Foreign Direct Investment By South African Companies in the Peoples Republic of China: Opportunities and Risks

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I, the undersigned, hereby declare that the work contained in this assignment is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Signature.

Date

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Summary

The study addresses the topic of foreign direct investment in the People's Republic of China (P.R.C.) by South African companies, focusing on opportunities and risks in the context of *'South-South Co-operation'* between the P.R.C. and South Africa. Relations between the two developing countries have only been forged since January 1998 when South Africa recognised the P.R.C. government as the *de jure* representative of China.

With the Chinese market of 1.3 billion potential consumers proving to be a lucrative opportunity for all international, multinational and transnational companies, it is imperative for South African companies to gain a foothold in the Chinese market. Therefore, entry requirements as well as impediments that could emerge have to be scrutinised. Analysis of governmental relations currently being forged between the two states is assessed as well as the wider context of '*Sino-Africa'* co-operation. China's recent entry into the World Trade Organisation (WTO) has and will continue to have a substantial effect on the international trading system. The implications of this for South African companies is given considerable attention in order to highlight resulting opportunities.

Apart from assessing the current state of relations and identifying investment and business opportunities, the study also focuses on the method of conducting business in China which has highly complex rules and regulations for companies entering the P.R.C. An analysis of the different modes of entry is conducted, coupled with a focus on the cultural sensitivities and norms that are associated with building relationships when negotiating possible business partnerships. The study finally identifies potential risks that foreign direct investors need to continually assess, namely, the transfer of political power to a new generation of relatively young leaders, corruption that is spreading within China and the restructuring of State Owned Enterprises (SOE's) and the inevitable consequence of job losses.

Opsomming

Hierdie studie spreek die onderwerp van buitelandse direkte investering in die Volksrepubliek van Sjina (VRS) deur Suid-Afrikaanse maatskappye aan, en fokus op geleenthede en risikos in die konteks van '*Suid-Suid samewerking*' tussen die VRS en Suid-Afrika. Betrekkings tussen die twee ontwikkelende lande is eers onlangs gesmee nadat Suid-Afrika in Januarie 1998 die VRS as die *de jure* verteenwoordiger van Sjina erken het.

Met 'n Sjinese mark van meer as 1.3 miljard potensiële verbruikers wat 'n winsgewende geleentheid vir alle internasionale, multinasionale en transnasionale maatskappye skep, is dit imperatief vir Suid-Afrikaanse maatskappye om hulself in die Sjinese mark te vestig. Dus moet toegangsvereistes asook moontlike hindernisse noukeurig ondersoek word. Die studie doen 'n analise van betrekkings wat huidiglik tussen die twee state se regerings gesmee word, en die breër konteks van samewerking tussen Sjina en Afrika word ook geëvalueer. Die VRS se onlangse toetrede tot die Wêreldhandelsorganisasie (WHO) het en sal aanhou om 'n wesenlike impak op die internasionale handelsstelsel te hê. Daar word ook aansienlike aandag geskenk aan die implikasies hiervan vir Suid-Afrikaanse maatskappye om sodoende geleenthede uit te lig.

Bo en behalwe 'n evaluering van die huidige stand van betrekkings en 'n identifisering van beleggings- en besigheidsgeleenthede, fokus hierdie studie ook op die manier waarop besigheid in Sjina onderneem word, wat uiters gekompliseerde reëls en regulasies insluit vir maatskappye wat die land betree. 'n Analise van die verskillende wyses van toegang is onderneem, tesame met 'n fokus op die kulturele sensitiwiteite en norme wat 'n invloed op die bou van verhoudings tydens die onderhandeling van moontlike besigheidsvennootskappe kan hê. Laastens identifiseer die studie potensiële risikos wat buitelandse direkte beleggers voortdurend in ag moet neem, naamlik die oordrag van mag na 'n nuwe generasie van relatief jong leiers, die verspreiding van korrupsie, die herstrukturering van staatskorporasies en die onvermydelike gevolge van werksverliese.

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Chapter 1

Introduction

1.1 Background

"Reform and opening is, in essence, a second revolution"

---- Deng Xiaoping

This brief yet loaded statement by the then leader of the most populous nation on earth, Deng Xioaping, was to bring the Peoples Republic of China (PRC) out of oblivion and seclusion from the International Community into the limelight, becoming the fastest growing nation on the planet for more than two decades.

"The progress made to date is outstanding, greater than anything that has ever happened before, even more than the industrial revolutions of the US and Europe, in terms of elevating people out of poverty, in terms of modernizing the most populated country in the world at a speed that has never been seen before. There is no doubt whatsoever that Deng Xiaoping, who is largely responsible for this, will go down as one of the truly great men of the Twentieth Century" (Callum Henderson)[1]

This epitomises the importance, depth and mammoth task of transforming the economy from one that was centrally planned and largely agrarian, to an economy that has adopted most tenets of a market-based economy. Modernisation has brought with it a change from the *'self-isolation'* that dominated China since the creation of the Communist State in 1949 to a *'socialist economy'* where the Chinese have sought to access the riches of Information and Technology from the Developed World in order to improve their plight.[2]

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[1] Zongshi, M. *"China's quest for Modernisation in the New Millennium"*
In the Contemporary China Review.
Volume 9, No 10, October 1999. Pg 1 – 20.
Pg. 5

[2] Chartier, C. *"China: Economic Reforms and WTO Accession"*
In the Thunderbird International Business Review.
Volume 40(3), May/June 1998. Pg. 257-277
Pg 257-258

In order to draw a picture of what internal reform and *'opening up'* to the International Community has brought about, consider the following: In the last two decades, China's economic growth has consistently remained in double digits, for the exception of two occasions, during the Tiananmen Square uprising in 1989 and since the Asian Financial Crisis in 1998. On both occasions, the PRC bounced back in phenomenal fashion. Eventhough growth has not topped double-digits since the Crisis in 1998, it has averaged around the 7.5 – 8% mark, which is at least two and a half times the global growth rate at present. It is noted that "if China's thirty Provinces were counted as individual economies, the twenty fastest-growing economies in the world between 1978 and 1995 would all have been Chinese".[3]

China's GDP per capita has increased over seven times in the same period, inevitably increasing living standards, decreasing illiteracy rates (from around 60% to less than 10% currently), stemming the population growth and most importantly revolutionised the way business is conducted in this vast country. The savings rate in China is the one of the highest worldwide and foreign reserves have continually ballooned.[4]

From being one of the poorest countries in the world, with around 80% of the population earning US$1 per day, China's economic transition has doubled the consumption rate and a staggering 200 million people living in China have been brought out of absolute poverty. (In order to bring this closer to home, it is the equivalent of five times South Africa's population). This has taken place

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[3] Stiglitz, J. Speech given by the senior vice President and Chief Economist of the World Bank.
"China: Challenges and Prospects"
In Hong Kong, SAR, Peoples Republic of China". Monday, 22 September 1997
http://www.worldbank.org

[4] Kyushu, K. *"Chapter 3- Recent Trends & Prospects for Major Asian Economies "*
In the East Asian Economic Perspective. Special Issue
The International Centre for the study of East Asian Development.
Vol 11, February 2000, Pg. 25 - 38
Pg 25-26

in the space of two decades, yet the approach has been one of extreme *'caution'*, *'experimentation'* and *'gradualism'*.[5]

A study undertaken by the Chinese Academy of Social Sciences on China's economic development targets, have estimated that in 2020 China's GDP would be ten times the size of its 1990 GDP, and by 2030, it would be nineteen times greater. During the latter period, "Chinese GDP would surpass the United States, Japan and Germany, with the PRC becoming the world's leading economic power."[6] While Western economists are sceptical of figures emanating from within the PRC, their projections are not far off. Paul Krugman contends that even if China's economy grows at around 7% in the next 8 years, by 2010, its GDP will be 82% of that of the US, resulting in a change in the International Economic System.[7]

The amount of FDI that the PRC has attracted in the last two decades have been unmatched by any other emerging market. This has helped China's economy grow at phenomenal rates. Despite the flat growth throughout the world, China is estimated to grow at around 8% this year, more than double the rate of its neighbouring economies[8] and certainly outperforming emerging markets in Latin America, Eastern Europe and Africa. "To many, the flow of jobs and capital to China is a form of economic cannibalism: it leaves less growth and investment to go around..."[9] This is not only a threat to China's Asian neighbours, but all fellow developing countries including South Africa.

In a report released by the United Nations Conference on Trade and Development (UNCTAD) in 2001, investment flows into South Africa had

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[5] -------, *"The World Bank and China"*
Country Brief – 2001.
http://www.worldbank.org/html/extr/offrep/eap/cn2.htm

[6] Cheng, C. *"China's Economy: Recent Development and Long-Term Prospects"*
Issues and Studies 36, No. 5 (September/October 2000): Pg. 122 – 157.
Pg. 146

[7] Ibid. Pg 149

[8] Pesek, W. *"China matures into Asia's big cheese"*
In the Business Report, Thursday, November 7, 2002. Pg. 7

[9] Ibid. Pg.7

decreased by more than 4% to US$877 in 2000.[10] While Africa received less than 1% of global FDI, of which South Africa received less than Angola, Egypt and Nigeria. China, on the other hand, received over US$40 billion and if FDI flowing into Hong Kong (SAR) is included with the Mainland, the figure jumps to $64 billion amounting to almost 29% of the total FDI flows into developing countries.[11] According to Trade and Investment South Africa (TISA), South Africa's poor performance was attributed to "the lack of competitive investment incentives as it appeared that the country's cost structures were very similar to a range of comparable potential FDI destinations."[12] According to UNCTAD, thew lack of investment was due to "continued political and economic stability"[13]

This is in direct contradiction to China, where investors are flocking not only because of the vast market of 1.3 billion people but as a result of China "quietly creating innovative and cost–efficient export businesses" and "providing stability in an otherwise gloomy world".[14] In the first six months of 2002, the PRC has already attracted US$24.58 billion, achieving a record growth-rate of 18.69 percent year-on-year.[15] This feat is no mistake, according A T Kearney; one of the largest business- strategy consulting firms operating globally, China is the number one destination for FDI. According to their rating system called the FDI Confidence Index, China scored 1.99 out of a possible 3, ahead of the United States who scored 1.89. The index is compiled and based on a number of surveys and interviews with the top executives of the worlds 1000 largest companies that contribute around 70% of global FDI.

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[10] Katzellenbogen, J. *"SA suffers drop in investment"*
In the Business Day, Wednesday, September 19, 2002. Pg. 15

[11] Ibid. Pg. 15

[12] SAPA, *"Africa's share of FDI pie falls to less than 1%"*
In the Business Report, Wednesday, September 19, 2002. Pg. 8

[13] Op Cit, Katzellenbogen, Pg. 15

[14] Op Cit, Pesek, Pg. 7

[15] -------, *"FDI in China keeps growing"*
In the Asia Times Online, released by Asia Pulse, 23 July 2002.
http://www.atimes.com

In there report, China is the number one investment destination option for a third of all executives interviewed. In addition to "its populous market, continued economic growth, stable political situation, sound investment environment, WTO membership and successful bid for the Olympics", the potential in various retail and wholesale industries and sectors such as finance, services, communications and high technology all contribute to it being the preferred choice for global capital.[16] Another reason that China has attracted massive inflows of FDI is its vast population. "Among the 400 million new consumers with annual incomes of over US$ 10 000 in the coming five years, half of them will be Chinese"[17]

China's presence in the international trading system is ever increasing. As the world's sixth largest trading nation in 2001 (up twenty-four places since 1978), the PRC has increased its imports and exports from a paltry US$20.6 billion in 1978 to US$ 509.8 billion in 2001.[18] The list of impressive statistics are numerous, there is no doubt that in order to increase market share, companies around the globe, including those in South Africa will need to position themselves in the PRC, not only to take advantage of the large market, but also utilise the PRC as a base for export-related business.

1.2 Problem Statement

With China's continued growth and influence in the International Economic System and its magnetism of global FDI, it is highly unlikely that South Africa, nor any other emerging market, will be able to compete effectively for FDI with China. What is required is a solid relationship with the PRC as a fellow developing-nation. In the context of *'South-South'* relations, South Africa should maximise its relationship not only to increase its physical

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[16] --------, *"China beats US as No. 1 FDI destination"*
In ExpressIndia. Tuesday, September 24, 2002. Pg. 1
http://www.expressindia.com/fullstory.php?newsid=15072

[17] Ibid. Pg.1

[18] -------, *"Analysis: Why China ranks 6th in world trade"*
In the Asia Times Online, released by Asia Pulse, 25 July 2002.
http://www.atimes.com

presence in the Chinese economy, allowing South African companies to take advantage of the vast market opportunities, but also to ensure that the PRC will become an effective mouthpiece for the *'Developing South'*. This would ensure that all developing countries that are currently marginalised in the global economy seeking to find a voice, can utilise an increasingly powerful China to force the *'Developed North'* into make concessions that would benefit the *'South'*. This initiative would fall in line with South Africa's increasing role in the global system, and help Africa in particular reach its aims set out in the New Partnership for African Development (NEPAD).

Apart from this broader strategy, South Africa could utilise its relationship with the PRC, to gain greater concessions for South African companies. However, there are many pitfalls for South African companies investing in China. With little assistance from the South African government, companies are increasingly relying on in-house research and relationship-building when considering the PRC as an investment destination. Cultural differences, geographical distance and lack of exposure, the PRC has not been a target for investment for many South African companies. In addition to the lack of adequate information, South African companies have little experience in investing in foreign markets since its re-introduction into the International System in the early 1990's.

1.3 Purpose of the Study

Considering these problems, this study evaluates the current relationship between South Africa and the PRC in the context of *'South-South'* relations, as a basis for increased trade and investment opportunities available in China. This will be the focus of Chapter Two.

With the PRC attaining membership in the World Trade Organisation (WTO), the Chinese economy will be opened up further for foreign companies to take part in this exciting journey. The success that can be attained are unparalleled in terms of opportunity in certain sectors For example, in the automotive sector tariffs will be reduced from around 80-100% to 20% in the next five

years, in a country where "the car market is expected to triple to around 5.8 million vehicles in 2010, with passenger car sales doubling"[19], the opportunities for South African companies involved in steel, automobiles and auto parts are enormous. The implications of China's recent admission into the WTO and the opportunities for South African companies are assessed in Chapter Three.

While opportunities are there for the taking, the method of conducting business in China is highly complex. If not approached with care, South African companies will suffer the fate of many foreign companies investing and doing business in China who have failed dismally. Companies seeking entry to this market have to follow strict rules and regulations when entering the PRC. A number of foreign investment vehicles are prescribed by the Chinese government, each having its own advantages and disadvantages. Chapter Four analyses the different modes of entry and also covers important requirements that most companies tend to neglect. This includes the cultural sensitivities and the manner in which relationships are built when negotiating possible business partnerships in China. This is possibly the most important facet of doing business in the PRC.

Chapter Five identifies potential risks that foreign direct investors need to keep a continual check on. While the facts and figures relating to China's growth and opportunities are highly impressive, three key areas are identified as having the potential to ruin the PRC's current successes and jeopardise foreign investment and companies involved in China. The transfer of political power to a new generation of relatively young leaders jostling for support, coupled with the changes taking place on an ideological level within the ruling Communist Party will play out in the coming few years. The consequences would either deeply entrench the current reform or propel China back into isolation and inevitable ruin. Secondly the corruption that is spreading within China poses a real threat to the PRC's development. Indicators measuring bribery and corruption released by Transparency International in its annual

[19] Inoue, K. *"Honda's expansion into China propels it past Japanese rivals"* In the Sunday Business Report, April 28, 2002. Pg. 4

report will be explored in addition to the causes of corruption in China. The last area that is focused upon is the restructuring of State Owned Enterprises (SOE's) and the inevitable consequence of job losses, as increased international competition forces SOE's to restructure or close down. The unemployment figures will continue to increase in the near-term as a result of WTO membership and economic reform. This will prove to be an important indicator of stability for foreign investors in China in the years to come. If not controlled it could become the most destructive force that the government will find itself pitted against.

1.4 Questions for Investigation

In order to understand what the possibilities for FDI in the PRC are for South African companies, answers to important questions are necessary. These questions include:

- What is the status of current relations between South Africa and the PRC? And do these relations set a solid platform for South African companies to take advantage of when investing in the PRC?
- With China's membership to the WTO taking effect in 2001, what are the implications for South Africa?
- What opportunities are available for South African companies with China being a part of the international trading environment?
- What are the key modes of entry for South African FDI into the Chinese economy?
- How should South African companies interact with Chinese counterparts when conducting business in China? and
- What are the key areas of potential risk facing companies involved in the Chinese economy and what indicators should be closely monitored in order to safeguard its interests in the PRC?

1.5 Methodology

The study necessitates both a quantitative as well as a qualitative approach. The analysis will be descriptive in assessing current relations between South Africa and the PRC and methods of entry into the PRC economy, while qualitative techniques will be utilised to quantify indicators such as market size, FDI inflows, unemployment rates and economic growth. Risk indicators utilised such as the various indexes measuring corruption and bribery also necessitate qualitative techniques. The above-mentioned indicators are those created by Transparency International, the Non-Governmental Organisation that focuses on global corruption. Explanatory and evaluatory approaches will also be employed in order to analyse factors that are not easily quantifiable such as the nature of political change within the PRC.

A number of data types and sources have been used in this study. Ranging from a number of documents released from International Institutions such as the World Bank and the United Nations Conference on Trade and Development as well as primary data including documents, press releases and statements issued by the South African and Chinese governments respectively. Another rich source of primary data that have been utilised come directly from documents released at the *Forum on China-Africa Co-operation - Ministerial Conference Beijing 2000*. A large number of speeches by high-ranking officials of both governments have also been accessed from the Asia-Africa Society in Pretoria, who have hosted conferences dealing with China-South Africa relations in 2001 and 2002.

