinery accounted for 17.8% and 15.1% respectively, while the share of vehicles, parts and accessories dropped to

Table 2: South Africa's imports from East Asia

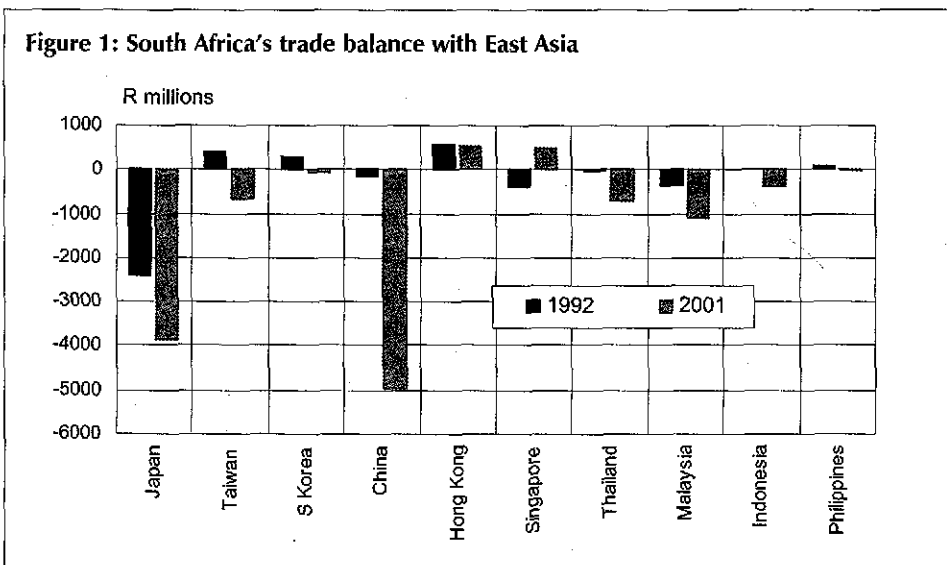
	<i>R million</i>		<i>% of total SA imports</i>		<i>% of SA imports from East Asia</i>	
	1992	2001	1992	2001	1992	2001
China	652	9,166	1.2	4.2	5.8	21.6
Hong Kong	943	2,090	1.8	0.9	8.4	4.9
Indonesia	133	1,332	0.3	0.6	1.2	3.1
Japan	5,560	14,838	10.6	6.7	49.4	34.9
Malaysia	357	2,456	0.7	1.1	3.2	5.8
Philippines	54	388	0.1	0.2	0.5	0.9
S Korea	708	3,896	1.3	1.8	6.3	9.2
Singapore	696	1,492	1.3	0.7	6.2	3.5
Taiwan	1,761	4,595	3.3	2.1	15.6	10.8
Thailand	387	2,213	0.7	1.0	3.4	5.2

Source: Commissioner of Customs and Excise, South African Revenue Service and author's calculations

5.3%, as the share of 'other imports' increased to 52.1% from 36.9%. 'Other imports' consist of a diversity of consumer and industrial goods. Their higher share indicates the changing mix of South Africa's import basket from East Asia.

The trade balance

As a result of this strong growth in imports from East Asia, South Africa's trade deficit with the bloc surged to R10.7 billion in 2001, from R2.0 billion in 1992. As illustrated by Figure 1, below, the strongest increase was in the deficit with China — which widened from R144 million in 1992 to R5.0 billion in 2001 — while that with Japan was higher at R3.9 billion from R2.4 billion. Deficits with Indonesia, Malaysia and Thailand also increased considerably over the period. In the case of Taiwan, South Korea and the Philippines, the trade balance switched from a surplus to a deficit, while with Singapore, South Africa recorded a R503.9 million surplus in 2001 from a R386.2 million deficit in 1992. South Africa maintained a trade surplus with Hong Kong over the period, but that surplus was slightly down to R533 million in 2001 from R551 million in 1992 in nominal terms.



South Africa's massive trade deficit with East Asia can be addressed by increasing exports of goods to the region, particularly to the rapidly expanding China. The Chinese economy saw vehicle sales surge by 30% during the first three-quarters of 2003, with sales of passenger cars up by 69%, while the construction industry also recorded strong growth in activity

(up 31.4%). China's official growth rate was an annualised 8.5% over the period. This booming economic activity has created enormous demand for commodities such as iron and steel, aluminium, copper and zinc. The booming car industry in both Japan and China also presents opportunities for South African carmakers, while component makers are also likely to take advantage of this. Amongst others, BMW South Africa has already shipped R20 million worth of components to China, following the establishment of an assembly plant by its German parent company in that country.

Precious metals, such as gold, and articles made from them also present an export opportunity in the light of China's enormous potential consumer demand. China's gold consumption per head was estimated at only half that of India, one-fifteenth that of Taiwan and one-thirtieth that of Hong Kong.³ However, agricultural production has lagged behind the overall economy's rapid expansion, with indications that the country might have to import food within the next decade. This presents opportunities for South Africa's agricultural producers. Demand for raw materials and intermediate goods from the manufacturing-oriented economies of the region such as Japan and Malaysia also presents significant markets for South African goods.

South African investment trends in East Asia

The nature of relations between South Africa and some East Asian countries before 1994 resulted in a dearth of fixed investment by South African corporates in that region, while there was considerable indirect investment by East Asian companies in South Africa. Over recent years, direct investment by East Asia in South Africa has grown strongly, with capital investments mainly from Japan, Malaysia and recently China. An estimated R6 billion was invested or committed by Japanese firms alone over the period between April 1994 and May 2002, while around \$115 million was invested by Chinese companies in South Africa in 2002.⁴

However, this strong trend has not been reciprocated by significant outflows of fixed capital from South Africa to East Asia. Large investments in East Asia by South African corporates are the \$400 million investment by SAB Miller Plc in the Chinese consumer goods sector over the past 10 years, while Kumba Resources is currently (June to December 2003) investing an estimated \$13.3 billion in a zinc smelter in China. According to the South African Institute of International Affairs (SAIIA), other South African corporates active in China include Iscor, Polifin, Sasol, ABSA and Nedcor, while Standard Bank also has an East Asian operation based in Hong Kong. South African corporate investment in China amounted to \$130 million in 2002.

Opportunities for South African companies in East Asia, particularly China, exist in financial services, mining and agro-processing. South Africa's management capability, i.e. the ability to organise production activities and technology, give the country's companies a competitive edge in global markets. China's banking sector is being liberalised, albeit at a very slow pace, and this presents opportunities for South African banks to target niche markets. (I refer to niche markets because the sheer size of the country may pose capacity challenges for South African banks.)

In the mining field, China has a large coal and gold mining industry, with the country being the world's fifth-largest gold producer (output was 182 tons in 2001). However, its mining industry is plagued by production inefficiencies and safety problems, presenting opportunities for South African mining conglomerates, which are renowned the world over for their management and mining technology. China allowed foreign participation in gold mining in 1994, but South African mining houses have not as yet taken advantage of this, with indications that only Anglo American is interested.

Agro-processing industries also present opportunities for South Africa in China. The agricultural sector accounts for 15% of China's economy and due to the large and expanding population, the agricultural sector struggles to keep up with domestic consumption.