Secondary data has been retrieved from a number of newspapers, publications, academic journals and books. The nature of the study has required up-to-date statistics that change on a quarterly basis, these figures have been accessed from governmental websites such as the Ministry of Foreign Trade and Economic Co-operation in China and various International organisations. Due to the lack of publicity in local news media, a number of Asian Newspapers have been accessed through their websites to gain material. The most insightful data was accumulated while conducting research in Taiwan for the

Stellenbosch Asia Project; the data collected was mainly in the form of academic journals that are not easily accessible in South Africa.

1.6 Key Concepts

1.6.1 *'South South'* Co-operation

The *'North South'* debate surrounding industrialised countries of the *North* and those developing, and less(er)-developed countries of the *South*. This entails the issue of equity and justice in the global system where many scholars are of the opinion that "the international political and economic situation in the world favours the interests of a minority of people, namely the privileged classes in the industrialized states. In turn, the interests of the majority of the worlds population are undermined or marginalized by prevalent global political and economic arrangements."[20]

Out of this debate, nations of the *South* (described as "those regions of the globe that have in common a political, social and economic history rooted in the inequalities of a colonial past"[21]) have been developing closer ties and have co-operated in order to collectively take on issues dealing with the disparities and inequalities that have been experienced by them. In this context South Africa and the PRC should further cement relations in order to achieve "*collective self-reliance*" through increased economic and technical co-operation. The '*raison d'être'* of '*South-South Co-operation'* is that "collective economic interaction… will promote mutually beneficial development by taking advantage of enlarged markets, economies of scale and complementarities while at the same time reducing dependency upon the industrialised countries of the North."[22]

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[20] Alden, C. *"Southern Africa in South-South relations"*
Chapter 13 in "*Power, Wealth and Global Order*"
(Eds. Mcgowan, P.J & Nel, P.)
University of Cape Town Press, Rondebosch. (1999)
Pg. 217

[21] Ibid. Pg. 217
[22] Ibid. Pg. 221

1.6.2 Foreign Direct Investment

Foreign Direct Investment (FDI) entails " international investment, which is made with the objective of obtaining a lasting interest, by a resident entity in one economy in an enterprise resident in another economy."[23] All FDI flows referred to in this study adhere to the above-mentioned definition. This type of investment does not include *Portfolio Investment* that is, relative to *Foreign Direct Investment*, short-term investment. According to the United Nations Conference on Trade and Development (UNCTAD) *Portfolio Investments* are those "investments (made) by a resident entity in one country in the equity and debt securities of an enterprise resident in another country which seek primarily capital gains and do not necessarily reflect a significant and lasting interest in the enterprise".[24]

1.6.3 Risk

According to Lindenberg and Morndal, *risk* can be defined "as the probability that an outcome will be unfaverouble".[25] Another definition of *risk* that they mention in their study is that of Miller and Lessard who claim that "Risk is the possibility that events, their resulting impacts and dynamic interactions may turn out differently than anticipated."[26] While this definition does not assume that *risk* necessarily results in negativity, it does cater for the potential areas of *risk* identified in this study. The risks identified in this study are more political in nature. The definition of *Political Risk* narrows the scope of *risk* further and

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[23] *Report on the Survey of Implementation of Methodological Standards for Direct Investment.* Released by the International Monetary Fund & Organisation for Economic Co-operation and Development – IMF Statistics Department and OECD Directorate of Financial, Fiscal and Enterprise Affairs, March 2000. Pg. 23
http://www.imf.org/external/bopage/pdf/mar2000.pdf

[24] *Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI): Characteristics, similarities, complementarities and differences, policy implications and development impact*
Document released by the United Nations Conference on Trade and Development – Trade and Development Board Commission on Investment, Technology and related financial issues. 15 April, 1999. Pg 4
http://www.unctad.org/en/docs//c2em6d2&c1.en.pdf

[25] Lindeberg, M & Morndal, S. *"Managing Political Risk – A contextual Approach"* Published by the Ekonomiska Instituionen, Linkopings Universitet. Pg. 20
http://www.ep.liu.se/exjobb/eki/2002/iep/012/

[26] Ibid. Pg 20

is defined by Kennedy as "the risk of a strategic, financial, or personnel loss for a firm because of such non-market factors as macroeconomic and social policies (fiscal, monetary, trade, investment, industrial, income, labour and developmental), or events related to political instability (terrorism, riots, coups, civil war and insurrection.)."[27]

[27] Ibid. Pg. 23

Chapter 2

"Sino-South African Relations as a basis for South-South Co-operation"

January the 1st 1998 signaled the beginning of a new relationship between the Republic of South Africa and the People's Republic of China (PRC). By formally recognising the PRC government as the de jure representative of China and acknowledging the *"One China Principle"*[1], South Africa chose to cancel its diplomatic relationship with the Republic of China on Taiwan (ROC), its strong ally during apartheid rule while facing international isolation.[2]

Historically, the African National Congress (ANC) had forged closer links with the Soviet Union while in exile, while the Pan Africanist Congress (PAC) held ties with the Chinese Communist Party (CCP). As a result of this, the ANC had not had a long history with the government of the PRC. Many analysts believe that as a result of this insignificant relationship during the apartheid era, once the ANC was elected as the ruling party (in the first democratic elections held in South Africa in 1994), the new government was not immediately drawn into recognising the Beijing government with any great urgency. Thus, apart from the Taiwanese efforts in wooing the new government in South Africa as well as the economic considerations[3], it took another four years for the State President of the time, Mr. Nelson Mandela, to officially recognise the PRC government.[4]

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[1] The "One China Principle" involves the recognition of the Beijing government as the sole legitimate government of China and the acknowledgement that Taiwan is a part of China.

[2] Davies, M.J. *"South Africa and Taiwan: Managing the Post-Diplomatic Relationship"* in East Asia Project Working Paper Series, University of the Witwatersrand, November, 1998, pg.1.

[3] South Africa enjoyed a substantial trading relationship with Taiwan while also receiving large amounts of aid. This was used by the Taiwanese government as a bargaining chip to convince the democratically elected government of South Africa not to cut off diplomatic ties.
See Davies Op.Cit pg. 7.

[4] Davies, M.J. lecture series conducted at the Department of Political Science, University of Stellenbosch, Aug/Sept 2000.

While following international precedent, by recognising the Beijing government, South Africa has actively sought to improve relations with the PRC in order to gain closer economic ties and improve bilateral relations as two competent developing nations. Equally important is the furthering of co-operation between nations of the *"South"*. President Mbeki returned from a state trip to Beijing in 2001. His reasons for visiting the PRC were threefold. While furthering the interests of South Africa through the Bi-National Commission set up between the two nations, the visit was also used as a vehicle to promote his continental plan for Africa labelled the New Partnership for African Development (NEPAD).[5]

Apart from this, South Africa would want to forge closer ties with the PRC as it not only holds a seat on the United Nations Security Council as a permanent member but as a fellow developing nation, its size, stature and influence could be used to extract concessions from the developed world. In line with President Mbeki's "Global Initiative"[6] calling for the restructuring and transformation of international bodies such as the World Bank, International Monetary Fund and World Trade Organisation into more equitable institutions. The PRC as an ally could add considerable weight to his global cause of transforming a world driven by globalisation to a "new-world order of prosperity and development for all and equality amoung nations of the world"[7].

2.1 Sino-South African Relations.

Since recognising the PRC in 1998, visits between leading members of both governments have been frequent. Three state visits have ensued. The first state visit was made by former President Nelson Mandela in 1999, followed by President Jiang Zemin reciprocating in 2000 and a return visit by President

[5] Editorial, *"Our man in Beijing"*, in the Business Day, December 11, 2001. Pg.7.

[6] Phrase used to describe President Mbeki's foreign policy agenda in Nel. P., Taylor .I., and Van der Westhuizen J., *" South Africa's Multilateral Diplomacy and Global Change"*. London: Ashgate Press. 2001

[7] Speech delivered by President Mbeki in 1998.

Mbeki at present.[8] Apart from these Head of State visits, a substantial amount of high level delegations have been received in both Beijing and Pretoria. Of the current top five ranked government officials in the PRC at present, four have visited South Africa, Vice President Hu Jintao, Chairman of the National People's Congress, Li Peng as well as Premier Zhu Rhongji.[9] In January of 2002, the Chinese Foreign Minister, Tang Jiaxuan, was also received in Pretoria as well a further visit by Premier Zhu Rhongji during the World Summit on Sustainable Development in September 2002, further cementing relations.[10] This indicates the level upon which China places its ties with South Africa. In four years the pace of relations has accelerated exponentially and does not seem likely to recede. South Africa is viewed by the PRC as its gateway into the Continent. As the PRC's largest African trading partner, South Africa has developed a favorable position that will bring the African Continent closer to the most populous nation on earth.

"I am sure that during our stay here we will explore new ways and means of continuing and increasing our investments in each other's economies in a manner that improves our trade relations and ensures greater volumes of imports and exports from both our countries." (President T, Mbeki 2001)[11]

President Mbeki, accompanied with influential businessmen from the South African Banking, Automotive, Mining and Brewery industries has outlined the framework for co-operation on a "state to state" level. The PRC, in the space of just three years, is currently South Africa's 10th largest export market. In order to ensure itself a slice of the lucrative market, South Africa should look for closer co-operation in various sectors of complimentarity on the Mainland.

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www.dfa.gov.za/speeches/president//.htm

[8] Department of Foreign Affairs. www.dfa.gov.za/events/asia.htm

[9] Liu Guijin, Ambassador of the PRC in South Africa, Speech delivered at the University of Stellenbosch, August 24th, 2001. Pg.9.

[10] ------, *"Premier Zhu Rongji and South African President held talks"*
Press release by the Ministry of Foreign Affairs of the PRC
September, 06, 2002.
http://www.fmprc.gov.cn/eng/34519.html

[11] Reuters, *"Visiting Mbeki vows closer Beijing Links"*
In the South China Morning Post, Tuesday, December 11, 2001.
http://china.scmp.com/cgibin/gx.cgi/AppLogic+FT
.../Printacopy&aid=ZZZ0C4N0YU

Coupled with China's WTO entry, co-operation is vital. Since the trade surplus between South Africa and the PRC is heavily skewed in the latter's favor (Exports to the PRC totaling R1.7 billion and Imports surging at R5 billion)[12], it would be imperative that the deficit does not grow larger and render this relationship one-sided on the trade front.

On arrival, South Africa's Minister of Foreign Affairs, Nkosazana Dlamini-Zuma stated that "We are looking at China as both a market and as an investor".[13] With both countries, seeking growth by way of Foreign Direct Investment (FDI), as developing nations, they essentially compete for the same funds that are available globally. However, in this instance, both nations seek to use each other as a source of investment as well as a market for their exports. With the solid relations built thus far, South Africa has not taken the initiative in solidifying relations by signing any concrete agreements. Preceding the State Visit a handful of agreements and Memoranda of Understanding had been signed between South Africa and the PRC. These included agreements on "Civil Air Transport", "Trade, Economic and Technical Cooperation", the "Establishment of a Joint Economic and Trade Commission", "Reciprocal Encouragement and Protection of Investments" and "Scientific and Technology Cooperation".[14] Some of the useful agreements that do exist range from "investment protection, trade and technology co-operation, the avoidance of double taxation"[15] and a couple of agricultural agreements.

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[12] Khan, F. *"South Africa, China reinforce ties"*
In Taiwan Economic News, Wednesday, December 19, 2001. news.cens.com

[13] -----, *"Mbeki in China to foster economic links"* Sunday, December 09, 2001.

http://www.iol.co.za/general/news/newsprint.php?art_id=ct2001120921052854_512424

[14] Department of Foreign Affairs. Profile of bilateral relations,
www.dfa.gov.za /for-relations/bilateral/china.htm

[15] Wang Weiguo. *"China's entry into the WTO"*
Speech given at the Asia Africa Society, Johannesburg. May 30th, 2000.
Pg. 3.

By inaugurating the Bi-national Commission agreed upon last year in the "Pretoria Declaration of Partnership between China and South Africa"[16] by the heads of both states, the opportunity has not been taken to further relations on the trade front. The current visit has provided the usual rhetoric of intent but no solid agreements apart from South Africa being granted "Approved Destination Status". This in itself is an achievement as only 16 countries have been granted this status of being a worthy destination for travel.[17] Economically the influx of Chinese tourists onto South African shores could have a number of economic spin-offs filtering from the tourism industry. It is estimated that over ten million Chinese visited foreign countries in 2000. In the first six months of 2001, "the number of outgoing visitors rose to 5.48 million...up 10% over the same period last year...The World Tourism Organization predicted that China will be the world's largest tourist market by 2020."[18] With a Middle-class roughly the size of the entire Western Europe, a well-marketed campaign targeting tourism officials within the National Tourism Administration, Tour Operators, and Travel Agents as well as Airlines in the PRC would be invaluable.

Apart from this, no real agreements were hammered out. With the United States as well as the EU hammering out trade pacts with the PRC, South Africa should not be complacent and take advantage of the solid relations it has built diplomatically. The PRC's formal entry into the WTO coincided with the South African visit. More should have been done to promote South African trading interests. President Mbeki did mention that both South Africa and the PRC would "plan to negotiate a free-trade agreement and co-operate in promoting a fairer WTO".[19] Although these were set to begin in 2002, it

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[16] Liu Guijin, Op Cit. Pg.16

[17] Sapa-AFP, *"China awards SA prestigious travel destination status"* In the Cape Times. Tuesday, December 11, 2001. Pg. 5

[18] ----------, *"Tourist destinations welcome Chinese"* in the Asia Times. Saturday, December 22, 2001. http://www.atimes.com/china/CL22Ad03.html

[19] Sapa-DPA, *"SA, China plan free trade pact - Mbeki"* In Cape Times, Wednesday, December 12, 2001. Pg. 5

remains to be seen if any concrete action is taken on the part of the South African government in the near future changing this intent into a necessary reality.

Another issue that needed to be addressed during President Mbeki's visit is the paltry amounts of Chinese capital that has flown into South Africa in the last three years. The 2000 figure was only around $115 million.[20] In order for South Africa to grow as phenomenally as the PRC has in the last two decades, FDI is essential to increase ailing growth figures. The South African government should promote South Africa as a viable destination for Chinese FDI not only providing lucrative returns but also to foster South Africa as an entry port and "home base" for all Chinese African-business concerns, especially in the Southern African Development Community (SADC).

2.2 Sino-African Relations

"In the new political and economic order emerging after the Cold War, China, as a Permanent Member of the Security Council and a leading Member of the Group of 77, has an important and indispensable role to play in shaping the new world order. We in Africa will work closely with the PRC to achieve our common objectives. This must be for the mutual benefit of all of us."[21] (Aziz Pahad)

Deputy Foreign Minister of South Africa, Mr. Aziz Pahad, reiterated the importance of strong relations between the PRC and Africa in a speech celebrating the 50th Anniversary of the founding of the PRC. With a relationship spanning over three decades, most African countries share the same view as the PRC with regards to the "International Order". High on the agenda is the continued call for the reform and "democratisation of the UN (and) the restructuring of the international financial system to serve the needs of the developing world". Apart from this, "Peaceful co-existence, mutual respect for territorial integrity and sovereignty, mutual non-aggression, non-

[20] Editorial, *"Our man in Beijing"*,
In the Business Day, December 11, 2001. Pg.7.

[21] Pahad, A. *"Anniversary of the founding of the People's Republic of China"*
Deputy Ministry of Foreign Affairs/Speeches, September 30, 1999.
www.dfa.gov.za

interference in internal affairs, equality and mutual benefit"[22] remain equally important. The maintenance of "non-interference in internal affairs" as an inalienable right of any state has been laid to rest since the "War on Terror" has been waged by the United States in Afghanistan. In the Cold War era, many of these mutually desired "goals" mentioned above held sway as a guarantee in avoiding any criticism or action regarding any states internal matters. It remains high on the list of priorities for the PRC government to avoid any animadversion of its internal affairs, most notably on human rights issues.

Having always maintained a sound relationship with the African continent, the PRC had primarily maintained a diplomatic relationship in which recognition played a major role. The synergies that existed were born out of shared experiences as both were "subjected to aggression and oppression by imperialism and colonialism in the past"[23]. The lawful takeover of the UN Security Council seat by the PRC government in 1971, was overwhelmingly supported by twenty-six African countries. This act is still fresh in the minds of most Chinese Diplomats and is recalled almost always in some form or the other when African delegations or Governments are addressed by the PRC and is still viewed as a victory for the "developing world"[24].

Former Premier Zhou Enlai put forward the "5 Principles" governing relations between the PRC and African and Arab States as the "8 principles" governing Foreign Aid granted by the PRC to African and Arab States in the 1960's[25]. This formed the bedrock of Sino-African relations for two decades. The core of these principles advocated the mutual respect between African nations and

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[22] Ibid.

[23] Minghui, K. *"Sino-African Relations and China's Policy Towards Africa"* in "Africa Beyond 2000,Symposium on the Developmental Perspective of Africa Towards the 21st Century" Institute of West Asian and African Studies, Chinese Academy of Social Sciences, Beijing, China. October 1998. Pg. 385

[24] Ibid. Pg. 385

[25] Ibid. Pg. 390

the PRC, without any leverage being extracted from these relations. The minimal aid given during this time was viewed as kind gestures to *"friends"* without creating any dependence. In the 1980's the *"4 Principles"* on Economic and Technological Cooperation proposed by visiting Chinese Leaders continued the theme of the 1960's, adjusting them somewhat to conform with the reform that was taking place economically within the PRC.

Up until the end of the Cold War, there were not any concrete relationships forged in the sphere of International Finance and Trade that stood out between the Continent and the PRC. *"South-South"* co-operation was used more as a rhetorical mechanism highlighting the plight of the "developing world" without much being done on an active level to increase trade and development. In the last twenty years of Chinese reform and exponential growth, trade patterns, considerable aid programs, and the transfer of technology between the developing giant of East Asia and those countries on the African Continent were negligible. On a State Visit to six African countries in May 1996, President Jiang Zemin highlighted five propositions for the future of Sino-African relations in the 21st Century:

1." To foster a sincere friendship and become each other's "all weather friend".
2. To treat each other as equals, respect each other's sovereignty and refrain from interfering in each other's internal affairs.
3. To seek common development on the basis of mutual benefit.
4. To increase consultation and co-operation in International Affairs.
5. To look into the future and create a more splendid world."[26]

[26] Wenping, H. *"China-Africa Relations Facing the 21st Century"* in "Africa Beyond 2000, Symposium on the Developmental Perspective of Africa Towards the 21st Century" Institute of West Asian and African Studies, Chinese Academy of Social Sciences, Beijing, China. October 1998. Pg. 398

Apart from reiterating previous rhetoric, President Jiang did not offer any new impetus for the relationship on the verge of the "Chinese Century". A Century in which China would be almost certain of achieving international acclaim as a "world power", economic success as well as respect and fear from certain quarters of the International System. Instead he sought to promote the selfsame principles of mutual respect and peaceful co-existence that had been called for in previous decades.

However, the Forum for China-Africa Co-operation - Ministerial Conference held in October 2000, in Beijing has signaled a new beginning for relations between the Continent and the PRC on a trading and developmental level over and above the diplomatic.

"China is the largest developing country in the world and Africa is the continent with the largest number of developing countries. At the turn of the millenium and the century, China and Africa are faced with both historical opportunities for greater development and unprecedented challenges. At this important historical juncture, an in-depth discussion between us on how to strengthen co-operation and promote common development will undoubtedly exert a far reaching important impact on the cross-century development of Sino-African relations, closer South-South co-operation and the establishment of an equitable and just new international political and economical order." [27] (Jiang Zemin)

The Forum has set the tone for future Sino-African relations. Four African Heads of State, The Secretary General of the Organisation of African Unity (OAU), Heads of Delegation and Ministers from forty-seven African Countries as well as representatives from seventeen International and Regional Organisations attended the Conference.[28] One the largest gatherings of African leaders outside the continent hosted by a single state has surely sent signals to the International Community as to how important Africa is to China. As a fellow developing nation, the PRC has gone to great lengths to improve relations with the Continent in promoting its ideals of "Peaceful Co-existence"

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[27] Zemin, J. *"China and Africa - Usher in the New Century Together"*
Speech given by the President of The People's Republic of China at the Opening Ceremony of *"The Forum on China-Africa Co-operation - Ministerial Conference Beijing 2000"*, October 10, 2000. Pg.2

[28] Annex: in *"Beijing Declaration of the Forum on China-Africa Co-operation."*
List of attending visitors Pg.1-7.

calling for a "Multi-polar"[29] world system with no nation being bound by a regional or international hegemon.

As with President Thabo Mbeki's "New Partnership for African Development" (NEPAD)[30], the forum called for the restructuring and reform of the International System. In his address, President Jiang Zemin called for the strengthening of ties by promoting *"South-South"* co-operation, the enhancement of dialogue between the *"Developed North"* and *"Developing South"* as well as participating on an equal footing in all bodies on the international stage. The primary message (forming the cornerstone of President Mbeki's NEPAD) was the call for developing nations to "enhance their capacity for self-development and increase their national aggregates"[31]

This has been the route taken by the PRC in the last two decades that has led to an obsession with annual *"national aggregates"*. The PRC has focused solely on its growth rate when measuring its success. The NEPAD has vociferously advocated Africa's renewal being spurred on internally. By throwing out the *"begging bowl"* approach and calling out for a fair game on the international scene (such as improved market access), African countries hope to increase their own development by reducing poverty, diversifying their economies, crossing the *"digital divide"*[32], settling various disputes

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[29] The term *"Multi-polar"* is a product of the terminology used during the "Cold War" era whereby the International System was viewed as a *"Bi-polar"* system in which the United States and the Soviet Union exerted influence and acted as hegemonic powers. The likes of the Russian Federation as well as the PRC have since called for a *"Multi-polar"* system in which all nations hold equal sway. The current International system is perceived by many analysts as a *"Uni-polar"* order whereby the United States acts as the sole superpower exerting undue influence on many sovereign states.

[30] The New African Plan for African Development (NEPAD) has succeeded previously named initiatives such as the Millenium Africa Plan (MAP) and the New African Initiative (NAI). The contents are essentially the same and the document has just undergone a name change.

[31] Qihua, Hu. *"Forum urges co-operation"*
In China Daily, Vol.20, No. 6397. Wednesday, October 11, 2000. Pg.1

[32]The term "digital divide" defines the technological gap between those states in the "South" (especially on the African continent) and those of the developed "North". In order for the Continent to develop and to attract investment , certain levels of communication, telecommunication and information technology are required. These essentials are lacking in most parts of the continent. With the technological sophistication of the "new e-economy" tacking root globally, Africa could be left far behind if it does not bridge the gap. In addition

peacefully and challenging various pandemics such as HIV/AIDS. In addition "aid for infrastructure development"[33] would be essential in helping this process lift off the ground. President Mbeki, Obasanjo (Nigeria), Wade (Senegal) and Bouteflika (Algeria) have showcased the NEPAD globally. Having introduced it to the World Economic Forum (WEF) in Davos, the G8 in Genoa and individually by most African Heads of State on various International Visits (President Alpha Konare of Mali had presented the Program at the Tokyo International Conference on African Development (TICAD) in December 2001[34]), President Mbeki ended 2001 marketing it officially in the PRC. This initiative was continued in 2002 at the World Summit on Sustainable Development that provided the largest International audience and exposure.

Support from the PRC is of paramount importance, as a fellow developing nation that has grown immensely, it's support would definitely ring out concessions in the future from the developed world as a result of its size and importance. Using "South-South" relations with the PRC as leverage in the future is cardinal for the future of Africa. The long-term gains of activating a close relationship with the future economic powerhouse would not only give developing nations and those least-developed nations a platform to promote their restoration but also a close ally forcing changes in the International Organisations that would be more receptive to their needs. Whether it be the restructuring of the United Nations Security Council in order to bring an African member-state as a permanent member, or the reform of financial institutions such as the International Monetary Fund and World Bank making it easier for African states to render it's services with less dictation, the PRC will inevitably play a fundamental role in casting these(favorable) type of decisions in the decades to come.

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to infrastructural and regulatory change, highly skilled individuals are required to put Africa online.

See *"Bridging the digital divide in Africa"* ITU Africa Telecom 2001 Review, In the Business Report, Thursday, November 8 2001. Pg 2.

[33] Khan, F. Op Cit. Pg.1
[34] Khan, F. Op Cit. Pg.2

With regard to economic relations between Africa and China, Premier Zhu Rongji outlined five areas of importance in his speech at the Ministerial Conference. Continuing to increase bilateral trade; *"Vigorously"* developing investment co-operation; Improving Chinese aid in Africa; Amplifying co-operation in various fields and working towards liquidating African debt.[35] According to the China General Administration of Customs' statistics, trade between the two has increased astronomically, in 2000 trade volumes were up by 63.3%, over $10 billion with a fairly balanced trade relationship. However, most imports from Africa include raw materials (crude oil, metals, minerals and timber).[36] Many African products do not reach the PRC, "...a figurative Great Wall certainly still keeps much of the African commerce out of the market that the rest of the world is scrambling to claim"[37] This criticism has not made its way into the mainstream thinking of most African statesmen. With China's entry into the WTO, many of these criticisms may well be laid to rest.

On the issue of aid, the Chinese government made a firm commitment to reduce the debt of Heavily Indebted Poor Countries (HIPC's) and Least Developed Countries (LDC's) by $1.2billion in the following two years.[38] With poverty a substantial but ever-receding problem facing China at present, this gesture is more than welcome by receiving African States and has no doubt set a precedent that many developed nations should take note of.

Chinese Enterprises had involved themselves in 485 projects in forty-seven countries by October 2000. These enterprises brought the contractual trade volume of up to $970 million between the two sides. Two-Thirds of the capital

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[35] Qihua, Hu. *"Premier calls for increase in trade"* in China Daily. Friday, October 13, 2000. Pg.1

[36] www.moftec.gov.cn - Statistics/Africa

[37] Fabricus, P. *"Chinese take away more than they give in trade talks with Africa"* In The Sunday Independent, 15 October 2000.

[38] Editorial, *"A milestone in Sino-African ties"* in China Daily, Friday, October 13, 2000. Pg.4.

emanated from the Chinese side.[39] This figure seems rather large but only accounts for under 10% of the total volume of overseas investment by the PRC. Another form of Chinese investment in the Continent that is steadily increasing is in the "external processing industry". By the first six months of 2000, " sixty-two processing trade projects in sixteen countries" had been established with a trade volume "of mutual investment amounting to $117 million, of which Chinese investment exceeded $80 million, making up 18.6% of its total external processing industry investment."[40] Considering the number of economies that are in close proximity to the PRC geographically which offer similar services, African states will need to continue promoting their viability as investment destinations in order to increase the above-mentioned trade volume percentages.

The Ministerial Conference in Beijing has set the ball rolling in developing more substantive relations between Africa and China. After the three day Conference, Both the "Beijing Declaration of the Forum on China-Africa Co-operation" and the "Program for China-Africa Co-operation in Economic and Social Development" were released. The latter document stipulated concrete actions that would be pursued by both sides. By way of Inter-governmental Co-operation both sides agreed to expand and deepen diplomatic and economic relations and trade and investment would be accelerated in accordance with internationally accepted rules and principles. With the intention of increasing as well as balancing two-way trade, both sides would also work under the WTO framework in order "to ensure that the multilateral trading system contributes to enhanced competitiveness, economic growth and sustainable development in their countries."[41] Key factors in this economic partnership would also include private investment by firms in "the setting up of joint ventures or sole ownership enterprises, including small or medium

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[39] Qihua, Hu "Debt Burden for Africa to be revived"
in China Daily, Tuesday, October 10, 2000. Pg.1

[40] Liu, Xiao. *"Investments reach 47 African countries"*
in China Daily - Business Weekly. October 15-21, 2000. Pg.2

[41] *"Program for China-Africa Co-operation in Economic and Social Development"*
Pg.3

ones and the establishment of joint business fora."[42] The recently held Africa-Asia Business Forum (AABF II) held in Durban July 8-14, 2001 is an example of this type of initiative whereby a number of Asian and African businessmen met for trading purposes in order to bolster two way trade and build linkages between Africa and Asia.

The Program also called for Co-operation in various fields such as Engineering and Other Infrastructural Projects; Finance; Debt Relief and Cancellation; Tourism and Migration; Exploration and Utilisation of Natural Resources and Energy; Agriculture; Science, Technology and Culture; Medical Care and Public Health; Education and Human Resources Development; Arms Control; Environmental Management and Bio-diversity as well as Multilateral Co-operation. This comprehensive document called most importantly for Follow-up Mechanisms held every three years on a Ministerial level, every two years by senior officials and regularly by visiting delegations from China and African visitors to the PRC.[43] In a follow-up meeting held in Lusaka in 2001, it was decided that Ethiopia would be the alternate venue for the Ministerial Conference in 2003.[44]

By holding regular forums, material gains and progress could be easily measured for all nations concerned. The scene is now set for both the PRC and more importantly it's African counterparts to embark upon a developmental path in this new century. By working towards goals set out in the NEPAD as well as the "Program for China-Africa Co-operation in Economic and Social Development", African States could alleviate it's poverty, debt, public health and conflicts. Implementation and action would see the Continent emerge from its quagmire of problems. As a member of the developing nations of the *"South"*, the PRC has initiated economic links apart from the solid political relationship. African States should flesh out these links and gain its place among the many nations across the globe eagerly seeking a share of the

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[42] Ibid. Pg.4

[43] Ibid. Pg. 4-9.

[44] Liu Guijin, Op Cit. Pg.11.

Chinese market as well as gaining Chinese investment in their own states. The ball is entirely in Africa's court to make more of this relationship.

Chapter 3

China's WTO accession, internal ramifications and implications for South Africa

"China's entry into the global trading system is about more than trade. It is about China's future role as the world's economic leader. And it is about the future direction of the global economy and our global community" (Renato Ruggiero, Director General, WTO 1997)[1]

Fifteen years of painstaking negotiating brought about reform in China's trading policies. This culminated in bringing the most populous nation entry into the WTO on the 11th of December 2001[2] (coinciding with President Mbeki's visit to Beijing). After years of sedulous planning, the PRC has finally entered the WTO; this is most definitely a "watershed in the evolution of the global economic system"[3]. Apart from all the fanfare, entry has not only brought with it future prosperity for the worlds seventh largest trading nation[4] and its eager trading partners, but also nervous anticipation and fear domestically as well as from competing trading nations.

The necessity of entering this important multilateral organisation are obvious: gaining the *"most favored nation"* status as a country and *"non-discrimination"* towards Chinese products[5], furthering the potential for future growth and development and opening the world's largest potential market is most welcome. However, entry would also hasten the pace of reform internally, by restructuring grossly inefficient and uncompetitive State Owned Enterprises (SOE's) and reducing tariff barriers, millions of people face uncertain futures as job security inevitably dwindles as foreign competition increases. While the opportunities for investments are plentiful, many

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[1] Ruggiero, R. *"China and the world trading system"*
Director-General of the WTO addressing Beijing University.
April 21, 1997. Pg. 5
http;//www.wto.org/english/news_e/pres97_e/chipress.htm

[2] Reuters *"China enters WTO with high hopes for reform"*
In South China Morning Post. Tuesday, December 11, 2001. Pg. 1
http;//china.scmp.com/cgi-bin/gx.cgi/AppLogic=FT

[3] Ruggiero, Op Cit. Pg.1
[4] Reuters, Op Cit. Pg.2
[5] Ruggiero, Op Cit. Pg.2

"developing" nations and Newly Industrialised Countries (NIC's)[6] fear China's ever- growing superiority in various exporting sectors.

3.1 The WTO: China's Challenge

Having acceded to the WTO, China has adopted a path for its continued development that not only has repercussions for itself but all trading nations. By plugging in to the global trading system, transparency is essential; the next decade will put the PRC under the international spotlight it has yearned for. Since 1978, China has incrementally opened up to the international community, by joining the WTO not only has it opened doors but allowed for the ripping down of all the 'great walls' it had built in the last half of the 20th Century. WTO means many things to China, further success, as well as total catastrophe. For coastal entrepreneurs it means more wealth and economic freedom, for blue-collar workers employed by the state it means job insecurity if not imminent loss and for rural peasants and farmers it means a prolonged fight against poverty. Now more than ever, the Chinese government will have to pay close attention to any problems that could bring the wrath of 1.3 billion people to the fore and render all reform, restructuring and change to a grinding halt by way of revolt.

By joining the WTO, "trade is expected to grow to at least $1 trillion dollars by 2006" and improve the quality of China's growth.[7] This will arise as a result of further liberalisation of China's trading practices (which would include the lowering of tariffs and the abolition of quota's), deregulation and continued economic reform. Analysts also predict that the increase in competition will also bring about job-loss and bankruptcies in the "short to medium term". By opening up the markets to foreign competition, the pace of China's restructuring efforts will have to be quickened, especially "the reform

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[6] NIC's refer to those states that grew rapidly in the 60's, 70's and 80's primarily in the Asian region such as South Korea, Singapore, Malaysia and Taiwan.

[7] , *"Analysis: WTO Accession to lift China's Growth Quality"*
In Xinhua, Tuesday, November 13, 2001. Pg. 1
Ebscohost - Business Source Premier - Item Number 2W82714973227
http://ehostvgw2...booleanTerm=China%20or%20WTO&fuzzyTerm=

of SOE's and the lifting of local-market protection measures", however painful this may be in the short term, it is undeniably necessary for the PRC's long-term future.[8]

While many skeptics and nationalist hard-liners may frown upon WTO entry for ideological reasons, the need for WTO entry far outweigh the challenges that will require further sacrifice from the Chinese people. Eventhough the increase in imports will skyrocket; exports are likely to do the same. It is estimated that in the next five years exports will grow by 15% per annum ("versus 9% in a non-WTO scenario over the same period")[9]. FDI is also set to double in the next five years to around $100 billion as a result of the opening up of "domestic sectors and greater utilisation of (China's) export potential and the shift of manufacturing to China amid falling global demand (and) weakening regional economies...".[10] When tacking Growth Domestic Product (GDP) into consideration, researchers predict that "WTO accession will boost China's annual GDP growth by 0.5% points on average (7.7% in 2002 - 2006 assuming the US economic growth recovers from 2003). This growth trajectory should take total GDP to $1.87 trillion in 2006 from $1.07 trillion in 2000."[11]

China's accession to the WTO will necessitate fundamental change in the way matters are dealt by the public and private sectors. From the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) to the National People's Congress (NPC) and the State Economic and Trade Commission (SETC), various programs will have to be activated in order for China to play a role as an influential member of the WTO. *"Regulatory revision"* of China's current economic and legislative system and *"education"* for both its government officials, public and private sector as well as the public at large would be vital for WTO accession to be successful.[12]

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[8] Ibid. Pg.1
[9] Ibid.
[10] Ibid.
[11] Ibid.Pg.2

3.1.1 Regulatory Revision

"Regulatory revision" deals with all the legal and regulatory changes that are needed in order for the PRC to act in accordance with WTO rules and prescriptions. Baring in mind that the PRC has functioned under a *"rules based"* system rather than a *"regulatory"* system will definitely change the nature of the Chinese Communist Party's (CCP's) grip on trading and economic power. This challenge will be one of many that disturb leaders in the upper echelons of power. WTO entry lays the foundation for "A government based on law and regulations (that would) replace a command-type government."[13] In so doing, the government bureaucracy that is "accustomed to non-transparent means of operation and ruling by fiat"[14] will need drastic correction. In attempting to thwart the challenge to the central authority, the PRC government, led by the CCP has bandied about a new aphorism: "To run the country well, it is imperative that the party be run well first."[15] By consolidating power, the contra forces of economic globalisation which WTO accession brings will provide a new struggle for the CCP leadership in the years to come.