Conclusion

The East Asian bloc remains a major trading partner for South Africa, accounting for the second-largest regional share of South Africa's total trade after the EU. While South Africa exports mainly raw materials to the region, manufactured goods are the main imports. The bloc's total share in South Africa's trade was largely unchanged in the period 1992 to 2001, expanding in line with the growth in South Africa's total trade. Changes in individual East Asian countries' shares in terms of South Africa's regional and global trade were characterised by strong increases in China's share in both exports and imports. The strong growth in imports from China resulted in South Africa's trade deficit with the East Asian bloc widening to R10.7 billion in 2001 from R2 billion in 1992. Increasing South African exports of agricultural products, precious metals, iron and steel, copper, vehicles and parts to the bloc can reduce this deficit.

In terms of investment, East Asia presents opportunities for South African companies in the niche financial services, mining and agro-processing industries. South Africa's management resources and technology would be the main factor in giving South African companies a competitive advantage in East Asian economies.

The East Asian bloc thus presents a great opportunity for South Africa to expand its imports and for South African companies to diversify their investments. The very large size of the region in terms of population and GDP, as well as the relative underdevelopment of some of the countries (particularly China), suggests that South Africa needs to develop a clear policy of expanding both trade and fixed investment in the region. In the scramble for China, it is important that South Africa is not left out in the cold.

Endnotes

- 1 The term 'restricted relations' means that while formal diplomatic relations were in place, economic relations were characterised by the imposition of economic sanctions against South Africa.
- 2 India, Turkey and the rest of Asia account for 14% of total Asian trade with South Africa.
- 3 See Adams JS, *Deregulation of the Gold Market in China*, Altrincham, England: AMCD (Publishers) Ltd, 2000.
- 4 See Mills G & G Shelton, 'From butterflies to take-off? Asia-Africa trade and investment ties', *Asia-Pacific and Africa: Realising Economic Potential*. Johannesburg: SAIIA, 2003, pp.30 & 36.

Spots on the Butterfly's Wings? Developing a South African Diplomatic Strategy towards Asia

Greg Mills

Introduction

Since South Africa's formal reintroduction into the international community in 1994, Asia's¹ profile from South Africa's point of view has gone through two distinct periods of alteration. Firstly, there was the 'expansion phase' in diplomatic, trade and investment ties from 1994 to 1999, coinciding with the honeymoon years of South African foreign policy during the Mandela period. Secondly, there was the 'consolidation phase' from 1999 onwards, characterised by a levelling off in the scale of trade and investment links and the seeking of deeper political relationships in line with the wider African aspirations encapsulated in the New Partnership for Africa's Development (Nepad). These phases and their impact on the development of a South African diplomatic strategy for Asia are examined below.

The status quo

On the face of it, South Africa's relations with Asia have enjoyed a tremendous period of expansion in terms of growth in diplomatic relations and increase in trade and investment ties. Consider the (nominal value) trade increases since 1994 shown in Table 1 (*over page*).

Before 1994, South African trade with Asia was limited to Japan, South Korea and Taiwan. Table 1 tells us that trade increased rapidly after political impediments were removed, though this expansion phase has tailed off significantly since 1999. A number of other trends are discernible in South African foreign policy towards Asia after 1994.

- Firstly, Asia proved to be — perhaps unsurprisingly — the site early on for the collapse of a South African foreign policy focused on human rights issues. This collapse was indicated by the political support given to

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Table 1: Select trade links: SA-Asia, 1994-2001 (R million nominal values)²

	1994 (SA exports)	1999 (SA exports)	% increase, 1994-99	2001 (SA exports)	% increase, 1999-2001
Australia	1,734 (521)	5,956 (2,678)	243	9,858 (3,841)	66
China (including Hong Kong)	4,826 (2,079)	10,749 (4,013)	123	17,629 (6,599)	64
India	894 (488)	3,874 (2,362)	333	5,282 (3,162)	36
Indonesia	345 (281)	1,946 (782)	464	2,248 (925)	16
Japan	12,051 (4,158)	22,671 (11,236)	88	33,915 (19,450)	50
Korea (South)	2,824 (1,745)	7,007 (4,201)	148	7,942 (4,051)	13
Malaysia	1,091 (343)	2,532 (750)	132	3,993 (1,525)	58
Philippines	251 (166)	503 (234)	100	758 (368)	51
Singapore	1,454 (460)	2,408 (1,036)	66	3,378 (1,915)	40
Taiwan	4,475 (1,871)	7,173 (3,538)	60	8,282 (3,876)	15
Thailand	1,673 (694)	2,671 (1,176)	60	3,518 (1,286)	32
Vietnam	28 (3)	128 (26)	357	271 (102)	112
Total (Australasia and Asia)	34,524	69,026 (32,890)	100	99,280 (48,367)	44

Suharto in Indonesia and the difficulty in upholding a policy based on human rights with mainland China (which is, of course, not unique to South Africa).

- Secondly, Asia has also proved to be a key area for financial support of the African National Congress (ANC). In 1997, for example, President Mandela acknowledged that at his request Prime Minister Mohamad of Malaysia had donated \$50 million to the party, while President Suharto of Indonesia had given \$60 million.³ Earlier it was announced that the ANC had received \$10 million in funding from the Taiwanese government for the 1994 election campaign.
- Thirdly, key countries in Asia, notably India from the time of Mohandas Gandhi, were also key supporters of the liberation struggle, providing a strong emotive link with the new South Africa, especially during the Mandela years. As President Mbeki put it on a visit to India in October 2003:⁴

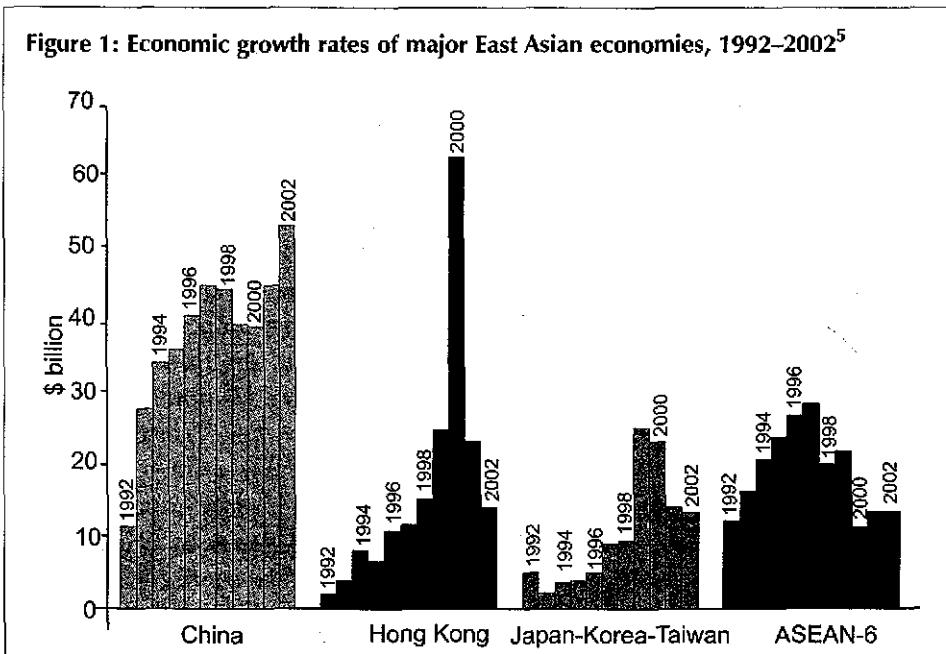
I stand here feeling that I have indeed come home again. This is particularly because Indian and South African freedom fighters have shared an enduring and special bond of kinship, friendship, solidarity and comradeship for more than a century. We can therefore say, without any hesitation, that we are not fair-weather friends — we have been, we are and always will be strategic partners for all seasons.

- Fourthly, while regular bilateral meetings have been held with key partners in Asia, the tailoring of specific national policies has been largely subjugated to broader overarching goals, such as North-South co-operation. This explains the diminished focus on the specifics of the relationships and the tendency to concentrate on the framework and process of interaction, such as the establishment in June 2003 of the India, Brazil and South Africa Dialogue Forum or the Sino-Africa Co-operation Forum launched in Beijing in 2000.

Key developments and trends

With the above in mind, there are a number of key regional trends that should be highlighted for the purpose of developing a South Africa-Asia diplomatic strategy.

- Firstly, there is the extraordinary growth phase of Asian economies, particularly South-East Asian economies, over the past 30 years. The figure below gives growth figures for the period 1992-2002.



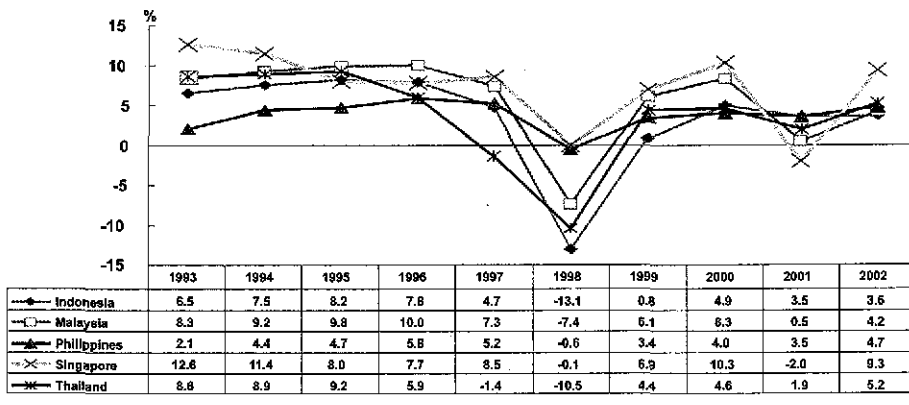
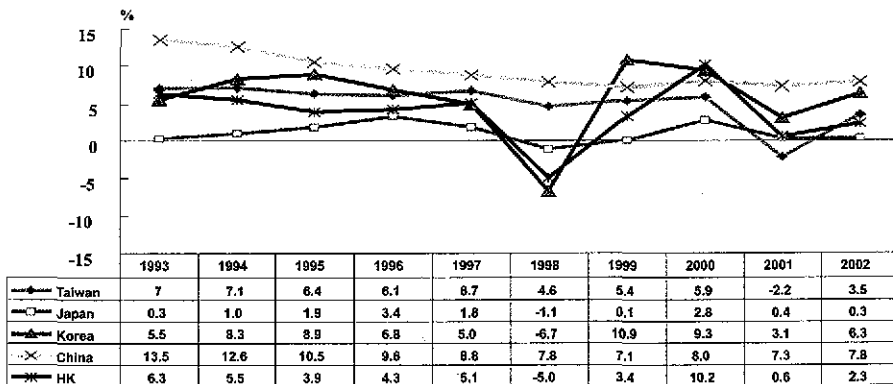
Indeed, it is predicted that East Asia's share of the global economy will increase from 5.4% of a \$21 trillion market in 1990 to an estimated 15.9% of a \$50 trillion economy by 2020.⁶ Table 2 (*over page*) gives a regional breakdown of the share in global gross domestic product (GDP) of the various regions of the world.

- Secondly, while South Asia should be disaggregated to a degree from South-East Asia and North-East Asia, the region's economies are remarkably interconnected. This is evidenced from Figure 2 below highlighting regional GDP growth rates.⁷

Table 2: Projected share of global GDP (%)

	1990	2020
Japan	13.9	9.6
East Asia	5.4	15.9
USA	26.1	18.5
Western Europe	24.8	19.4
Others	29.8	36.6

Figure 2: East Asian regional GDP growth, 1993–2002



- Thirdly, the development of 'Greater China' — or China Inc — is possibly the most significant economic development over the past two decades and arguably will be the most important factor shaping the global economy for the foreseeable future. No matter what the People's Republic of China (PRC) looks like in 10, 15 or 20 years from now — a permanently half-reformed state economy, a corporatist state, an incipient market economy, or on its way to becoming something different altogether — the implications for the rest of the world will be immense. In the year 2010, 'Greater China' will have close to 1.5 billion people, making it the largest homogenous linguistic region in the world with the largest pool of talent and an increasingly well-trained supply of labour. Driven by exports, GDP growth averaged 9.7% over the two decades to 2000,⁸ and recorded 7.5% in 2001, 8% in 2002 and 9.9% during the first quarter of 2003.⁹ According to *The Economist*,¹⁰ the combined economies of the PRC, Taiwan and Hong Kong amounted to \$1.437 trillion in 2002, making 'Greater China' the fourth-largest economy in the world. In September 2003, the combined foreign reserves of the PRC, Hong Kong and Taiwan amounted to \$686.6 billion,¹¹ an amount by far exceeding any other emerging market. When we talk of billions and trillions, the figures are so vast that they become almost meaningless, so it is worth re-expressing them in more manageable terms.¹²
 - If the Chinese ate as much fish per head as the Japanese, they would consume the entire world fish catch of 101 million tons.
 - If the Chinese used as much vegetable oil as the Japanese, they would require seven million more tons than they do at present, expanding the world market by one-third.
 - If the Chinese consumed as many eggs as the Americans, they would require a flock of 1.3 billion hens. Reaching this goal would require an additional 24 million tons of grain, equal to Canada's entire grain exports.
 - If China were to reach the US level of car ownership and oil consumption, it would require 80 million barrels of oil per day. The world currently produces only 64 million.¹³
- Fourthly, there is the current emergence of India, a market of around one billion, from its 'Hindu rate of growth' to enjoy today GDP growth rates in the 5-7% annual range.¹⁴
- Fifthly, as Table 3 (*over page*) indicates, there is an increasing regional awareness of the benefits of and willingness to enter into regional free trade agreements, notably those in the Asia Free Trade Area, but also a number of bilateral agreements between, for example, Singapore–New Zealand (2001) and Japan–Singapore (2002). Those under negotiation or

recently concluded include Korea–Chile, Japan–Mexico, Singapore–Australia, Singapore–US, Singapore–Canada, Singapore–Mexico, Singapore–EFAT (European Free Trade Area), Singapore–Hong, and China–Association of South-East Asian Nations (ASEAN). Those under study include Japan–Korea, Japan–ASEAN, Japan–Thailand, Japan–Philippines, Japan–Taiwan, Japan–Australia, Japan–Chile, Korea–ASEAN, Korea–Singapore, Korea–Australia, Korea–New Zealand, Thailand–Australia, Thailand–US, Singapore–Chile, Singapore–Taiwan, Singapore–India, ASEAN–India and ASEAN–US.¹⁵