Despite this, the PRC government has undertaken changes that are required to bring its regulations in line with those of the WTO. By October 2001, the State Council "repealed 71 rules that conflicted with new government policies, and another 80 that were due to expire."[16] The number of abolished laws and regulations had reached 221 by the end of October 2001.[17] Although these

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[12] McDaniels, I.K. & Waterman, J. "*WTO: a done deal?*"
In The China Business Review,
November/December 2000. Pg.22

[13] Lam, W.W. *"China's WTO membership -- now the hard part begins"*
On www.cnn.com. Tuesday, November 13, 2001. Pg.2
http://asia.cnn.com/2001/WORLD/asiapcf/east/11/13/willy.column/index.html

[14] Ibid. Pg.1
[15] Ibid. Pg.2

[16] Dow Jones, *"For A Few Dollars More"*
In the Sunday Business Report, October 21 2001. Pg.2

revisions are required, it reflects the commitment of the PRC government thus far, considering that between 1994 and 2000 it had repealed just 70 laws in total.[18]

These regulatory and legislative changes will most certainly make entry into the Chinese market easier for foreign companies. This process requires a drastic overhaul of the current regulatory system in place and poses a number of challenges to the Chinese authority. All these changes do not need immediate implementation but will be phased in over a period of five years as a result of the transition of the PRC's economy. The range of reform varies from altering the Tax Code to the abolition of State subsidies granted to domestic exporters and SOE's. The government will have to eradicate laws that run contrary to Trade Related Investment Measures (TRIMS's) and relax controls on Distribution-related services and trading rights that are used as Non Tariff Barriers (NTB's). The harmonisation of separate codes for domestic and foreign products such as Sanitary and Phytosanitary Measures as a protectionist mechanism will also need to be phased out. Enforcement of Intellectual Property Rights (IPR's) in accordance with the standards set by the WTO's Trade Related Aspects of Intellectual Property Rights (TRIP's) are deemed of highest importance by almost all foreign enterprises.[19]

In China, intellectual property rights have most notoriously been disregarded. From CD's, electronics, motor spares, toys, clothing brands and now most importantly software, copyright has never been an issue. According to The Business Software Alliance (BSA), "94% of all the software installed in China last year was counterfeit."[20] This illustrates the magnitude of the problem facing the PRC government. One of the heaviest criticisms leveled against the PRC is as a result of copyright theft and has not only served as a hindrance for many companies thinking of entering the Chinese market but has also caused

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[17] Lam, W.W. Op Cit. Pg.1
[18] Dow Jones, Op Cit. Pg.2
[19] McDaniels, I.K. & Waterman, J. Op Cit. Pg. 23-24

[20] Munroe, T *"China fights counterfeiters"*
In the Business Day, Wednesday, October 17 2001. Pg. 21

many to leave. Although legislation is in place and numerous highly-publicised raids on counterfeiters take place, not enough is been done. With the national mindset not orientated to what "private property" entails (as a result of the system of "public ownership" ingrained in the minds of the population), the government will need to enact programs to not only seize counterfeit goods and prosecute offenders but also educate the nation as to what IPR's entail. Without taking a strong stand on the issue, China's reputation is compromised and serves as an unwanted barrier shutting out FDI, the PRC's main source of growth.

On the whole, these above-mentioned changes will benefit both Chinese and foreign firms.

"Economically it will be the opposite of death by a thousand cuts; it'll be life by a thousand stitches - the knitting together of literally thousands of rule changes, big and small, that will make China a faster-growing, more efficient economy. That in turn will mean more capital investment, higher productivity and higher living standards for the Chinese "[21]

3.1.2 Education

From the central government, to provincial and local leaders, all state bureaucrats, village leader's, municipal workers and law enforcers, everybody needs to learn what WTO entry requires, what it entails and how to implement regulations. A massive campaign is needed to "educate officials and companies (state-owned and private) about WTO principles and procedures and the implications of membership for local economies."[22] The government has an overwhelming task of not only training its own officials, but also explaining how state subsidies will be cut from non performing SOE's, how to prepare for international competition and why so many jobs will be lost.

However in an information-scarce country, the ramifications of WTO entry will (and has) been explained in a different way to the public. For fear of a

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[21] Powell, B. *"China's Great Step Forward"*
In Fortune Magazine, Vol. 144 Issue 5. September 17, 2001. Pg. 5.
Ebscohost - Business Source Premier - Item Number 5127077

[22] McDaniels, I.K. & Waterman, J. Op Cit. Pg. 25

calamitous uprising as a result of the short-term losses, the PRC government will probably tighten political controls more than ever to avoid any unrest. This is illustrated by the fact that the daily Chinese-language paper such as "The People's Daily" often interprets economic developments and reforms through an ideological prism, far different to the local English print and "western" media interpretations.[23] The obvious contradictions that exist between the economic (capitalist) route taken with regard to the economy and official CCP ideology will only widen as time progresses.

3.1.3 Benefits and Costs of WTO Accession

As the world's 7th largest trading nation, China faces many benefits and risks as a member of the WTO. While continuing the process of *'opening and reform'* that has taken place in the last two decades, transforming the economy into one which is *"market based"* is beneficial to both China and the rest of the world. As a member of the WTO, China will be able to participate in "the setting of international rules and standards rather than accepting them as an outsider."[24] This would not only extract benefits for China, but the entire global *"South"*, who look upon China to lead their call for reform in the international trading system. Apart from this, with China in the WTO, many nations would be assured that China "is subject to the same rules and disciplines as everyone else".[25]

With falling growth rates since the Asian Financial Crisis and weaker export numbers as a consequence of the global economic slowdown[26], WTO entry

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[23] Lawrence, S.V. & Murphy, D *"Repression"*
In Far Eastern Economic Review.
(Issue cover-dated) December 13, 2001
www.feer.com

[24] Laidler, M. *"China and the WTO: A European View"*
Address by the European Union Ambassador to South Africa
To the Africa-Asia Society, May 30th, 2000. Johannesburg. Pg. 2.

[25] Ibid. Pg.3

[26] ------, *"Ready for the competition?"*
Economist.com, September 13, 2001. Pg.1
http://www.economist.com/PrinterFriendly.cfm?Story_ID=780479

will most definitely bring further FDI and sustain growth levels which are needed to spur on future structural reform.[27] Reform that is urgently needed in the public sector. SOE's as well as China's banking system require massive restructuring. With foreign competition the majority of SOE's face extinction, with proper measures in place and an ever growing economy in terms of growth, the government could facilitate the partial relocation of workers from the public to the private sector in the future without creating social unrest. By allowing the banking sector to make decisions based on financial viability rather than political reasons dictated by the State, reform in the banking sector could put *'bad loans'* behind them avoiding crisis levels such as those facing Japan at present.

By participating as a WTO member in the international trading system, Chinese exports will not be targeted by various protectionist NTB's and quota's which have up until now, kept many of their exports at bay. With excessively low labour costs, Chinese exports, especially those in labour intensive industries such as textiles, will grow, bringing about more job-creation.[28] Eventhough exporting capabilities create jobs; the imports that will flow into the PRC will have a far greater effect on the amount of employment that will be lost. While WTO accession will bring about huge opportunities for foreign firms and efficient private enterprises (especially as a low-cost manufacturing base),[29] the impact on unemployment is cataclysmic.

With SOE's facing stiffer competition, especially those uncompetitive factories in certain sectors that were hitherto protected, many will be forced to conduct a number of large scale lay-offs. The automotive industry is probably going to be the worst hit. With "tariffs to be cut from the current 80%-100% to 25% six years after WTO entry and those on car parts to fall to an average 10%...Economists estimate that only about 40 of the more than 130 car

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[27] Laidler, M. Op Cit. Pg.3
[28] Laidler, M. Op Cit. Pg. 3.

[29] O'Neill, M. *"WTO delivers mixed blessings"*
in South China Morning Post. Monday, November 5, 2001. Pg.2
http://special.scmp.com/cg...agename=SCMP/

makers will survive the impact of WTO entry..." [30] This could lead to the loss of upto 500 000 jobs being lost in the next few years.[31]

Morgan Stanley analysts predict that over 25 million jobs will be lost in the next five years as a direct consequence of WTO entry and restructuring programs.[32] More disaster looms in the agricultural sector. Of China's 1.3 billion people, 900 million are based in rural areas and are dependent on the land. It is estimated that in the farming sector a total of 1.6 million jobs will be lost every year in the next five years.[33] In seven years time that figure will grow to around 9.6 million "because the grain and other products they grow cannot compete with food grown on highly mechanised agro-business farms in the west." [34] With disgruntled farmers moving to the highly congested urban centers in search of work, the social backlash would reverberate right to the top of the PRC authority. As startling as these numbers may be, WTO entry will in the long term create a net gain in the employment sector, especially in the highly skilled end of the market, such as the information technology, finance and service industries. However appealing this may be, most farmers or public sector employees have neither training nor skills in these fields.[35] These restructuring and reform measures that are called upon would have been required whether or not China entered into the WTO in order to sustain further growth. The fact that active steps are being initiated now, rather than later can only benefit the Chinese people who are still seeing rapid improvements in their living standards and life chances as the days go by. Twenty years of sacrifice and struggle have brought the Chinese people on the verge of success, the Government requires its population to stand firm through this

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[30] Ibid. Pg.2

[31] Li, R. *"Unemployment outlook gloomy"*
In the South China Morning Post. Saturday, November 17, 2001. Pg.1
http://special.scmp.com/cgi-bin/gx.cgi/AppLogic+Ftimes.../

[32] Powell, B. Op Cit. Pg. 5

[33] ------, *"Ready for the competition?"*
Economist.com, September 13, 2001. Pg.2
http://www.economist.com/PrinterFriendly.cfm?Story_ID=780479

[34] O'Neill, M. Op Cit. Pg. 2

[35] Li, R. Op Cit. Pg. 1-2.

initial entry-period and eventually the rewards of joining the global trading system will be enjoyed by almost all its population.

3.2 Implications for South Africa

"It is estimated that the PRC's total trade will double to US$ 600 billion by 2005 from US$ 361 billion in 2000. It is estimated that by 2005 China's accession will boost its total annual imports by US$ 105 billion to US$ 115 billion, with US$ 65 billion coming from the lowering of tariffs, US$ 20 billion to US$ 30 billion from the removal of Non Tariff Barriers, and a final US$ 20 billion from the expansion of foreign investment in the PRC"[36]

For many countries similar in economic structure as South Africa, as well as most African states, China's WTO entry will "provide easier access to the Chinese market."[37] However, "the structure of their exports in particular will bear the brunt of China's increased competitiveness...especially in the light industries such as textiles, apparel, footwear and toys".[38] With most African nations competing in these industries, they should be wary of the possibility that Chinese goods might replace their own on many shelves worldwide. The other major implication is the increased amount of FDI that will flow into the PRC, with African states competing for a share of these funds for their own development, the negligible FDI figures (Africa currently attracts under 2% of total FDI funds flowing into developing nations as compared to 60% for China) will decrease even more. Thus WTO entry will necessitate reforms not only for China but all developing nations, in order to further their own growth and development. Enhancing free-trade agreements with China is vital for all developing nations, not only to save their exporting sectors but also to benefit rather than loose out as a result of China's entry into the WTO.

The Bi-national Commission between South Africa and the PRC, as well as agreements signed between the two nations covering the avoidance of double taxation, agriculture and shipping, "all have had, as the objective the facilitation of trade and the opening of market opportunities for South African

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[36] Davies, M. *"Will China be SA's competitor or collaborator?"* In the Business Report, Thursday, December 6, 2001. Pg.2

[37] Laidler, M, Op Cit. Pg. 4.

[38] Ibid.

companies in China, as well as attracting more Chinese investment into South Africa."[39] The presence of South Africa companies is quite formidable, with investments in China (including Hong Kong (SAR)) totaling over $800 million, corresponding Chinese investment in South Africa has reached $150 million, with over 200 companies operating in South Africa [40]

China, is South Africa's 10th largest export market, moving up the list from number twenty a decade ago.[41] Trade between the two nations is heavily skewed in the favor of the PRC. The Department of Trade and Industry have released figures for 2000 that show South African exports to the PRC totaling R2.39 billion, while imports from the PRC amounting to R6.9 billion.[42] On the Chinese side, the trading relationship is viewed as a balanced one in which South African exports eclipse imports from the PRC. The latest figures available are those of 1999 in which "total trade amounted to US$ 1.722 billion - Chinese exports of US$ 860.5 million and South African exports of US$ 861 million. The different accounting standards used for trade through Hong Kong adds to the problem of determining true figures. When negotiating a bilateral free-trade agreement this issue could bring about problems.[43]

In order to reverse the trend of running a deficit with the PRC, South African business should expand its range of exports to absorb the cost of competition in light industries and labour intensive sectors. The textile, clothing, footwear and toy industries are likely to be the hardest hit domestically. With drastically low labour costs in the PRC, many factories in the manufacturing sector are shifting production to the PRC, not only for production reasons but also to

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[39] Pahad, A. *"China's entry into the WTO, Implications for South African Business"* Address by the Deputy Foreign Minister to the Africa-Asia Society, Johannesburg. May 30th 2000. Pg. 3.

[40] Ibid.

[41] Wray, Q. *"Mbeki leads high power team to China"* In the Business Report, Wednesday, December 12, 2001. Pg.2

[42] Davies, M. Op Cit. Pg. 2

[43] Davies, M. *"A Strategy for South Africa toward its Commercial Engagement of the PRC"* Research Paper Produced for the Stellenbosch Asia Project. Department of Political Science, University of Stellenbosch. November 2001. Pg. 3

gain entry into this lucrative market. The South African government would do well to gain preferential market access for a number of South African goods, especially those needed in the mammoth purchasing supply chains of the SOE's, a sector which although open to all foreign enterprises is a relatively closed process. Tariffs in the PRC are already down to an average of 17%, thus advantages as a result of the reduction of these tariffs will not increase South African exports by large numbers.[44]

With the PRC reciprocating the "Most Favored Nation" (MFN) status as a WTO member and the value of the South African currency in decline despite the current resurgence, South African exports would be more than competitive and successful in the Chinese market. The opportunities are plentiful and the timing could not be better in certain sectors.

3.2.1 Opportunities for South Africa

President Mbeki's visit to the PRC should have brought greater emphasis on trade and investment between the two nations as well as easing market entry for South African companies. With WTO entry obtained, South African companies would need favorable conditions for their exports in the hostile Chinese market. The government had made certain headway in discussing "economic co-operation in many areas - including nuclear power and opportunities for South African firms."[45] South Africa stands to gain "roughly US$ 400 million over the next two decades because of China's WTO membership"[46] This will come about as China reduces tariffs and South Africa increases the amounts of exports in their role as "suppliers of inputs in China's production."[47] South African trade figures for 1999 show that total exports to China comprise of "Iron Ore, Slag and Ash products accounting for 36.24% of

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[44] Davies, M. Op Cit. *"Will China be South Africa's competitor or collaborator "* Pg. 2

[45] Wadula, P. *"SA and China head for free trade"*
In the Business Day, Wednesday, December 12, 2001. Pg. 10.

[46] Wadula P. *"Contours of world trade to change"*
In the Business Day, Wednesday, October 10, 2001. Pg. 2.

[47] Ibid.

total exports. Personal household goods formed 11.89% of the total, Mineral fuels, arid Mineral oils accounted for 10.66%, Machinery and Mechanical appliances formed 8.38%. Iron and Steel products accounted for 3.39% and wool and animal hair accounted for 3.39% of total exports."[48] This reflects the nature of South African exports that are not diversified, consisting largely of raw materials and mining related products, and does not contain large percentages of manufactured goods.

South Africa has conducted trade relations with China as if it were a member of the WTO, granting the PRC de facto MFN status. Once this treatment is reciprocated, many sectors will be opened up as walls protecting SOE's and domestic enterprises begin to tumble in the PRC.

"As many state industries begin to collapse under the pressure of competition from foreign based firms, so will more opportunities emerge in the sectors that will have been left by the dying state sector. Possible gainers include the automotive industry, agro-industries, the chemical sector and the South African multinationals that are now operating in that market."[49]

Sectors that South African Companies should look into include: The Automotive Industry; The Steel Industry; The Machinery Industry; The Petroleum and Petrochemical Sector; The Agricultural Sector and the Telecommunications Industry.[50]

The Automotive industry has been one of the most protected sectors in the Chinese economy. With Tariffs ranging from 80-100% for sedans and anything from 12-50% on major parts. The average tariff in this industry is around 55%. With this average being reduced to around 25% by 2005, the influx of foreign competitors will be inevitable, causing a number of job-losses and bankruptcies in the domestic automotive industry. The PRC will also have to reduce tariffs on auto parts and spares which at present need to be

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[48] Hendricks, L. *"Business Opportunities and Threats for South African Companies arising from China's entry into the WTO"*
Address by the Deputy Minister of Trade and Industry
At the Africa-Asia Society Conference, May 30th 2000. Pg.2.

[49] Ibid. Pg. 3.

[50] Davies, M. Op Cit. *"A Strategy for South Africa toward its Commercial Engagement of the PRC"*
Pg. 5-14

produced in the PRC. "The PRC government requires that at least 40% of the parts used in domestic cars must themselves be domestically made."[51] BMW South Africa (PTY) Ltd. has been unsuccessful to date in gaining approval for exporting cars to the PRC, confusion has arisen as a result of its parent company in Germany eventhough BMW South Africa is registered in South Africa and acts as a separate legal entity. Apart from this, unless approval is given from the central authority, no company can gain successful entry without the relevant political contacts.[52]

With automobile sales set to skyrocket in China as living standards increase and prices fall as a result of the increased competition, opportunities for South African auto spares manufacturers are available. With Chinese production not competitive enough, lacking in quality and thin in scope, the chance for successful foreign enterprises in this sector could be a lucrative undertaking. In addition to the market for automobiles and spare parts, increased amounts of steel will be required to take care of the increased demand for cars. "The Chinese automobile sector will require 8.9 million tons of steel…of this total, steel materials will consume 5.4 million tons with parts and accessories accounting for 880 000 tons. The domestic Chinese metallurgy industry is currently unable to provide the needed varieties of steel plate, quality steel and iron required by the automobile industry, making imports necessary."[53] Thus South African steel Producers would do well to take advantage of these shortfalls faced by the PRC's steel industry and develop a position of strength in the Chinese market.

The Agricultural Sector will undergo dramatic change one China implements all WTO requirements. The country with the most mouths to feed worldwide will present a number of opportunities for agricultural exporters such as South Africa. It is estimated that by 2003, 37% of the world's food demand will emanate from the PRC. With the relaxation of China's policy of grain self-

[51] Ibid. Pg. 5
[52] Ibid. Pg.5
[53] Ibid. Pg.5

sufficiency, a swell in imports is likely in the largest agricultural market.[54] "Projections indicate that the number of elite and consumers who can afford processed food - will have expanded from 87 to 195 million by the year 2005 - 225% increase"[55]

Opportunities in this sector will continue to expand as China reduces tariffs and improves its economic growth. With the population increasing at 1% per annum, 12.5 million more mouths will have to be fed every year. With increasing disposable incomes, greater purchasing power among the Chinese citizenry will create more pressure on the agricultural sector as demand increases. "Changing diets, with greater diversity and acceptance of different ethnic foods (will create) a greater demand for processed foods."[56] With incomes increasing, so will the number of refrigerators as well as microwaves enter Chinese homes, this will most definitely increase the demand for fresh, chilled and frozen foods as well as convenience-food products.[57]

With China's economy shifting away from being an agricultural economy into labour intensive manufacturing, its comparative advantage in agriculture as dwindled since initiating reforms and will inevitably make the PRC a net-importer of agricultural goods. Tariffs have been reduced from an average of 42% in the last decade, and will decline to 17% by 2004.[58]
Products that are of interest to South Africa still face exceptionally high tariff barriers. The average tariffs on South African products is 39%."High levels of protection exist on barley (91%), maize (114%), wheat or meslin flour (91%), cereal groats and meal (maize) (91%), sunflower seeds (91%), wine (65%), meat (45%), fruit (generally 30-40%), sugar (30%) and processed fruit and vegetables (25-30%). South Africa's main export commodity to china is fine

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[54] Ibid. Pg.10

[55] Du Toit, D. *"South Africa as an exporter to China under the WTO"*
Address by the Deputy Minister of Agriculture to the Africa-Asia Society Johannesburg. May 30th 2000.

[56] Ibid.Pg.2

[57] Ibid.

[58] Tschang, Chi -Chu. *"Debate over farm subsidies toughest of hurdles"*
In South China Morning Post. Monday, November 5, 2001.
Wysiwg://67/http://special.scmp.com/cg...agename=SCMP/

or course animal hair accounting for almost 70% of exports to China and the average tariff is only 9%. Tariff peaks on the main commodities presently exported from South Africa to the PRC exist on fruit juices (22% of exports), 35% tariff; Wine (7% of exports), 65% tariff; and beer made from malt (<1% of exports), 50% of tariffs."[59]

When looking at the above-mentioned statistics, South African exports have done fairly well despite the high tariffs. Once tariffs on various products such as Beef (45% down to 12-15%), Wine (65% down to 20%), Citrus fruits (40% down to 12%)[60] are decreased, an increase in exports will bring the trade deficit down leading to a greater balance in the relationship between South Africa and the PRC. "The most important agricultural export products at present from South Africa to China are fine and course animal hair, fruit juices, wine, beer, barley, fish, food preparations, live sheep, bird eggs in shell, hides, skins and animal feed."[61]

However with the signing of two important agreements between the two countries, further opportunities exist for South African exporters of fruit, vegetables, live animals and meat. The "Agreement between the Governments of the Peoples Republic of China and the Governments of the Republic of South Africa on Phytosanitary Co-operation" and the "Agreement on Co-operation in Animal Health and Quarantine" concluded in 2000, allows for "trade in plant and animal products respectively while preventing the spread of noxious plant pathogens and diseases or pests from one country to another.[62] South Africa is fortunate to have these agreements in place, as the PRC will probably use a number of Non Tariff Barriers such as 'plant and animal risk studies', which require technical information that is time consuming before allowing certain commodities into the country. This ploy is used to reduce the number of imports coming into the PRC, which compete with local production by making the process cumbersome.

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[59] Du Toit, D. Op Cit. Pg. 4.
[60] Ibid. Pg. 4-7.
[61] Ibid. Pg. 6

As food consumption increases, so will the opportunities. Exports such as maize, wheat, barley, oil seeds, peanuts, sugar, meat, egg, aquatic products, fruit, vegetable oils will be necessary as demand outperforms supply. The same can be said for dairy products as well as high technology exports such as "genetics, embryo's, biological pesticides and animal health treatments."[63] "China's consumers will more than double their meat consumption by 2020 and although domestic production is growing, it cannot keep pace with the growth in demand." The prospects for exports in circumstances such as these prove to be mouthwatering to say the least.

Apart from the automotive and agricultural sectors that have been dealt with, as mentioned earlier, opportunities also exist in various sectors such as machinery, petroleum and petro-chemicals as well as telecommunications. In the Petro-chemical sector, SASOL has taken great steps forward by opening up offices in Beijing and Hong Kong. "SASOL exports to the PRC will amount to approximately R500 million in 2001, while SASOL Polymer's chemical exports to the PRC are projected at R1 billion for the coming year."[64] The tremendous success of SASOL records the opportunities for South African companies in this sector

A number of capital machinery items used in mining related industries in South Africa could be exported into China where technological sophistication in mining is in its infancy compared to South Africa. In the jewelry sector, various platinum, gold and diamond items are increasingly in demand by the ever expanding middle class. Machinery such as diamond cutters, cleaning machines and other hi-tech equipment are required to deal with the demand.

South Africa has increased its gold sales to the PRC in the last seven years on an annual basis as gold was bought as an investment.[65] Investec's

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[62] Ibid. Pg. 5
[63] Ibid. Pg. 6

[64] Davies, M. Op Cit. *"A Strategy for South Africa toward its Commercial Engagement of the PRC"* Pg. 9.

International Banking division has already signed an agreement with the Peoples Bank of China to supply it with a ton of gold every three weeks. This should see 15 tons of gold being transferred per annum with increases in the future. With China consuming around 200 tons a year (3rd largest gold consumer), the opportunities for the largest gold producing nation will be available once China liberalises the gold market, which at present is one of the most highly regulated. "At the moment, the Central bank fixes gold prices at all levels of the supply chain, changing its pricing infrequently to bring it in line with the ruling market price."[66]

This by no means outlines the only available opportunities in the PRC at present; a t best it outlines a fraction of what is available for South Africa. Business in South Africa should take the initiative in finding what avenues do exist coupled with the help of government officials in both the Department of Trade and Industry as well as Foreign Affairs. With the South African Currency favourably low for exporters at present , it is the opportune moment to export to the largest market worldwide. By finding a niche in a particular sector, by no means signifies great riches. The Chinese system and its people are far more complex. A few guidelines will be needed for any possible entrant into the Chinese market, as to how business is conducted in the PRC. This is the focus of the next Chapter.

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[65] Bain, J. *"Gold still glisters for China and Vietnam"*
In the Business Day, Monday, November 19, 2001. Pg. 13.

[66] Joffe, H. *"Investec, China seal gold-shipment deal"*
In the Business Day. June 15, 2000.
www.bday.co.za

CHAPTER 4

Conducting Business in China

"China is one of the last business frontiers and the largest market on this planet. In its diversity, variety and complexity, it is unmatched my any other country. Few markets in the world have been entered by a comparable number of foreign companies, resulting in an extremely high competitive intensity. Given all these factors, China possibly has the toughest business environment in the world which is extremely difficult to understand and excel in. At the same time, foreign businessmen often underestimate its enormous intricacy and competitive intensity."[1]

Foreign Investment in China has proved to be a viable option for many Multi-National Corporations (MNC's) worldwide. In relocating production facilities for export purposes or seeking a foothold in a large market of 1.3 billion people, companies have invested in more money in China than any other emerging market.[2] While a market of more than 1.3 billion may seem appetising, the problems that some companies have faced to date, require a serious viability study by possible entrants to be done before entering this environment. Apart from the cultural and language problems facing foreign companies, the legal and regulatory system governing entry into the Chinese market is often times murky, unclear and complex. Distribution networks as well as differing standards and requirements vary from province to province and locating the real decision-makers within the governing authority is most cumbersome. Generally most MNC's currently involved in the PRC are not making sizeable profits, rather consolidating their positions in a market that is yet to unleash its potential as most of the population is obsessed with saving. The process is time-consuming and difficult with ever-changing rules governing how business can be done, but with WTO entry, a system based on *'rules'* will inevitably become one based on the solid foundation of law where all commercial rights and obligations will be given clarity and most importantly become enforceable. WTO entry will most certainly decrease many of the risks facing foreign investors wanting to gain entry into China. The very best of the business world are carefully maneuvering themselves for

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[1] Schlevogt, K. (a) *"1. The Business Environment in China - Getting to Know the Next Century's Superpower"* In Thunderbird International Business Review. Vol.42 (1) 85-111. January-February 2000. Pg. 85-86.

[2] Katzenellenbogen, J. *"South Africa suffers drop in investment"* In the Business Day. Wednesday, September 19, 2001. Pg. 15.

the coming decades where the competition for ultimate domination will begin for the biggest prize in the business world - success and survival in China.

4.1 Foreign Direct Investment

Chinese reform and 'opening up' in the last two decades has brought about significant changes and improvements in the lives of all Chinese people. Eventhough reform has taken place incrementally; growth rates have exceeded double digits in most of the last twenty years. Averaging around 8% for twenty years has been a phenomenal achievement by any standards.[3] With consumption doubling, GDP per capita rising threefold, life expectancy increasing considerably, infant mortality decreasing and illiteracy dropping to single digit figures[4], China is set to enter this new century far better off than imagined a quarter century before.

"According to the World Bank, it took Britain about 58 years to double its per capita income from 1780-1838, 34 years for Japan (1185-1919) and 11 years for South Korea (1966-77), but only 9 years for China (1978-87) and another 9 years to double again (1987-96). By 1997, China with per capita GNP of US$ 860 had 'graduated' from the category of 'Low Income Countries' into that of 'Lower Middle Income Countries'."[5]

This growth has come about as a result of various supply and demand side explanations. On the demand side, China has achieved large amounts of domestic investments, maintained high domestic savings rates (the highest in the world) as well as high export growth all creating "a virtual cycle of growth."[6] On the supply side, growth has been for the most part reliant on a colossal influx of Foreign Direct Investment (FDI). This continues to be the case in the new Century.

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[3] --------, *"The World Bank and China"*
Country Brief
www.worldbank.org/html/extdr/offrep/eap/cn2.htm

[4] Kyushu, K. *"Chapter 3 - Recent trends and Prospects for Major Asian Economies"*
East Asian Economic Perspective - Special Issue.
The International Center for the Study of East Asian Development.
Vol. 11. February 2000. Pg. 26.

[5] Wong, J. "Southeast Asian Ethnic Chinese Investing in China"
In East Asia Institute Publication, National University of Singapore.
EAI WP NO 15. October 23rd 1998. Pg. 1

[6] Ibid. Pg.2

FDI has skyrocketed into China in the last decade making China the second largest recipient after the US worldwide.[7] Total FDI had reached over US$220 billion from 1979-97, [8] flows in 1998 saw another US$45.5 billion pumped into China[9], US$35.6 billion in 1999[10], a further US$ 41 billion in 2000[11] and final figures for 2001 would probably remain at this level despite the global economic slowdown. This brings a total of around US$ 380 billion worth of FDI into the Chinese economy in 22 years.

The gradual reforms that allowed FDI to enter into China had the aim of bringing in foreign exchange as well as accelerating the process of transferring technology in order for China to catch up the developed nations. Deng Xiaoping introduced the "Law of the Peoples Republic of China on Joint Venture Using Chinese and Foreign Investment" at the Fifth Peoples Congress in July 1979 which in effect granted FDI legal status in China.[12] With the establishment of the four *"Special Economic Zones"* in Shenzen, Zhuhai, Shantou and Xiamen followed by Hainan in 1988 and the opening up of various coastal cities along the eastern seaboard, it was possible for FDI to flow into these areas.[13] Although FDI flowed into China it was by no means

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[7]-------, "China- Country Commercial Guide"
Trade Compliance Center - Asia/Pacific.
http//infoserve2.ita.doc.gov/tcc/Intern...0b84e4932585256655005f4fda?
OpenDocument

[8] Wong, J. Op Cit. Pg. 5

[9] --------, *"UNCTAD Press Release"*
TAD/INF/2823. September 23, 1999.
http://unctad.org/en/press/pr2823en.htm

[10] -------, *"Foreign Investment in Brief- Year-end 1999"*
The United States-China Business Council. January 2000.
http://www.uschina.org.public/briefinvest.html

[11] -------, *"China Versus Southeast Asia In The Race For Investment"*
In the Asia Pacific Bulletin. November 2nd 2001.
http://www.asiapacific.ca/apbn/bulletin.cfm

[12] Chunlai, C. *"Recent Developments in Foreign Direct Investment in China"*
Chinese Economy Research Unit. University of Adelaide. April 1996. Pg. 33
http://www.adelaide.edu.au/CERU/

[13] Wong, J. Op Cit. Pg. 3

dramatic, in 1986 further legislative changes were made to encourage increased FDI. Fees for labour and land use, the establishment of a limited foreign currency exchange market for joint ventures, the extension of the duration of joint venture agreements could exceed 50 years and the permission for the establishment of Wholly Owned Foreign Enterprises was enacted.[14]

By 1990, further restrictions on FDI were lifted and the Shanghai Pudong New Development Area was given the status of a Special Economic Zone (SEZ).[15] It was not until 1992 when FDI accelerated far beyond expectations increasing by billions of dollars year on year.

"Following Deng Xiaoping's celebrated tour of South China in February 1992, China was to transform itself into a "socialist market economy" and to throw its "economic door" wide open to foreign trade and foreign investment. Not just the designated SEZ's and selected coastal cities, but many interior regions were now opened to FDI. Within a few months after Deng's tour, some 1784 localities were opened to FDI compared to 117 in 1989. FDI was now permitted in sectors and industries previously closed to foreign capital. These include areas such as foreign trade, domestic commerce, insurance, finance, aviation and infrastructure." [16]

While China has attracted more FDI than any other developing country and second only to the US on the global level, many analysts believe that a substantial amount of this FDI comes from Hong Kong and Taiwan as well as funds *"round-tripping"*[17] its way out of the Mainland through Hong Kong back into China in order to gain tax concessions. Approximately one-third of FDI is thought to enter China through this channel.[18] Once legislation regulating domestic as well as foreign investment unifies into a unitary, non-discriminatory system and body of law, the need for such practices will fall away. Entry into the WTO will kick-start this process.

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[14] Chunlai, C. Op Cit. Pg.34
[15] Ibid. Pg.35
[16] Wong, J. Op Cit. Pg.4.

[17] "Round-tripping involves the circular flow of capital out of China (in most cases to foreign affiliates of Chinese transnational corporations) and the subsequent "re-investment" of this "foreign" capital in China for the purpose of benefiting from fiscal entitlements accorded to foreign investors. By round-tripping, Chinese investors avoid the regulatory regime governing domestic investment by channeling capital through foreign affiliates and thereby bringing this capital under the more favourable regime governing foreign investment."
See Chunlai, Op Cit. Pg.37

[18] Wong, J. Op Cit. Pg.5.

While MNC's continue to pour money into the PRC, adequate rates of return have not been reflected; "...more than half the multinationals in China are failing to make a profit".[19] However, the rationality behind this, is a "desire to position themselves for easy access to the huge domestic market"[20]and take advantage of the cheap labour, especially in labour-intensive manufacturing industries. While this may be seen as a reasonable motivation, skeptics argue that this is far to great a risk. Some investors have pulled out of China as a result of a number of problems that have impeded their chances of making viable profits relative to the amounts of capital they have invested.