Table 3: The changing pattern of intra-regional trade in world trade¹⁶

	Intra-regional trade as a % of global trade		Intra-regional exports as a % of a region's overall exports		Intra-regional imports as a % of a region's overall imports	
	1990	2001	1990	2001	1990	2001
East Asia	8.4	11.9	40.1	47.5	47.5	56.9
NAFTA	6.7	10.0	41.4	54.6	35.0	42.0
EU	29.1	22.3	66.0	60.8	66.6	62.1

The growth of the Chinese economy

If we focus on the growth of the Chinese economy, it should be noted that China has attracted more than \$350 billion in foreign direct investment (FDI) over the past decade. This is a result both of the size of the increasingly wealthy market represented by its more than 1.2 billion people and the global competitiveness of its production costs. While not democratic, China is politically stable. To put the scale of this growth into perspective, sub-Saharan Africa's population of 600 million is, by comparison, becoming increasingly poorer, attracts less than 10% of China's FDI figure, and, while democracy has spread, is characterised by widespread conflict and instability. Whereas China's GDP per head growth rate was 9.5% in the period 1990–99, sub-Saharan Africa's was –0.4%.

The impact of the development of an increasingly economically integrated China Inc apart, the growth of the Chinese economy has a number of implications that are worth highlighting here.

- Firstly, there is a concern that China's emergence as an industrial power could 'hollow out' other areas of industrial capacity, particularly in East Asia, but also in other developing and developed regions alike, as a result of increased competition in manufactured goods and in the traditional

markets of other economies. However, recent analysis has shown that 'China's expansion and its growing role in regional trade is not at the expense of the rest of Asia.' Overall, China's growth is seen 'as a positive sum game for the region ... overall all economies appear to be gaining.' Economic analysis of East Asia shows that 'China's continuing industrial expansion is not damaging but benefiting other regional economies. China is more closely integrating into mutually beneficial regional production chains, stimulating regional trade growth.'¹⁷ Countries have responded to China's comparative labour efficiencies by shifting exports into other areas, particularly capital, technology and human capital-intensive industries.

- Secondly, it is important to point out that, for East Asia, China's economic expansion is 'causing rapid changes in production patterns and trade flows within East Asia and between the region and third markets.'¹⁸ As noted above, this will inevitably have an impact not only on manufacturers and their export profiles, but also on exporters of services and commodities. Competitors will have to move into areas where they have comparative strengths, i.e. away from labour-intensive industries. An assessment of the impacts of China's rise and the changes it is bringing about are critical for other countries, such as those in Africa, as this may significantly alter profiles of exports, not only to China, but to the whole of the East Asian region. For example, China's economy is expected to surpass that of Japan's by 2030, moving up the value chain as a target for export goods.

Table 4: Projected relative size of the Chinese economy, assuming constant exchange rates, 2000–50¹⁹

China's size relative to ...	2000	2010	2020	2030	2040	2050
United States	0.1	0.2 (0.1 to 0.2)	0.2 (0.1 to 0.3)	0.3 (0.2 to 0.6)	0.4 (0.2 to 0.9)	0.4 (0.1 to 1.2)
Japan	0.4	0.4 (0.3 to 0.5)	0.6 (0.4 to 1.0)	1.0 (0.5 to 1.9)	1.5 (0.6 to 3.7)	1.7 (0.5 to 5.5)
Germany	0.6	0.9 (0.7 to 1.1)	1.4 (0.8 to 2.2)	1.9 (0.9 to 3.9)	2.7 (1.0 to 7.0)	3.1 (0.9 to 10)
South Korea	2.4 times	2.6 (2.0 to 3.4)	2.9 (1.6 to 5.0)	3.5 (1.5 to 8.1)	4.2 (1.3 to 13)	4.4 (1.1 to 17)
Australia	2.6 times	3.7 (3.0 to 4.6)	5.3 (3.4 to 8.1)	6.8 (3.6 to 13)	8.9 (3.8 to 21)	9.6 (3.3 to 28)
Taiwan	3.5 times	3.8 (3.0 to 5.1)	4.2 (2.4 to 7.4)	5.1 (2.2 to 12)	6.2 (2.0 to 19)	6.5 (1.6 to 26)

- Thirdly, given the overall benefit of China's economic expansion in terms of stimulating restructuring and boosting industrial efficiency and growth, this should boost third-country exports to the region. However, specific sectoral analysis is required — for example, China will probably continue to show strong demand for most minerals, energy and agricultural commodities.

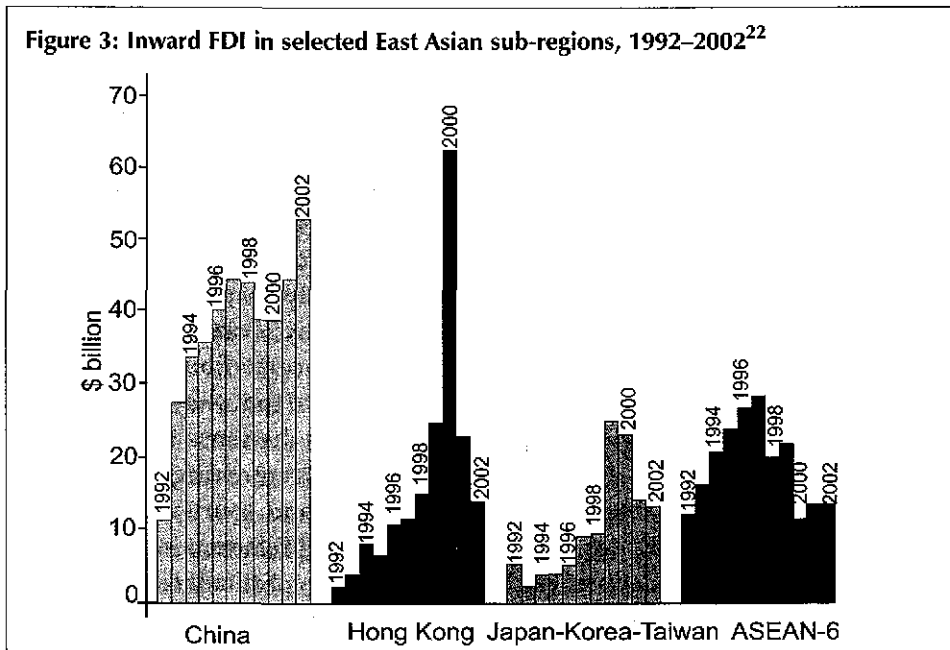
Table 5: Current and projected Chinese net imports of selected Australian exported commodities, 2002 and 2010 (\$ billion)²⁰

	2002 (actual)	2010 (projected)	Average annual percentage increase
Iron ore	2.77	3.81	4.10
Hides, skins and leather	2.30	3.23	4.30
Petroleum gas	1.35	2.39	7.40
Copper ore	0.81	1.50	8.00
Alumina	0.62	0.90	4.80
Wool	0.80	0.87	1.10
Canola seed	0.15	0.89	24.90
Barley	0.29	0.53	7.80

But as other East Asian economies respond to China's rise, the export of commodities may fall to these countries. China's coal industry may also supply an increasing percentage of the regional demand. Areas where South African exports have been growing — such as the auto industry — also require detailed analysis. A report by the Federation of Korean Industries and the Korean Ministry of Commerce, Industry and Energy notes that, for example, China is outstripping Korea in six industrial sectors: electronics, steel, automobiles, textiles, petrochemicals and shipbuilding, and that China will surpass Korea in competitiveness in the auto industry by 2010.²¹

- Fourthly, China's relative attractiveness to investors is a challenge for East Asia, as it is for Africa. FDI into China has doubled over the past decade, peaking at some \$53 billion in 2002, larger than even the US. While this share is not disproportionate to China's GDP and its population, it will at the very least stimulate competition and trade, when coupled with increased trade liberalisation under the World Trade Organisation (WTO).