"...they had tired of China's opaque policymaking process, in which sudden policy changes are poorly explained, and of their many restrictions on their business activities, from outright prohibition of investment in certain industries to controls on foreign exchange conversions."[21]

One example of the Chinese authorities sudden rule changes was illustrated in 1995. Tax concessions on imports of capital equipment that proved highly popular with investing MNC's, was abolished without prior warning given to investors. Not only did this decrease FDI but also caused large disinvestments as a result of the rise in costs that this move would incur. Although these exemptions were reinstated in 1997, the continual threat of the authority backtracking on concessions remains a problem. Numerous tax concession have been repeatedly phased out (to fill tax coffers when needed) and are reinstated when FDI recedes. With the lack of transparency in the Chinese decision making process, investors cannot gain insights as to what laws will be enacted or phased out in the required time needed to alter or change plans.[22]

Despite these problems, as China assimilates its rules to those prescribed by the WTO conducting FDI, a stable system will inevitably evolve. The Chinese authority has done its utmost to make the environment secure for continued

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[19] Henly,J; Kirkpatrick,C & Wilde,G. "FDI in China: Recent Trends and Current Policy Issues"
In World Economy, March 1999. Vol.22.
Ebsco Host - Business Source Premier.
Item No 1858069. Pg. 7

[20] Ibid. Pg.8

[21] Gelb, C. *"Foreign Investors Wise Up"*
In The China Business Review. Vol. 27. No 26.
November-December 2000. Pg. 8

FDI to take place as its economy becomes more dependant on it for future growth, however the bureaucratic logjams pose significant problems for MNC's involved in China.

Foreign investors may enter the Chinese market in certain sectors of the economy. In 1995, The Ministry of Foreign Trade and Economic Co-operation released the "Catalogue Guiding Foreign Investment in Industry"[23] which set out four categories in which FDI may take place: namely *"Permitted"*; *"Encouraged"*; *"Restricted/Discouraged"* and *"Prohibited"*.[24] All projects over US$30 million require central government approval as well as all investments in *"Restricted/Discouraged"* sectors. *"Encouraged"* sector projects require local government review and "equity and geographic restrictions still exist in many sectors, particularly services; what the PRC terms "pillar industries" like aviation, autos, and chemicals; and in sensitive areas like publishing. Inflexible structures still exist, especially in sectors- such as soft drinks, pharmaceuticals, or auto parts - in which foreign investment has been restricted."[25] However, as alluded to in Chapter 3, With the recent WTO entry, these sectors which had previously been protected will now be opened up to foreign investors such as the automotive and auto parts industry.

The *"encouraged"* sector includes those in which new technology can be transferred into China such as agriculture, "construction of energy communications and raw materials projects for industry, new and advanced technology that enhance exports, projects that use renewable resources, ...equipment for pollution control and investments developing Central and Western China."[26] *"Prohibited"* sectors were those in which MNC's, could not enter such as telecommunications services[27], print media and various

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[22] Ibid. Pg.12

[23] Sutter, K.M. *"Investors Growing Pains"*
In The China Business Review. Vol. 27. No 26.
November-December 2000. Pg. 14

[24] Gelb. Op Cit. Pg. 8
[25] Sutter, K.M. Op Cit. Pg. 14.
[26] Henly, J. Kirkpatrick, C & Wilde, G. Op Cit. Pg. 9.
[27] Gelb, C. Op Cit. Pg. 8&12

information related industries that China considered to be of national importance in terms of national security. These prohibitions will also be up for change with WTO entry, especially in the telecom sector. With heavy-handed State control in the print and electronic media, China faces an awkward position in the future, Foreign investors have entered into the Internet Service industries with minority interests but have been subject to close scrutiny by the Central Government. While media related technology (satellite, electronic, or print) is welcomed, the control of information dissemination is of utmost importance for the governing authority and is unlikely to be opened up allowing foreign control in the near future.

Banking, retail, insurance and infrastructure sectors could all be considered in greater depth, especially with China's WTO entry. Once identifying the particular sector of interest where FDI is permissible and potential opportunities exist, foreign investors have a few market-entry options available.

4.2. Foreign Investment Vehicles

A host of alternative entry vehicles exist as ways to enter the Chinese market. Subject to various sector requirements and permission from the central and local and regional authorities, they vary from Wholly Owned Foreign Enterprises (WFOE's); Equity Joint Ventures (EVJ's); Contractual Joint Ventures (CJV's); Representative Offices (RO's); Holding Companies; Foreign Invested Share Companies (FISC's); Holding Companies (HC's) and Research and Development Centers (R&D).

For the purposes of this study, WFOE's and both EJV's and CJV's will be looked at in detail as they are the most relevant and used form of entry by foreign investors to date (over 80% of entrants utilise these forms of entry).[28] Joint Ventures (JV's) as a whole (including both EVJ's and CVJ's) have been successfully used by foreign investors as a means to enter the PRC. But with

[28] Ibid. Pg.9.

the gaining of experience, familiarity of the environment and increasing 'know-how' and confidence, coupled with the relaxation of restrictions by the government, the number of WFOE's has increased in the last four to five years.

While both forms of entry present successful opportunities, depending on the relevant industry and sector certain methods may be compulsory. If not, those who have had experience in the Chinese market, and have established good relations with governmental officials relevant to their sectors, WFOE's may be a better option. First time entrants may find the language, culture and business practices quite overwhelming in China, without any political or business networks, entering into a JV with a Chinese affiliate may be the best way to start up.

The first step that should be taken is the establishment of a "Representative Office"(RO). While not being able to "engage in any 'profit-making' activity, such as receiving fees for services or signing contracts"[29], it allows MNC's to establish a presence, build a network in both the political and economic sectors and to learn how the Chinese market operates. By discovering where the opportunities lie, if any, directly rather than from a distance, MNC's could save large amounts resources and time if it decides to enter the market or leave if it seems unlikely that the future investment might not be successful. The RO's are generally required to open in "expensive city centers", are taxed heavily "on deemed profits and losses for the whole venture" and are permitted for no longer than three years.[30]

WFOE's are most optimal for foreign investors who seek outright control, although restricted to certain sectors and conditions, WFOE's have grown rapidly. Investors are solely responsible for all risks, profits and losses. The WFOE has to "either export 50% of its output or qualify as a 'high technology'

[29] Sutter, K.M. Op Cit. Pg. 16.

[30] Sutter, K.M. Op Cit. Pg. 16.

enterprise"[31], the definition of which is open to interpretation. While most WFOE's, do not have the hassle of having to take on a Chinese counterpart, large amounts of start up capital are needed and the ability to gain contracts are limited as they do not have Chinese backers or connections. While the authorities have not promoted WFOE's in the past as a result of little or no technology transfers, the need for FDI has brought about many legal changes granting WFOE's more autonomy and less hassles. The legislation regarding WFOE's are stipulated in the "PRC Law Concerning Enterprises with Sole Foreign Investment" (1986) and the "Implementing Regulations" (1990)[32]

EVJ's are limited liability corporations formed between foreign investors and Chinese counterparts. The risks, profits and losses are shared between the partners in proportion to their initial contributions. Foreign Investors have to contribute at least 25% of the registered capital. Contributions by either partner can take the form of "cash, land-use rights, buildings, equipment, materials, intellectual property or labour."[33] EVJ's give foreign investors the advantage of taking on a partner that has expert knowledge of the domestic consumer market, all the regulatory requirements as well as government connections to gain certain concessions. At first EVJ's were the only vehicle that could be used by foreign investors, but with regulatory changes WFOE's have become more popular. The major drawbacks of EVJ's are the strong minority rights given to shareholders that hold minimal shares in the venture. Any decision has to be unanimously taken as minority shareholders have a veto to block any decisions. Managerial duties are also shared leading to conflicts of interest if the agreement does not explicitly mention how the relationship will be managed. The transfer of managerial 'know-how' and technology also make certain foreign investors apprehensive. The government encourages EVJ's for obvious reasons as the transfer of technology takes place and greater control can be exerted through the Chinese counterpart. While WFOE's are on the rise, the government has allowed certain amounts of foreign equity in 'sensitive' industries such as "auto's, retail,

[31] Ibid. Pg.15
[32] Ibid.
[33] Ibid.

telecommunication services and other industries." Making EVJ's as viable options in the future.[34]

CVJ's are different to EVJ's in that the former allows a foreign investor and the Chinese counterpart to conclude a contract whereby "profits and losses (are) shared as specified in the venture's contract, not according to the equity share." The partners would act as "separate legal entities and bear their own liabilities" if they so wish. Without any prohibitions of withdrawing the registered capital and the ability to unilaterally apply for the dissolution of the contract, CVJ's are a safe option for some investors.[35] Generally all three forms of investment entry vehicles are subject to a 30% national income tax in addition to a 3% local income tax.[36]

4.2.1 **WFOE's VS EVJ's - Options for South African Investors**

While EVJ's were the most popular form of entry into China in the 1980's and early 1990's, by 1999 "more than half of all foreign investments in China were WFOE's."[37]

This has resulted because of the legislative changes that have, and with WTO entry, continue to take place but also as a result of the "dissatisfaction among foreign partners with the performance of their EVJ's in China."[38] Deng sets out a number of reasons as to why WFOE's are a better entry mode for MNC's. Firstly, as EVJ's bring together two business partners sharing the management of the newly formed company, "partners can disagree on just about every aspect of the venture, thereby paralysing decision-making. This is particularly true with Sino-foreign JV's , where partners have divergent objectives, disparate expectations, incompatible business practices and social and cultural differences..."[39] If the joint-owners do not set out clearly defined parameter's

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[34] Sutter, K.M. Op Cit. Pg.16
[35] Ibid.
[36] Ibid.

[37] Deng, P. *"WFOE's: The Most Popular Entry Mode into China"*
In Business Horizons, July/August 2001. Vol.44 Issue 4. Pg.1
Ebsco Host - Business Source Premier Item No: 4750347
[38] Deng, P. Op Cit. Pg.2
[39] Ibid.

conflict is inevitable. The problems outlined above are not entirely exclusive to Sino-foreign JV's. When looking for a Chinese counterpart, adequate research should be done in order to find the right partner who shares the same goals and has a proven record locally to be worthy as a partner. With specific objectives in place, the decision-making process can be swift without any blocking from either partner.

One of the legitimate problems facing foreign investors is the fact that both partners have different strategic objectives that are not entirely visible. "The primary motivations for the Chinese in entering a JV are to obtain technology, capital, management expertise and short-term success. The aim of foreign investors, however, is to gain market access to China with a potential for long-term growth. Because these partners share the same bed but have different dreams, their expectations and approaches to running a business tend to be vastly different, thus leading to tensions in many EVJ's."[40] While this assessment of the motivations for Chinese partners may be harsh there have been a number of instances where this has proved to be the case.

Intellectual Property Rights (IPR's) are notoriously disregarded by a large number of companies in the PRC. For some Chinese companies, EVJ's allow them to gain access to various advanced technologies that are relevant in the specific industry and are either used by themselves in other geographic regions registered as separate enterprises. Or the technology is passed on to other companies who "produce knockoffs or products that compete directly against their foreign partner."[41] The Chinese Courts have not punished companies infringing IPR's severely enough, nor have the authorities clamped down hard enough as mentioned in Chapter 3. A recent example mentioned by Deng is that of Gillette "who recently fought a battle with a razor blade counterfeiter in Jiangsu Province that ended up with the counterfeiter being fined only US$ 2400 when found guilty."[42]

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[40] Ibid. Pg.3
[41] Deng, P. Op Cit. Pg. 4.
[42] Ibid.

Apart from these problems Deng also mentions that Chinese partners in the EVJ often oversell their ability to provide a client base, solid distribution networks as well as political connections. In some instances Chinese partners also lack the capital to cover unexpected losses, or moves to expand.[43]

Thus many MNC's may find that WFOE's are the safer option which permits total control, no shared management and less of a risk in having their technology and management 'know-how' ending up in other hands. However, if the right partner's are found, carefully stipulated objectives are set out, a record of delivery or capabilities are exposed and a little compromise from both partners, EVJ's are still viable options.

When taking potential South African investors into consideration, EJV's might be the best alternative. South African Breweries (SAB) have been a great example in showing how successful EVJ's can be. While WFOE's are largely used by MNC's who have large financial muscle to take on such large investments, the average South African company capable of entering China is not that well established to conduct vast operations entirely on its own. SAB has proven to be a worthy MNC, capable of entering China on their own, but their experience has shown that EVJ's may be more successful if entered into properly with the right partner. SAB have become the biggest foreign brewer in China and have shared a prosperous relationship with China Resource Enterprises (CRE) as its EVJ partner.[44] Holding a 49% share in the EVJ, SAB have increased its interests in 14 breweries in various provinces across China since entering in 1994.[45]

Small and Medium Sized Enterprises (SME's) from South Africa could look at Taiwanese companies involved in China. Despite the fact that Taiwanese firms have greater cultural affinities with respect to language, food and belief

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[43] Ibid. Pg. 3

[44] Mathews, C. *"SAB boosts presence in Chinese province"*
In the Business Day, Wednesday, October 10, 2001. Pg. 20.

[45] Cohen, T. *"SAB wins China, but flat at home"*
In the Business Day, Friday, June 1, 2001. Pg. 14.

systems, many lessons can be learned. The majority of Taiwanese firms that have entered into the Chinese market are SME's who take advantage of the cheap labour and have invested in the labour-intensive manufacturing sectors for the purposes of exporting to third countries.[46] South African companies that are similar in size, have the intention to enter into light industry sectors also have weak government support when entering China.

While the Taiwanese business lack strong government backing due to political and historical reasons,[47] South African companies lack government support as a result of inadequacies within government ministries such as the Department of Trade and Industry. Without adequately skilled personnel and resources located in PRC, the South African government, for all its intent, is not pursuing coherent strategies promoting China as an investment destination for South African companies, nor is it assisting business involved in China at present with any impetus. This responsibility is left largely on the shoulders of self-motivated companies who are required to gather their own information regarding opportunities, deal with local government officials in China and confront any problems they may face largely on their own.

Based on the experience and success of Taiwanese firms, South African companies should at first set out specific time frames and profit targets, the products and services that will be rendered should be those generally encouraged by the Chinese authorities. Companies that enter into investment projects that are export-orientated receive numerous benefits such as "reduced or exempted site-use fees, given priority in receiving loans, in obtaining water, electricity, transportation services, communication facilities" as well as reductions in their taxes.[48] By investing in projects that are promoted by the Chinese authorities, their support is of greater use than the possible scrutiny that the project could endure.

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[46] Ralston, D.A. & Wang, X. *"Strategies for Small and Medium-Sized US Businesses Investing in China: Lessons from Taiwanese Companies."*
In Thunderbird International Business Review,
Vol. 42(6) 677-701
November-December 2000. Pg. 686/687.

[47] Ibid. Pg. 689.

[48] Ibid.

One of the most important lessons when entering into the Chinese market is to understand from the outset that this massive landmass containing 1.3 billion people is anything but a homogenous country and market. Differing tastes, languages, strains of culture and language exist, as do income differentials. In the eastern coastal regions, per capita earnings far outweigh those in the inland areas, while consumers in the south have diversified tastes and consuming patterns.[49]

If South African companies planning to enter the China in order to tap into the market, it is important to locate the relevant region as well as target market it wishes to enter into and capture. Consumers in the eastern regions have far larger disposable incomes. High-technology and luxury items are bought by those in urban areas, especially in the eastern coastal regions where despite their small numbers (around 17% of the total population) relative to the rest of the country, they account for at least a third of all national retail sales.[50] 70% of China's population remain in the rural areas inland, while the remaining 30% are found in urban centers concentrated on the eastern and southern seaboards. [51]

Those South African companies entering into projects that are export-orientated should locate themselves closer to the ports and harbours located in coastal SEZ's, where concessions from the government are available (as mentioned above) and there exists "an abundance of the better-trained personnel and proximity to the world market".[52] Eventhough incentives to invest in the lesser developed Western and inland areas exist as a result of their underdevelopment in comparison the Eastern and Southern coastal areas, the lack of adequate infrastructure and poor transportation pose considerable challenges to investors.[53]

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[49] Ralston, D.A. & Wang, X. Op Cit. Pg. 692.
[50] Schlevogt, K. (a). Op Cit. Pg. 109.
[51] Ibid.
[52] Ralston, D.A. & Wang, X. Op Cit. Pg. 692.
[53] Ibid.

Foreign investors who wish to tap into the Chinese market should also pay careful attention when setting up a production base, in addition to the infrastructural and transportation problems, the provincial and local authorities in certain regions often erect barriers impeding movement across China. Establishing distribution networks are almost impossible because of the differing entry requirements and rules imposed by provincial authorities. Logistical problems arise since transport networks were primarily focused on getting cargo from factory points straight to the harbour for export, without any consideration for local networks within the country. Railways and roads are not networked in conjunction with each other making transportation an arduous process.[54]

Most investors are under the false impression that once into China, 1.3 billion consumers can easily be captured. But distribution rights are heavily curtailed. In entering any province with a manufacturing license, investors are practically only able to capture that particular market. Provincial tariffs and tolls exist at every border because of the excessive competition amoung the various provinces. Chinese provinces are like separate countries, and have developed in this autonomous way as a result of the central authority's inability to exercise total control. Although this may not be so clear from afar, but according to some analysts, "China is the land of 10 000 emperors." [55]

This situation has culminated by virtue of the previous economic doctrine espoused by Mao, namely "provincial and local self reliance... (where) tight state control over distribution was aimed at maximum employment…(and) each province developed its own self-contained industrial infrastructure…(resulting in a) huge duplication of bureaucracy, manufacturing and distribution capacity." [56] Another reason for this is that economic authority has been largely decentralised and given to local authorities who have put up protective barriers against goods entering from

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[54] Tanzer, A. *"Chinese Walls"*
In Forbes. Vol.168, Issue 12. November 12, 2001. Pg. 74-75.
Ebsco Host - Academic Search Premier. Item No. 5425931. Pg. 2

[55] Ibid.