In summary, overall, as China expands its economy and market, most other countries should benefit. But as the previously mentioned Australian Department of Foreign Affairs and Trade report notes, 'China's industrial rise



is a major boon for the region, providing a strong engine of growth, but the most flexible economies will reap the greatest benefits in the significant industrial restructuring now underway.²³ For example, those countries in the East Asian region that are currently restructuring their economies to meet this challenge — including Japan, Korea, Taiwan, the Philippines and Singapore — will stand to gain most.

Developing an appropriate diplomatic strategy

Until now, the South African government has relied on overall policy rubrics such as *Nepad* and the so-called 'African Renaissance' (the latter currently the 'first priority' for the Department of Foreign Affairs)²⁴ to set policy parameters for the national interest, both of which are very vague guidelines. Greater policy direction and focus has come from the Department of Trade and Industry (DTI), though it is still unclear where the establishment of free trade areas with Asian countries sits in terms of overall DTI priorities relative to other areas. Such obtuseness may reflect competing departmental priorities and the extent to which policymakers and practitioners are overloaded, and may also indicate the difficulty for both the National Party government and the ANC of changing direction from an apartheid-focused foreign policy. It also reflects the advantages that this generation of practitioners has enjoyed in its foreign ties generally. In moving from isolation to integration and from the anti-apartheid movement

into government, it has been able to surf a wave of emotional goodwill, which is an enormous if slowly dissipating foreign diplomatic asset. As John Reed, the *Financial Times* correspondent in South Africa, has argued, '[i]t is nice to live in a land everyone wishes well.'²⁵ Currently, the South African government's official strategy (inasmuch as one can be discerned beyond high-profile visits, speeches, aid conferences and a report-back on all of these) towards Asia and the Middle East is: 'Increased focus on opportunities such as trade, investment, tourism and skills development; Closer relations with China as the world's fastest growing economy; Focus on combating transnational crime; [and] Focus on Multilateral Co-operation.'²⁶

Such broad parameters are good and bad: bad in that they offer little in the way of specific guidelines for embassies; good in the sense that while the African Renaissance and Nepad are to be the overarching focus of all activities, almost every and any activity — trade and tourism promotion, general information activities, promotion of bilateral relations — falls under this rubric. Broad guidelines are thus neither a particular asset or an insoluble problem or an impenetrable barrier to mission activities. However, the above economic developments argue for attention to the following points.

- Firstly, a more nuanced strategic and tactical approach is needed, taking specific developments into account. For example, any diplomatic strategy has to consider the impact of the development of the Greater Chinese economy, not just in market terms, but also in terms of its wider impact on Africa.
- Secondly, with regard to Taiwan and China, there is a critical need to take note of developments between Beijing and Taipei. The debate on the two unfortunately tends to be dominated by the political impasse existing between them, and as a result the South African government (among others) prefers not to engage meaningfully with the relationship. What is seldom mentioned is the other side of the coin, the degree of economic integration and the warm people-to-people relations that exist across the Taiwan Strait.

Taiwan is the largest single investor in the PRC. According to the Mainland Affairs Council of Taiwan, approximately 300,000–400,000 Taiwanese citizens live in the PRC — mostly in areas such as Shanghai, Jiangsu, Guangdong, Fujian, Zhezian and Hebei — where they are engaged in manufacturing and industry. About 50,000 Taiwanese companies have been established on the Chinese mainland. Official figures released by the Taiwanese Ministry of Economic Affairs estimate that Taiwanese business has invested about \$60 billion in the mainland. Observers suggest that the real figure could be as high as \$100 billion.

During the first five months of 2003, approved foreign investment amounted to \$6.2 billion, of which \$4.7 billion was approved for investment in the PRC. The mainland has attracted over 75% of Taiwan's total foreign investment, distributed among the electronics and electrical appliances industries, basic metals and metal products, food and beverage processing, and plastic products. In 2002, China surpassed both Japan and the US to become Taiwan's largest trading partner. Some \$30.8 billion (23.6%) worth of Taiwan's exports were destined for the mainland.

In the information industry, which has the highest total turnover of any sector in Taiwan, its production of information technology (IT) hardware totalled \$47.8 billion. Of this output, Taiwan produced 30% in the PRC — a factor that reflects not only the growing importance of the PRC as a base for IT hardware manufacturing, but also the degree of integration that has evolved across the strait in this particular sector, where Taiwan ranks fourth globally after the US, the PRC and Japan.²⁷ The trend towards manufacturing offshore has continued to grow, with Taiwan's overseas production comprising 63.7% of all Taiwanese IT hardware manufacturing. More and more low-end products are thus being manufactured overseas, while the sales, research and development, and production of high-end items have remained in Taiwan. This outward investment — mostly to the PRC — is shifting Taiwan from a manufacturing hub into an international service supply centre of information, telecommunications and consumer electronics. Simultaneously, the two economies are becoming increasingly intertwined and interdependent.

With the above in mind, South Africa's diplomatic approach towards Asia, I suggest, should be as follows.

- Firstly, South Africa should tailor a strategy linked to a series of country-specific goals, which are transmitted beyond the elite of government to the appropriate government departments, business and the public. In this strategy, binational and bilateral commissions are not necessarily the answer to improving relations, even though they may look impressive on the ambassadors' 'score cards'. Currently, South Africa has too many such commissions²⁸ to service them effectively, arguably a worse situation than having none at all. If these are to be retained and to work effectively, they should be paralleled by business conferences.
- Secondly, relationship building must begin at home. This emphasises the importance of diplomatic niceties, which Asian diplomats have complained are not observed in Pretoria, which, one claimed, 'is the rudest capital I have worked in.' Such courtesies are critically important

to Asians, the absence of which can cause deep offence. This also stresses the learning of foreign languages and about foreign cultures by diplomatic staff posted abroad, which takes time and resources.

- Thirdly, South Africa should build links between business knowledge and practice and government efforts. Up to now, business has largely expanded into Asia (and, indeed, most foreign domains) without and sometimes in spite of government. These links can be constructed around joint visits and shared information, but will have to be underpinned by a strong commitment by political leadership. The Japan–South Africa business link through the South Africa Foundation may provide a model here.
- Fourthly, South Africa should invest in and engage with trade opportunities. South African companies reportedly are reluctant to exhibit their products at international trade fairs. Compared with countries like Japan, Australia, South Korea, the US, Indonesia, Malaysia and the EU member states, South Africa performs woefully. For example, Taipei hosts 30 international trade shows every year at its World Trade Centre. These vary from shows of bicycles, stationery and sports equipment to computers, tourism, electronics and engineering. In the past two years, South Africa has only participated in the travel fair (in co-operation with South African Airways and travel agents in Taiwan). The only other South African presence was a modest stand by Ceres at the 2003 food and beverages fair. Other models are worth investigating for trade promotion. For example, interacting directly with Australian business, the Australian trade promotion agency, Austrade's, areas of operation include market research for companies and it provides assistance to exporters whom it encourages to exhibit at these trade fairs. Austrade's budget is augmented substantially by revenue derived from the services that it provides to private institutions and companies.
- Fifthly, South Africa should monitor and offer ongoing assessments of the impact of China Inc on Africa, both as a market (trade and investment) opportunity, but also as a strategic competitor to FDI flows and African industry. The same applies to market opportunities elsewhere in Asia.
- Sixthly, South Africa should set benchmarks for trade and investment. It is not enough to talk of Asia simply as the one wing of a DTI butterfly as was preferred by former Trade and Industry Minister Alex Erwin. Austrade, for example, has the goal of doubling the number of Australian companies exporting by 2006.
- Seventhly, all this demands a broad knowledge base in the Ministry and Department of Foreign Affairs specifically and the public and private sectors at large. Intergovernmental relations have a number of poles or

points of contact and interaction: respective foreign and trade ministries; the various desks (not only the bilateral desk, but also multilateral, protocol, consular, etc.) as interlocutors and facilitators; and the ambassadors. Each of those can be weak or strong. It is to be hoped that the strong ones compensate for the weak ones. Much depends on personalities, the activity level of each of the key players, and the chemistry between them. This makes the training and selection of staff a key factor. More fundamentally, to ensure that there is a strong foundation of understanding, interest and expertise over the longer term, efforts should be made to support the study of Asia in our schools and universities. This is an obligation that resides primarily with the South African government, but also, to a lesser extent, with foreign missions based in this country.

Going forward, however, this diplomatic task is inevitably going to be more difficult and should be informed by analysis rather than anecdote and by empirical information rather than by the sentiment and glamour of South Africa's political transition. As the warm and fuzzy feeling of goodwill wears off, this will in turn demand the allocation of resources to the analytical and policy task from the bottom up. This should be part and parcel of the development of an overall country-by-country, business-sector-by-business-sector strategy towards Asia, as with other regions. The development of a strategy of engagement towards Asia will take time and resources — it is, as one foreign diplomat has commented, 'the work of generations.' But now is the time to start.

Endnotes

- 1 For the purposes of this paper, Asia is taken to include Australia and New Zealand.
- 2 These figures are calculated from various editions of SAIJA, *South African Yearbook of International Affairs*. Johannesburg: SAIJA.
- 3 See 'ANC rakes in foreign funds', *Business Day*, 20 April 1999. The alleged payment of Winnie Mandela's trial costs earlier in the 1990s partly by the Libyan government also raised a few eyebrows. See also 'Friends in need', available at <http://archive.iol.co.za/Archives/1997/9710/29/ leed23.html>; and 'Mandela takes Gaddafi cash for election war chest', *Sunday Telegraph* (Johannesburg), 30 May 1999, available at <http://www.telegraph.co.uk>.
- 4 Third Alfred Nzo Memorial Lecture, Indian Council of World Affairs, 16 October 2003, available at <http://www.dfa.gov.za/docs/mbek031016.htm>.
- 5 ASEAN-6 comprises Indonesia, Malaysia, the Philippines, Singapore, Vietnam and Thailand. This figure, together with Tables 4 and 5 and Figure 3, are taken from Australian Department of Foreign Affairs and Trade (DFAT), *China's Industrial Rise:*

- East Asia's Challenge*. Canberra: Department of Foreign Affairs and Trade, Economic Analytical Unit, 2003, available at <http://www.dfat.gov.au/eau>.
- 6 See 'Japan's new trade policy: WTO or FTA?' Presentation made at SAIIA by Shujiro Urata, Waseda University, July 2003.
 - 7 The figure was developed by Horst Brammer from data supplied by the Taiwan Institute for Economic Research (TIER).
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 - 9 http://english.peopledaily.com.cn/200309/23/eng20030923_124758.shtml.
 - 10 World in Figures, 2002. *The Economist*: London.
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 - 12 See De Villiers M, *Water Wars: Is the World Running out of Water?* London: Phoenix Press, 2001.
 - 13 See 'At risk: The environment', *Newsweek*, 9 March 1998.
 - 14 See, for example, 'India's economic growth forecast at 6% in 2002', available at <http://www.adb.org/Documents/News/2002/nr2002048.asp>.
 - 15 See Urata S, op cit.
 - 16 Based on figures from the Japan Export Trade Promotion Organisation (JETRO).
 - 17 DFTA, 2003, op cit.
 - 18 Ibid.
 - 19 The figures in brackets reflect the range of shares related to low and high growth rates assumed. Average growth rate assumptions: China, 5–8% until 2020, 4–7% until 2050; US and Australia 2–3.5% 2000–50; Japan 0.25–2% until 2040, 1–3% until 2050; Germany 1–3% 2000–50; Korea and Taiwan 4–7% until 2020, 2–5% until 2040, 2–4% until 2050.
 - 20 Projections are based on a linear trend extrapolation from 1992–2002.
 - 21 DFAT, op cit, p.2.
 - 22 The jump in Hong Kong's FDI in 2002 is mainly due to China Mobile's \$33 billion acquisition of several Chinese mobile phone companies.
 - 23 DFAT, op cit, p.xiv.
 - 24 See <http://www.dfa.gov.za/departments/stratplan03-05.htm>.
 - 25 'Outside view of a nation everyone wishes well', *Business Day*, 28 October 2003.
 - 26 Department of Foreign Affairs *Annual Report 2001–2002*, available at http://www.dfa.gov.za/departments/report02/part3/p3_73.pdf.
 - 27 See 'Taiwan's biggest earner ranks 4th worldwide', *Taiwan News*, 22 September 2003.
 - 28 These total 31, and include: Algeria (Binational Commission [BNC]), Algeria (Partnership Forum [PF]), Angola (PF), Australia (Joint Ministerial Forum), Botswana (PF), Brazil (Joint Commission), Cuba (Joint Bilateral Commission), Egypt (PF), Flanders (Bilateral Commission), France (Forum on Political Dialogue), German (BNC), India (Joint Ministerial Commission), Japan (PF — meetings at ministerial level), Lesotho (PF), Libya (PF), Morocco (PF), Mozambique (PF), Namibia (PF), Nigeria (PF and BNC), PRC (BNC), Rwanda (PF), South Korea (Consultative Conference — Foreign Office consultations at the level of senior officials), Russia (two separate commissions, one for science and technology), Spain (Memorandum of Understanding on Consultations), Sweden (BNC), Switzerland (Working Group), Tanzania (PF), Tunisia (PF), UK (Bilateral Forum), US (Bilateral Consultative Forum), and Zimbabwe (PF). All Africa Partnership Forums are either Joint Bilateral Commissions, Joint Permanent Commissions for Co-operation, or Joint Bilateral Commissions for Co-operation.

China Inc: An Assessment of the Implications for Africa: New Diplomatic Initiatives

PJ Botha

Modern China: Setting the stage for a different diplomatic approach

The danger of overselling the phenomenal statistics, particularly economic growth figures, on modern China is that debates become emotionally driven and analysis is not always sufficiently penetrating. Almost every speech, paper, presentation, media article or academic intervention assessing the impact of modern China is interspersed with mind-blowing statistics of this type. In the light of the above-mentioned danger, the question can justifiably be asked: How accurate are these assessments?