[56] Ibid.

other provinces in order to gain favour with the Central government by increasing "local economic growth, employment, social stability and tax revenues. (Taxes historically have been captured where goods leave the factory, not where they are sold)"[57]

Thus movement of goods from one province to another and licensing rights to distribute in various provinces may be cumbersome. China's WTO membership will ensure that the Central Authority will undertake massive regulatory changes to negate these problems as well as increase expenditure to ease infrastructural problems. Foreign Investors will inevitably be given the right to distribute their goods on a national level from a single nerve center in the future once further liberalisation takes place. At present, foreign investors should enter each market individually, once these endeavors are met with success, the relevant experience can be taken to the next market place.[58]

The choice of entry for South African SME's or MNC's should be by way of EVJ's, especially if no previous experience can be drawn from. It must be re-iterated that a viable partner is chosen with respectable credentials and similar objectives. Chinese partners are essential for their local market knowledge; existing client base and distribution networks. Coupling with a Chinese partner in any investment project increases the chances of achieving greater concessions from authorities, improving the prospects of gaining contracts and allows easy access to business and political networks. Once South African investors have developed their own networks and have gained substantial experience and confidence in the Chinese market, then the use of WFOE's as an investment vehicle becomes a feasible option. This is the "two-step entry strategy" that Taiwanese firms have employed in order to achieve their goals in this highly competitive, difficult yet at the same time, exciting and lucrative market.

4.3 Cultural Influences on Business Practices

[57] Tanner, A. Op Cit. Pg. 2
[58] Ralston, D.A. & Wang, X. Op Cit. Pg. 693.

In China, the foundation for any success is based on the relationships that have to be fostered. The importance of political and business connections have been stressed upon for notable reasons. In order to negotiate with future JV partners, central and local authorities and other organisations within the Chinese business world, an understanding of the cultural influences on business practices in China will make future prosperity an easily achievable goal.

When dealing with a high-context culture such as that found in China centered on teachings that are thousands of years old, it is important to understand the impact on how various issues are approached. "Confucianism" is the embodiment of guiding principles that influence Chinese thinking and action. Confucianism advocates the moral cultivation of human beings based on certain persuasions rather than a comprehensive body of law. The importance of relationships (Guanxi), the respect for age and hierarchy; the orientation around the family or collective rather than the individual and the important concept of 'face' (mianzi, lian) whereby 'a sense of shame' is inculcated into the mindset of all Chinese people all play a meaningful role in how Chinese businessmen or authorities deal with foreign counterparts.[59]

In addition, one must not forget that the governing authority if the PRC is a Communist Party and despite the contradictions on the economic front, it is still a Socialist State where authority is highly centralised and has " an all-pervasive influence on every aspect of Chinese life." Without a genuine legal system in place, decisions taken by the central authority still take precedence in many cases. The Chinese Government has taken many bold steps in opening up China to foreign investors to take advantage of the vast market, but

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[59] Fang, T & Ghauri, P. *"Negotiating With The Chinese: A Socio-Cultural Analysis"*
Journal Of World Business, Fall 2001, Vol.36 Issue 3.
Ebsco Host - Business Source Premier. Item No: 5151724
Pg. 5

(For an in depth and detailed account of how Chinese businessmen negotiate, the strategies employed, and the role of culture in this process, the study by Ghauri and Fang is essential for any potential investor interested in entering the Chinese market. The study is based on several years of negotiations conducted by the Swedish Telecom Company Ericsson, with its JV partner as well as various governmental authorities.)

it is coupled with a priority to gain access to advanced technology from potential investors. [60] This in an attempt to maintain development, sustain growth and most importantly make China the respected *'Middle Kingdom'*[61] it once was. Chinese people in general have large amounts of national and personal pride. It would be advisable not to put the Chinese in uncomfortable and uncompromising positions as it would bring them a loss of 'face' and could ultimately hamper future interactions.

One of the fundamental factors leading to the conclusion of successful contracts are the relationships (guanxi) that are built in the pre-negotiation phase. When lobbying for a contract, wooing a potential JV partner or seeking a viable supplier or distributor in the value chain, without solid introductions to heighten credibility or the establishment of trustworthy interpersonal relationships, projects are doomed to fail.[62]

While most foreign investors (including South African's) deem written contracts the essence of fruitful negotiations, Chinese counterparts place the corresponding level of faith on the relationships that are cautiously established into trusting friendships. In a society where reputation and 'face' are more important than a piece of written paper, it is essential to understand and take this important factor into account. In most cases once a verbal agreement is made, it signifies a guarantee. While Chinese businessmen have come to understand the apprehensive nature of foreign investors, they have become more receptive to signing contracts without viewing it as a lack of trust. Even if signed, terms are often times 'renegotiated' after the fact, as they view it as an evolving relationship rather than a static agreement stipulated by terms and

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[60] Ibid. Pg.4.

[61] The *'Middle Kingdom'* refers to the era of the illustrious Tang Dynasty. A period where China saw herself as the superior civilisation at the time. This thinking is still part of the Chinese psyche, and is perpetuated in geographical maps that place China at the centre of the globe with all the other Continents at the periphery.

[62] Li , Ji. *"Negotiating with China: Exploratory Study of Relationship Building"*
In Journal of Managerial Issues, Fall 2001, Vol. 13 Issue 3.
Ebsco Host - Business Source Premier - Item No: 511839
Pg. 9.

clauses.[63] While these instances do occur, the majority of Chinese businessmen have taken it upon themselves to sign and honour contracts in line with international best practices and in accordance with prescriptions set out by the WTO.

South African investors willing to enter the Chinese market can find a number of worthwhile opportunities. By conducting adequate research, choosing the right investment vehicle, the PRC presents "a special challenge: it is the world's largest emerging market, largest Communist bureaucracy, and the oldest culture"[64], keeping this in mind will make every possibility a flourishing one.

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[63] Schlevogt, K. (b) *"2. Investing and Managing in China - How to Dance With the Dragon"* In Thunderbird International Business Review. Vol.42 (2) 201-226. March-April 2000. Pg. 217-218.

[64] Fang, T & Ghauri, P. Op Cit. Pg.1

Chapter 5

Potential Risks Facing the PRC in the Twenty First Century

The fact that China has been the economic success story in the last quarter of the previous century and will continue to be the one in the current Century is seen as an inevitability. However, certain factors need to be taken into account in order to bring some reality to this phenomenal journey. The PRC's economic growth has far surpassed any expectations, its attraction of global FDI has outstripped all competing emerging markets collectively. But with entry into the WTO, one would not be inclined to think that potential risks boiling under the wave of this success could reverse all the gains made thus far.

It is hard to find more than a handful of economists globally that are not optimistic of the future of the PRC. However an economist sceptical of China's entry into the WTO and future course is Han Deqiang who argues that "many Chinese people are overlooking potential risks because of a *'worship of market forces'* and the alluring prospect of cheaper imported goods."[1] The real possibility of increased unemployment as time progresses as a result of uncompetitive enterprises that are largely State Owned is a serious problem as domestic consumers go global in seeking imports. The greatest fear for many skeptics is that while "China gains from dismantling bloated government monopolies it will lose by surrendering more of its markets to control by big foreign companies". Mr Han takes this point further that the United States is actively using the PRC's membership to the WTO "as a way of gaining control of China's economy and speeding up the pace of the *'Westernisation'* in China."[2]

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[1] ------ , *"China and the WTO – Ready for the competition?"* Economist.com, September 13, 2001. Pg.2 http://www.economist.com/PrinterFriendly.cfm?Story_ID=780479

[2] Ibid. Pg.2

These may be extreme views on the fringes of mainstream thought in China, but if unemployment surges ahead, redeployment in the private sector does not take place for many factory workers as well as those in the agricultural sector (as cheaper agricultural imports enter into the PRC) and growth rates subside, the political leadership may face unprecedented problems in the social and economic domains of this vast country.

For the purposes of this paper, three key areas will be focused upon that could upset the rapid progress and metamorphosis of the PRC and could ultimately pose serious risks on any company potentially involved in the Chinese economy. The first is the transfer of power currently taking place within the Chinese Communist Party (CCP), as well as the ramifications of the policies the new leadership will follow. The second area that threatens this colossal country's existence and future prosperity are the levels of corruption that seem to be continually spiraling at a faster rate than the extraordinary growth the PRC currently enjoys.

Lastly, an area of potential risk is the future restructuring and privatisation of all non-performing State Owned Enterprises (SOE's) and the rising unemployment rate that is, and will continue to be one of the largest problem areas facing the State in the years to come. What is interesting and unique about these three particular areas that could evolve into potential problems is that each is intertwined with the other and has ramifications for the political, social and economic well being of the PRC and by implication all foreign companies that are actively participating in China. It is imperative that all companies keep an avid eye on the development of issues pertaining to these three areas, as they will definitely prove to be key indicators of the future direction of the PRC.

These three areas of potential risk identified will prove to be the key challenge facing the new generation of China's leadership that was recently elected at the 16th Party Congress held in November 2002. The new political environment that includes the changing face of the ruling Communist Party is

a risk in itself and this decade could be the defining moment of not only the ruling Party, but also the Chinese political system as a whole.

5.1 The Communist Party turns a "brighter shade of red"[3]

The Communist Party of China has played with the definition of many words in order to push through all the market related reforms it has undertaken, but had always managed to convince Party hard-liners that no leftist principles had ever been compromised. Outgoing President Jiang Zemin has perhaps redefined what the Chinese Communist Party had evolved into the last twenty years in the clearest of terms by allowing the admission of capitalists into the Party.[4]

This step is more important in changing the course of the future of the PRC than any other significant event in the last two decades. Jiang Zemin's contribution to Communist Theory embodied in his *"Three Represents"* which include the necessity of the Communist Party to represent and promote *"Advanced Productivity"*, *"Advanced Culture"* and the *"Fundamental Interests"* of all China's people, has allowed for this political move to fit comfortably into the Constitution of the Party.[5] The inclusion of businessman into the party can be viewed as a positive step towards the political change that some advocates believe is necessary for the PRC to further progress economically.

Many Communist Party members are of the opinion that this unprecedented move is necessary and will allow the Party to exert control over an ever-

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[3] This phrase is taken from the title of an article written by Francesco Sisci entitled *"Jiang's party turns a brighter shade of red"* in Asia Times Online. September 28, 2002.

[4] Wolf Jnr, C. *"China's Capitalists Joint the Party"*
in the New York Times, August 13, 2001. Pg. 1
http://www.nytimes.com.

[5] The *'Three Represents'* are indicative of the reality of the current situation in China. For all intents and purposes *"Advanced Productivity"* is a mask for the very fundamentals of a capitalist and market-led economy that is emphasised by Jiang. The inclusion of the necessity that all *"Fundamental Interests"* of the people be attended to and sought includes the interests of entrepreneurs, businessman and the middle-class that have become the drivers of change in the PRC.

growing sector of the Chinese population that is generating large amounts of wealth. Their inclusion would propel the Party into a greater position of power in the coming years. If *'capitalists'* are excluded from the Party there is the threat that in addition to the financial muscle available to them and the further integrated they become in the International Community, they could as a class, develop into a force that the Communist Party and inevitably the State, would find themselves pitted against in the decades to come.

This is a real threat to the political *status quo*, as one Senior Party Theorist mentioned:

"If these entrepreneurs are not included inside the party, they will be inclined to develop organizations and channels outside the party line and they will have ample resources to do so." [6]

An analyst at a prominent US think-tank contends that "faced with the choice of further ideological compromise or increased estrangement, from where the action is, the Party has opted to accept the former risk in order to reduce the latter one."[7] While this may me a viable option, one cannot count out the ultra-leftist arm of the Party, which may find this *'ideological compromise'* one step too far and cause the eruption of an open power struggle within the Communist Party itself. The *"Three Represents"* espoused by Jiang and the admission of *"red capitalists"* into the party is a clear deviation from the Marxist Principle "of the proletariat as the leading force for change." If Jiang manages to 'enshrine' his theory into the Party Constitution, this would almost definitely put the party on the road to political transformation. "If the proletariat and its tradition are left behind, the old Leninist tradition can be set aside and the party can start working on the rule of law and democratization as they are forms of modernization."[8] Were this initiative to be successful, Jiang's *"Three Represents"* would take over as the key set of guiding

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[6] Op Cit. Wolf Jnr, C. Pg 2

[7] Ibid. Pg 2

[8] Sisci, F. *"Chinese Politics: Secrecy in an open world"* in the Asia Times Online. August 20, 2002. Pg.1 http://www.atimes.com/atimes/China/DH20Ad01.html

principles of Chinese Communism after *"Mao Zedong Thought"* and *"Deng Xiaoping Theory"*.[9]

While this may seem to be an opportunistic if not an utopian idea, there have been signs that progressive leaders have considered the ideological change of the Party. The annual leadership meeting of 2001 held at a seaside resort of Beidahe in Northern China, had as its main focus, the issue of *'Party Construction'*. In order to stay in power as a supreme force in this new Century, Jiang is purported to have pointed out that the Communist Party "had no choice to change from a party of workers, farmers and other proletariats to a *'quanmin dang'* or, party for all people."[10] This largely implies that some quarters of the leadership have come to the conclusion that "in the IT epoch, businessmen and professionals have displaced relatively less educated workers, not to mention farmers, as society's vanguard"[11]

In order to progress and grow these seeds of change, many analysts believe that the *"Fourth Generation"* of leaders should take this initiative a step further and transform the Chinese Communist Party (CCP) into a Socialist Democratic Party fashioned into the mold of those found in Europe. This possibility may not be advocated in the State run media in the PRC but the Party has conducted in-depth studies concerning this idea. This was confirmed in 2000, when a delegation led by Politburo Standing Committee member Wei Jianxing visited the German Social Democratic Party (SDP) discussing issues relating to party ideology and organisation.[12] If the new leadership were to inculcate these changes, it would not only be met with resistance from the inner circles of power, but the Party at large; and even if

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[9] --------, *"Chinese Dragon dons business suit"*
by the Sunday Times Foreign Desk
in the Sunday Times Business Times, November 10, 2002. Pg. 7

[10] Lam, W. *"China Progresses with the times"*
in CNN.com. September 5, 2001. Pg.1
http://asia.cnn.com/2001/WORLD/asiapcf/east/09/04/china.ccp.willy/index.html

[11] Ibid. Pg 1

[12] Ibid. Pg. 2

the slightest disruption were caused, one would shudder to think how the already fragile socio-political fabric would be managed.

5.2 The Fourth Generation of Leaders[13]

"There has never yet been a peaceful and constitution abiding transfer of power of the top echelon in the CCP's 81 year history. Top most leaders either died or got booted out of their jobs and then lived in disgrace in order to discharge their powers."[14]

With Beijing virtually draped in *'Communist Red'*[15] during the 16th Party Conference, the transition of power from one generation to the next has been markedly different to the last two occasions. Mao had come to be the founding father of the Chinese Communist Party and the PRC in 1949 after a long and protracted Civil War that was interrupted by World War Two. Deng Xiaoping's coming into power after Mao's death, was by virtue of a military coup that toppled the members of the notorious *"Gang of Four"* and led to a large number of political executions. Jiang Zemin's coming into power was not seamless either as he came into power under the shadow of power struggles within the Party that led to the gunning down of pro-democracy demonstrators at Tiananmen Square and brought a large amount of International criticism. This also resulted in the expulsion of one of the *'liberals'*, Zhao Zeyang from the Party Leadership.[16]

The current transition of power has taken place in an orderly fashion. However, as in most political parties, especially in the Chinese Communist Party that shrouds itself in secrecy, there is more to this transition than meets the eye. Heir-apparent Hu Jintao was earmarked for greatness during 1992 when Deng Xiaoping chose him for grooming under Jiang Zemin. The natural

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[13] The Fourth Generation of Leader's, are those after Mao Zedong (First Generation), Deng Xiaoping (Second Generation) and Jiang Zemin (Third Generation).

[14] Yufang, Xu. *"China's changing of the guard"*
in the Asia Times Online, August 5, 2002. Pg.2
http://www.atimes.com/archives

[15] Sapa – AFP. *"Hu Jintao emerges as China's likely leader"*
In the Business Day, Friday, November 8, 2002. Pg. 10

[16] Bezlova, A. *"Chinese people unmoved by leadership changes"*
in the Asia Times Online. Friday, November 8, 2002. Pg. 1
http://www.atimes.com/archives.

progression to the top of the Party leadership was almost inevitable, but may play out differently in the coming years. Jiang Zemin has always favoured his own protégé Zeng Quinghong who is part of the strong Shanghai faction led by Jiang Zemin (former Mayor of Shanghai) in the Party leadership. Zeng will play second fiddle to Hu in the new leadership rankings[17]. A constructive relationship will prove to be a vital between the two that could avert a threatening power struggle in the longer term. Hu Jintao will need to develop closer ties and build alliances within the political elite in order to govern and push through his own agenda and maintain political stability that is necessary for China's economic progress.

One of the reasons that no real tensions have arisen is that Jiang's policies have not been severely challenged within the party and would probably be enacted in the coming decade. This was emphasised in a statement made last year in an interview, that for him (Jiang) "Unity of thought is particularly important as the party is making its transition from the third-generation to the fourth-generation leadership."[18] Coupled with this, Jiang will still head up the Central Military Commission, a post he has not relinquished, in order to keep and exert an influence on China's future political landscape.

The importance of this leadership transition that has just taken place is that it has global consequences. The ramifications of this change will almost definitely affect the global trading and political environment. This is typified in the analysis of a single statistic:

"The next generation of leaders will stay in power for the next five or ten years. During that time China's economy is expected to continue its rapid growth, overtaking the size of any European national economy. Thus China will become the largest economy on the planet next to Japan and the United States, and this will in turn create new issues with Japan, the US and the world as a whole."[19]

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[17] Op Cit. Yufang, Xu. Pg 1.