China is different from anything our modern world has experienced. People who travel to China need not be supplied with statistics about the country to understand the scale of growth and development that is going on there. It is visually self-evident.

The naysayers have been predicting for the past 10 years that the economic bubble will burst and everything will fall apart. Such people are often opportunists and gamblers, hoping that they will be right so that their views will bring them fame. On the facts, China is in the typical growth phase that other Asian economies have already gone through and it will continue to experience unhindered export-driven growth for at least another decade. As with other Asian countries, this has similarly affected the evolution of China's foreign policy and the way in which it perceives its international role.

What makes China different, however, is the scale of the changes and growth that are taking place. At present growth rates — and I must apologise for providing some more mind-blowing statistics — there will be 50 cities the size of London in China in 25 years' time!

China's economic growth is undoubtedly the driving force in the global economy at present. The economy's recovery after the severe acute respiratory syndrome (SARS) outbreak has been impressive. The gross domestic product (GDP) growth forecast for 2003 is 7.5%. China's trade

surplus in July 2003 amounted to \$1.6 billion, with an export value increase of 30.6% to \$38.11 billion over July 2002. Import growth is equally dramatic, with imports in the same period increasing 35.3% to \$36.51 billion. Continuous trade surpluses have led to China accumulating the largest foreign exchange reserves of any economy at \$331 billion. This phenomenal growth achieved despite SARS indicates that the Chinese economy is proving itself to be crisis resistant.

Another unique feature of China is the way change has taken place. The Chinese are immensely nationalistic and there is a deep-seated desire that China should take its rightful place as one of the leading powers in the community of nations. This is the historical and political imperative that drives China Inc. The Chinese are Chinese first. Even those living in other countries share the same sentiment, and only then are Americans, Australians, Canadians etc. It is this Chinese will to succeed that defines China's international policies. It also brings a sense of purpose and cohesion to China's expansion drive, a phenomenon that we have not seen in other cases, such as Japan Inc. This phenomenon impacts materially on China's strategic diplomatic interests and moulds its policies. The result has been a shift away from pure ideology-based policies to more pragmatic policies driven by economic interests. For it is growing economic power that will allow China to take what it considers to be its rightful place on the world stage and make the Middle Kingdom the centre of the universe again.

One example will illustrate this. Recently, the Chinese Ministry of Commerce reduced the minimum registered capital required of domestic import and export enterprises from RMB5 million to RMB1 million. Furthermore, Chinese manufacturing firms wanting to apply for trading rights will only need a minimum capital requirement of RMB500,000, dropping from the previous requirement of RMB3 million. This policy applies to both state and privately owned trading companies, resulting in even more trade competitiveness from China. This will undoubtedly boost its already strong export performance.

China's international expansion strategy

Economics drives politics in China today. The Chinese government's strategy is to address the serious domestic issues of unemployment and the restructuring of state-owned enterprises by increasing production or, at the very least, trying to maintain present levels of production. To do so, they need to have ever-expanding domestic and foreign markets. This has resulted in Chinese companies aggressively entering global markets.

To a large extent, the drive to acquire market share at any cost guides

China's approach not only to new markets, but to diplomatic relations as well. Unfortunately, the result of this is that new Chinese business entrants into markets have often flouted the rules of fair and acceptable business practice in their drive to obtain market share. I believe that this is not by design, but has developed as a result of the highly competitive business environment in China and the fact that China does not have an established tradition of business ethics and corporate governance. Deng Xiaoping's opening up of the economy started in 1985 with his open-door policies. So with the exception of Chinese returning to China after long periods abroad, no one in the country has more than 18 years of business experience.

The proportion of cases of customs violations, licensing violations and intellectual property rights infringements involving Chinese businesspeople is testimony to a win-at-all-costs approach to business. Add to this the Chinese subsidisation of products and businesses, and the dumping of sub-standard or below-cost products in new markets, and it is not surprising non-Chinese businesses find themselves uncompetitive and at a serious disadvantage. The tacit acceptance by Chinese government departments of many of these practices has created the impression that the government condones them because of the advantage they gain for the country.

If modern diplomacy revolves around economic interests, how do these developments in China affect foreign policy formulation and, more particularly, how will they influence future bilateral relations with Africa?

Admission to the World Trade Organisation (WTO) has created expectations that Chinese businesses will be forced to comply with the regulations governing international trade. However, this process will take many years. In addition, many African countries do not have the capacity to manage many of the issues that the WTO is supposed to deal with. For example, there has not been one anti-dumping case in the Southern African Development Community (SADC), apart from in South Africa. In the meantime, until the WTO starts to rein in Chinese excesses, diplomatic leverage and bilateral interventions will be the only remedies for aggrieved countries.

Africa's relevance for China

Diplomatic relations with African countries in the past were based on China's support for the Pan-African movements and the expansion of communist ideology in the Third World. Cold War politics dictated relationships. Owing to China's perceived vulnerability on the international stage at the time, it regarded Third World countries as natural allies. Its policies concentrated on assisting African countries to counter the

expansionist policies of the capitalist world by way of aid assistance, military support and solidarity with African multilateral interests. China also competed with the Soviet Union for influence in Africa.

The other major political issue driving China's policies toward Africa has been Taiwan. Both China and Taiwan initiated diplomatic drives into Africa aimed at preventing each other from obtaining a foothold on the continent. Taiwan targeted countries in desperate need of financial assistance, in many instances those that were most vulnerable after a change of government by irregular means, such as a civil war or coup. At times, it appeared that Chinese and Taiwanese policies were — and still are — based on little more than the wish to keep Taiwan out of Africa (in the case of China) and the wish to add another country to the list of accredited countries (in the case of Taiwan). This will not change in the foreseeable future and is linked to the progress (or lack of it) made by China and Taiwan in resolving their ongoing sovereignty dispute. No new diplomatic initiatives are expected on this front in the immediate future.

With the exception of the Taiwan situation, the diplomatic scenario has entirely changed because of the collapse of the Soviet Union and the new economic policies in China. The clearest indication of a change in policy towards Africa was the statements made and conclusions reached at the China–Africa Business Forum held in Beijing in October 2000. The forum's main purpose was to formulate a new Chinese approach to Africa for the new millennium. It ended with the adoption of the Beijing Declaration and Programme for China–Africa Co-operation in Economic and Social Development, which was to serve as the blueprint for co-operation between China and African countries. China pledged to push forward China–Africa co-operation in economic and social development. At the same time, the Chinese government pledged to continue to provide assistance to African countries within its means, to reduce or cancel debts of \$1.2 billion owed by African countries, to set up a special fund to encourage well-established Chinese enterprises to invest in Africa, and to establish an African human resources development fund to train more professionals for the economic development of Africa.

The shift from aid, donor funding and donor projects to economically viable and sustainable projects has resulted in a substantive change of emphasis in China's foreign policy towards Africa.

Africa's strategic interests

Viewed from a Chinese perspective, Africa offers various strategic opportunities. But what of Africa's strategic interests and how should

China's designs in Africa influence the way Africa interacts with that country?

In the past, China was a benevolent partner, but this may change, requiring a more considered formulation of policy by Africa towards Chinese involvement in the different African regions. Projects should be more carefully considered, since they are no longer altruistically motivated. The impact of Chinese industry and manufacturing should be carefully analysed and the professed advantages more carefully investigated. I am not suggesting any degree of bad faith on the part of China, but when a country is merely driven by self-interest, the interests of both parties do not always converge.

A case in point is the fact that the number of companies registered in Botswana has more than doubled over the last few years, with the majority of the newly registered companies being Chinese. What lies behind this development? Is it to provide a base for Chinese economic expansion in the SADC region in an environment where activities are less stringently monitored? Does the Chinese government turn a blind eye to commercial expansion in the region or does it monitor the business activities of its companies?

These are questions that should be considered and debated amongst interested African parties. Certainly, given the large numbers of staff at its diplomatic and commercial offices, China has the capacity to play a more proactive role in ensuring that proper business practices are pursued. To what extent is the economic expansion co-ordinated between the respective governments involved and channelled into sectors that will bring mutual benefit instead of mere unilateral exploitation? To a large extent it is expected that China should police itself, as many African countries do not have the capacity to negotiate from a well-researched and informed position.

It is likely that the change in China's economic approach to Africa will affect its diplomatic relations and that existing relations in Africa will be influenced by these changes in the future. Because of China's non-judgmental approach to Africa in the past, African governments, as a rule, are well disposed to China and have an 'open-arms' approach to any ventures or interventions.

This could all change if African states are confronted with irate citizens who have been put out of business or economically displaced by their Chinese counterparts. For example, in 1990 there were very few Chinese trading stores in Namibia. Today there is not a single town in Namibia that does not have at least one Chinese trading store. Who have these businesses displaced? What has been the reaction of the local populace and will this be fed back into political structures, eventually affecting bilateral relations

between the two countries? The process of disillusionment with Chinese trade policies in African countries will be slow, but once the 'penny drops', it may be too late for China to recover lost African goodwill.

New diplomatic initiatives

In the past, China generally set the diplomatic agenda for China–Africa interaction. It was not a relationship of equals, and this should change. Should this not happen, it could negatively affect future Chinese diplomatic relations with the continent. Africa needs to be more forceful and certain in its relationship with China. The African Union (AU) agenda and AU multilateral objectives must strongly influence bilateral relations.

I would like to suggest that Africa take the following steps when developing new diplomatic initiatives to manage the Africa–China relationship.

- It should distill from the New Partnership for Africa's Development (Nepad) and AU agendas a strategy for interacting with the new China.
- It should engage China on the issue of sustainable and responsible development, as opposed to a 'Klondike rush' into Africa by its companies.
- It should insist on the better monitoring of Chinese business activities and strategies by the Chinese government.
- It should develop a framework for greater African access to Chinese markets as a quid pro quo for allowing Chinese businesses free access to African markets.
- It should curtail the activities of Chinese small arms merchants in areas of conflict in Africa.
- It should work out a protocol for the protection of endangered African species, with active Chinese government participation.
- It should institutionalise bridge-building initiatives, such as the China–Africa Business Forum.
- It should engineer a close association with China on South–South issues and non-aligned positions in international forums to replace the 'ad hoc-ism' that presently exists.
- It should encourage a more realistic and less emotive approach to the zero-sum policy regarding relations with Taiwan. At the very least, relationships should match those that exist between Taiwan and China.
- And finally, it should expect the involvement of Chinese forces in peace missions and the monitoring of conflict situations.

As a permanent member of the UN Security Council, China can champion

African causes. With its newfound economic muscle, it should be required to play a more active role in international missions to Africa. The isolationist China of the past is no longer possible because of its rapid economic expansion into international markets, which has brought responsibilities and commitments.

Given the similarity of current developments in China and Africa and the developing-world culture that they share, there is an opportunity to enter a new phase in relations between China and Africa that will be beneficial to all and build on the solidarity of the past. Should this process not be managed positively and actively, then the alternative could be a retrogression in relations that will take generations to reverse.

Select Glossary of Acronyms

AEC	Asian Economic Community
AEMU	ASEAN Economies Monitoring Unit
ANC	African National Congress
ARATS	Association of Relations across the Taiwan Strait
ASEAN	Association of South-East Asian Nations
AU	African Union
BNC	Binational commission
CEPA	Closer Economic Partnership Agreement
DFTA	Department of Foreign Affairs and Trade (Australia)
DTI	Department of Trade and Industry
EU	European Union
FDI	Foreign direct investment
FTA	Free Trade Area
GDP	Gross domestic product
HKC	Hong Kong China
IMF	International Monetary Fund
IT	Information technology
MNC	Multinational company
NAFTA	North American Free Trade Area
NEPAD	New Partnership for Africa's Development
NIC	Newly industrialised country
NIE	Newly industrialised economy
PF	Partnership forum
PRC	People's Republic of China
PRD	Pearl River Delta
SADC	Southern African Development Community
SARS	Severe acute respiratory syndrome
SEF	Strait Exchange Foundation
UN	United Nations
US	United States
WTO	World Trade Organisation

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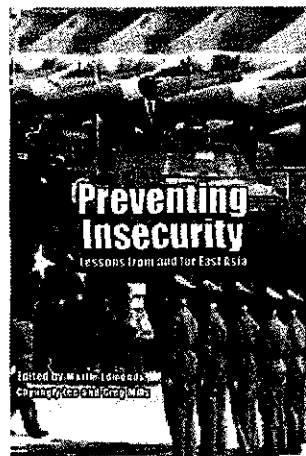
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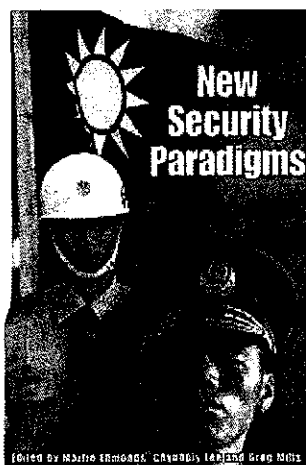


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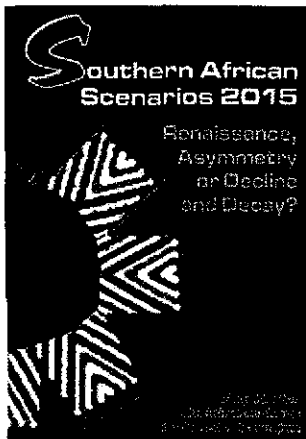
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The combined economies of China, Taiwan and Hong Kong amount to US\$1.437 trillion making 'Greater China' the fourth largest economy in the world. Driven by exports, China's GDP growth averaged 9.7% in the two decades to 2000. Average GDP growth was 7.5% in 2001, 8% in 2002, and 9.1% in 2003.

What are the implications for South Africa and Africa of the continued expansion of the Chinese economy? Will the growth of 'Greater China' crowd Africa out of an increasingly competitive foreign direct investment (FDI) market? Will it prove to be a competitor to African industries or will these challenges be compensated by the market opportunities on offer in China?

African business leaders and governments need to respond to these issues by developing appropriate diplomatic and business strategies which identify trade opportunities and also monitor the impact of 'China Inc' on Africa, both as an investment opportunity and a strategic competitor.

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