[18] Lam, W. *"Jiang determined to hang on to power"*
CNN.com. August 21, 2001. Pg 1.
http://asia.cnn.com/2001/WORLD/asiapcf/east/08/21/willy.column/index.html

[19] Sicsi, F. *"One for the history books"*
Asia Times Online. Firday, November 8, 2002. Pg. 1.
http://www.atimes.com/archives.

On the domestic front, and more important to all foreign investors currently involved in the PRC as well as those considering investment opportunities, the political situation in the near-term will be stable rather than threatening to harm any interests in the country. The new leadership will be focusing all its attention on further economic progress that is needed to negate any chances of domestic violence and social unrest to break out while continuing with economic reform. On a strictly political level, only the Falun Gong spiritual movement has brought any formal opposition to the government, but it has been suppressed without any real domestic uprising or International criticism. This can be attributed to the large amounts of capital invested in the PRC by Western countries that do not wish to be embroiled in a political dispute with the PRC as well as the Global *'War on Terrorism'* which has taken the focus away from a multitude of domestic issues in most countries that would have in normal circumstances gained attention or publicity.

Living in contemporary China today is far different from the environment a decade ago; the government has "managed to achieve greater effectiveness in pursuing its goals while actively shrinking its power. The government in principle will (a) leave the people alone, as long as they do not confront the central authorities, and (b) try to make sure that politics will facilitate the economy and not obstruct it."[20] Furthermore with China's WTO membership and its increasing role in the International Financial System, any future government has less of an ability to stray from Internationally accepted norms and principles that would scare off FDI and erode the confidence that has been created thus far.

The massive societal, economic and political change that China will be embarking upon will be an inevitable risk at a macro level. However the new generation of leader's are well placed to stave off a leftist uprising to thwart any possibility of a large-scale revolution and overhaul of the political and economic system. Thus the key challenge facing the leadership in the coming

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[20] Ibid. Pg. 1

decade is to manage the expectations of the differing interest groups that are currently evolving by giving a "consistent and unconfusing voice" to all sectors of society.[21]

In order to do this, two important areas of potential risk need to be addressed in a controlled manner with firm conviction, these areas include the ever-growing force of corruption and the management of the issue of the privatisation and closure of State Owned Enterprises. This will inevitably lead to the unemployment of millions and the dislocation of a large number of the rural population that are currently moving into the urban areas in search of better opportunities in the new Chinese economy. Judging the leadership of the last two decades, there is no reason why China's development into a global economic superpower will be hampered as stringent political management has led to social cohesion and successes that have been unparalleled in most countries far smaller and far easier to control.

5.3. Corruption with 'Chinese Characteristics'[22]

"Many interpreted Deng's dictum *"To get rich is glorious"* as meaning that any way you got rich was good, that you didn't have to be too fussy about how. Crime, graft and corruption grew. There was a flourishing of old vices and a few new ones invented as well" (Member, Chinese People's Political Consultative Conference)[23]

What is lacking since China opened up to the rest of the world was a strong moral code that would safeguard society from the excesses of the so-called *"free world"*. With wealth accumulation becoming the cornerstone for all in society, the moral generation of the population faded into the background. According to Sydney Shapiro, an advisor to the government on economic policy, most, if not all the corruption experienced in the PRC is as a result of this gap in society. For him, a *"moral rearmament"* is required to maintain

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[21] Ibid. Pg.2

[22] *"Corruption with 'Chinese Characteristics' "* is a phrase coined by Huang Weiding an Executive Director and Senior Economist at a central government level publishing house that produces a large number of articles/periodicals and books relating to corruption and China's 'shadow' economy.

[23] Shapiro, S. *"Unprecedented Experiment"*
In *"China's Century "*. Brahm, L.J. (2001)
John Wiley & Sons, Inc. New York. Pg. 22.

social stability in the coming decade, that would not only release China from its feudal heritage that remains in part to this day, but will also help reduce the immorality "manifested in crime, vice and corruption". While times and policies have changed drastically since the Maoist era, there has been no strictly defined moral code that was previously in existence. This has led to "greed and corruption…to fill the vacuum. Today, using *'connections'*, paying bribes, putting private loyalties above public good and blind worship of authority – as widespread practices – are unfortunately considered almost required behaviour for advancement and survival in Chinese society."[24]

Many analysts believe that the current problem of corruption has evolved as a result of the radical economic changes that have taken place in the last quarter of a century. Huang Weidang calls this *"transition period corruption"*. The first type is that of the relationship between money and power, which was previously non-existent in the centrally planned economic system. In this new epoch, the market is allowed some independence because of reforms initiated, however, the economy is still controlled to a certain extent by administrative bodies, and individuals in positions of power at local, provincial and national levels. Some of these individuals have maintained their interests and abused their power by allowing certain projects to go to favoured individuals with whom they have relations or extract some gains in exchange for *'decisions'* that are amenable to an exclusive few. This type of "power interfering in the market is the greatest warming bed for nurturing corrupt opportunities."[25] One of the most destructive phenomena that has taken root is that of administrators, officials and CCP leaders in the provincial, local and national arena's extracting "fees, penalties and apportioning charges known as *'chaotic collecting of fees'*…(which) is a common form of creating income through the use of power."[26] Most foreign firms potentially investing in the PRC should take careful consideration as to whom within the administration they are

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[24] Ibid. Pg. 22-23.

[25] Huang, W. *"Fighting Corruption Amidst Economic Reform"* in *"China's Century "*. Brahm, L.J. (2001) John Wiley & Sons, Inc. New York Pg. 43.

dealing with, and should contact the relevant department dealing with corruption if it becomes a precursor for advancement. The problem with this ethical approach is that most firms, without openly admitting, often use the shadow channels in order to speed up its activities or gain connections within the governmental machinery.

Another reason for the increase of political corruption results from an incomplete set of market related regulations that should fully cover all aspects of running a market-economy. This has led to a administrators extracting maximum gains out of the transition of the economy and have become rich, not "through diligent work and legal means", but as a result of the lack of adequate control and gaps in the legislation put out by the central government. This type of corruption will however be easily eradicated once tighter controls are put in place and a large comprehensive set of tabled legislation is produced.[27]

"Irregular competition" is another contributing factor to the growing corruption problem. Most private entrepreneurs offer bribes and kickbacks to Government officials in order to get their products onto the market and purchase resources from the State at greatly reduced prices in order to be more competitive. This also extends to the workplace where certain officials turn blind-eyes to working conditions and treatment of workers when receiving commercial bribes. This is alarming for foreign firms who are exposed to "a dual commodity priced system for raw materials," where bribery or *'incentives'* could be given in order to reduce costs. For most foreign direct investors, adhering to the letter of the law would mean uncompetitive products on the market that would not survive; this is potentially one of the most damaging modes of political corruption that requires immediate attention.[28]

The amount of money involved in corruption cases is staggering, and makes our arms deal furor pale into insignificance. Officially the largest corruption

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[26] Ibid. Pg. 50-51.
[27] Ibid. Pg. 44
[28] Op Cit. Huang, W. Pg. 45

case to date involved a sum around Rmb150 million (around R200 million). The sums of money involved in corruption cases have grown proportionality to the economic growth of China running into the millions in a large number of cases. While corruption exists in most countries, the disturbing thing about the case in China is that a large number of high-ranking officials within the government are involved in corrupt activities, and the occurrences are growing on a yearly basis. In addition to this, a number of organised groups have been identified and emerged. This form of *"Collective Corruption"* include private entrepreneurs, variously ranked CCP cadres, government officials and members of the Peoples Liberation Army (PLA) that are involved in smuggling rings, extortion, bribery and tax evasion that run into the billions.[29] The growing influence and stature of organised crime has been characterised as the *"Sicilianisation of China"*.[30]

Added to this are managers who run SOE's who maintain that losses incurred are as a result of uncompetitive products, wages and upkeep rather than the personal enrichment that is taking place at the top levels of the management structure. Apart from the economic sector, corruption is beginning to spread its wings in key departments such as Justice, where a number of officials have colluded to lessen the sentences of family members and friends and taken bribes from other members of society. On a local level, those administrators involved in the areas of "water, electricity and public facilities, city management and public transformation among other government departments, can use their professional advantage to *"eat, take, stop others and make demands"* "[31] on the local people.

While this may seem as a deeply embedded problem, anti-corruption measures have been put in place to curtail this force that has the ability of undermining the legitimacy of the State. The new leadership will need to take even more

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[29] Ibid. Pg. 39 - 40

[30] Sisci, F. *"China's competing powers"*
in Asia Times Online. November 8, 2002 Pg. 1
http://www.atimes.com/archives

[31] Op Cit. Huang, W. Pg. 41

active steps to stop this growing wave by inculcating a moral code within its society and maintaining strict disciplinary measures. Currently, execution is the preferred method of punishment for those found guilty in serious corruption cases. This is known as the *"Strike-hard"* anti-crime campaign that has already led to the execution of senior officials such as the former National People's Congress Vice-Chairman and the former deputy Governor of the Jianxi Province. The former was executed for embezzlement, while the latter for taking bribes.[32]

According to Transparency International, the cost of corruption in China's economy is estimated by some economists at 2-3% of Gross Domestic Product (GDP) while others, such as a Professor at Tsinghua University in Beijing put this figure around a staggering 13 –16% of GDP. Cases of corruption have increased at around 15% per annum since 1999. In 2000, 45 000 cases were being investigated. The positive out of this deluge is that the national news agency has increased the spotlight on corruption investigations.[33]

The two key indexes released by Transparency International on a yearly basis, do not place China in a faverouble light. The first index is called the *Corruption Perceptions Index* (CPI), and relates to "perceptions of the degree of corruption as seen by business people, academics and risk analysts."[34] The index ranges between scores of 10 (highly clean) and 0 (highly corrupt). China has been given an alarming rating of 3.5 which puts it joint 59th place

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[32] Sapa-AFP. *"Red party tackles corruption in China"*
in the Business Day, Friday, November 8, 2002. Pg. 10

[33] Callick, R. *"East Asia and the Pacific – Global Corruption Report2001 "*
as part of a document released entitled:
"Introducing the Global Corruption Report 2001"
put together by the Chairman of Transparency International, Peter Eigen
http://www.transparency.org Pg. 11.

[34] ------, *"Corruption Perceptions Index 2002"*
Released by Transparency International, 28 August, 2002. Pg. 6
http://www.transparency.org/pressreleases_archive/2002/2002.08.28.cpi.en.html

alongside Ethiopia and the Dominican Republic. This rating was given after eleven independent surveys were analysed.[35]

The second index released, called the *Bribe Payers Index* (BPI) is damning in its assessment of multi-national corporations from both developed and developing countries who "are pursuing a criminal course to win contracts in the leading emerging market economies of the world."[36] Corporations from Russia and China were singled out for using bribes "on an exceptional and intolerable scale". Fifteen emerging market economies were assessed, with 835 business experts being interviewed. The main question in one of the sections that is most pertinent in this context was "*indicate how likely companies from the following countries are to pay or offer bribes to win or retain business in this country?*" With 10 being a perfect score of having zero propensity to pay bribes and 0 being the highest propensity for bribe paying, China was given a score of 3.5, only being bettered at bribe paying by Russia with a score of 3.2.[37] The index acknowledged the anti-corruption measures put in place but felt that not enough was done to curtail bribe paying activities.

Many analysts are of the opinion that the PRC is suffering from *"systemic corruption"*,[38] which hitherto has been denied by the government. This is something that most people are beginning to agree with on the ground. The cost of this corruption is being felt by the layman on the street who is either out of a job, increasingly confronted by corrupt officials trying to extract gains for social services and continually being shocked as revelations of corruption are made. This has prompted outgoing President Jiang to comment that the scourge of corruption is considered to be "the life and death of the party". In a recent statement released the spokesman of the Party Congress conceded that

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[35] Ibid. Pg. 5

[36] ------, *"Bribe Payers Index 2002"*
Released by Transparency International 14 May, 2002. Pg. 1
http://www.transparency.org

[37] Ibid. Pg. 2

[38] ------, *"Something Rotten in the State of China"*
in the Economist. February 14, 2002.
http://www.economist.com. Pg. 1

the "cleaning up (of) the government and the fight against corruption still fall(s) short of the requirements of the Party Central Committee and the expectations of the general public." [39]

The reason President Jiang believes it is the life and death of the party is that increasing cases have been linked to associates, family-members and protégés of incumbents at the highest level of the leadership. Leaders such as Premier Zhu Rhonji and current head of parliament and number two in charge Li-Peng, while not incriminated, have close ties with those being investigated by the authorities. In the case of Mr Peng, both his wife and children have been allegedly linked to corruption cases.[40] This is politically damaging for the Party and the State as its legitimacy is being eroded at a time when it should be at its most solid. Some academics are of the opinion that "if corruption in the CCP is made public, the Party would risk coming apart. To please the crowds, a few selected cases are exposed and anti-corruption campaigns are staged regularly to show resolve and action."[41] This is disturbing in that it exposes the stiff resistance within the Party that has to date not allowed President Jiang to "possess the power to let anti-corruption investigations extend too far into the Party and Government Organisations, in fear of upsetting the stability of the country and make dangerous enemies in opposing Party factions"[42]

The new generation of leaders that will be coming into power soon will learn valuable lessons and should make the fight against corruption its central task, in order to safeguard its own existence and that of the Chinese economy. A change in strategy has been adopted regarding the exposing of Party officials

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[39] Op Cit. *"Red Party tackles corruption in China"*, in the Business Day, Friday, November 8, 2002. Pg. 10

[40] Op Cit *"Something Rotten in the State of China"* in the Economist. February 14, 2002. http://www.economist.com. Pg. 1-2

[41] Nemerius, P. *"Daring to fight tigers? – Anti-corruption work in contemporary China"* Published at the Department of Political Science at Stockholm University 1 June 1997. Pg. 44.

[42] Ibid. Pg. 44

involved in corrupt activities and this initiative needs to gain further momentum. While these cases seem frightening to the foreign direct investor, it should be remembered that this is a society, economy and political environment that is in transition. A massive State bureaucracy such as the current Chinese Administration will take some time to adjust to the fast pace of reform. Huang Weiding believes that the problem currently raging in the PRC can be managed sooner rather than later and succinctly puts this issue into perspective:

"Of course, we must remain alert in seeking to eliminate the existing conditions that give rise to corruption. We cannot slow reforms for fear of corruption growing, but must increase the pace of reforms, as this will eventually eliminate those very conditions that give rise to corruption. Although corruption cannot change the general trend of social development in China, it will destroy the reform process if allowed to run unchecked. It will even change the direction of reforms. The deepening of reforms and elimination of corruption must take place in parallel and be mutual, complimentary goals"[43]

5.4. The Reform of State Owned Enterprises (SOE's).

One of the greatest problems facing the PRC in its drive to modernise is the reform of SOE's, that since 1949 were created to form the backbone of China's economy. Since the 1950's SOE's produced large amounts of low quality products that were pushed onto the market in the centrally planned economy. SOE's employed all members of the working class providing *'cradle to the grave'* benefits to all employee's. This formed part of the social security that kept the society together. As with all SOE's, they became largely unprofitable and were protected to the hilt by the Chinese Government. These inefficient giants were protected in the *closed economy* before China's change in policy advocated by Deng Xiaoping in 1978. Up until this point SOE's accounted for 98% of China's GDP and 100% of the total value of industrial output.[44]

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[43] Op Cit. Huang, W. Pg. 46

[44] Le Pere, G. Dr & Shelton, G. Dr. *The Modernisation of the Chinese Economy: New trends in state owned enterprise reform"* East Asia Project, University of the Witwatersrand. Issue 30 July 2001. Pg. 4

As competition began to be incrementally introduced, their rigidity, inefficiency and inability to compete began to put strain on the entire economy and required further protection from the State. This led to high tariff and non-tariff barriers to be introduced by the government. Decades later and WTO membership a reality, SOE's face a necessary extinction in a market economy. The Government has had to reduce the amount of money pumped into these dinosaurs of industry as decisions are increasingly made due to economic reasons rather than political ones. In order to improve the lives and increase the livelihood of all Chinese people in the future, painstaking reforms have been initiated, to keep in line with the PRC's rapid progress. The downside of these reforms in the near term have the potential to be catastrophic if they are not managed carefully.

The reforms that SOE's are to undergo in the short term include: increased efficiency of those large and medium sized SOE's in order to move out of the red; establishing new management policies and procedures in line with well established International Norms; increasing the quality of output and the productivity levels that would lead to greater profits; and introduce new technologies to rapidly modify modes of production.[45] This inevitably means the loss of jobs and the closure of money-sapping SOE's that have been kept alive by the government and its protection mechanisms.

This puts the Government in a dilemma as SOE's continue to contribute 60% of all State revenue and remains to be the backbone of the economy in sectors such as infrastructure, energy, transportation and public utilities. Despite this, almost 40% of SOE's are bankrupt[46] run by inefficient and in most cases corrupt management who are dependent on non-performing loans dished out by the four State owned banks.[47] While privately owned enterprises continue to flourish and produce stunning results and contributions to the Chinese

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[45] Becker, J. *"Growing pains for a new economy"*
In the South China Morning Post, Monday, November 5, 2001

http://special.scmp.com/cg...agename=SCMP/Prrintacopy&aid=ZZZIS9SR1SC. Pg. 2

[46] Op Cit. le Pere, G. Dr. & Shelton, G. Dr. Pg. 3-4
[47] Ibid. Pg. 8

economy as the years pass, their development is not fast enough to cater for the increasing amounts of the workforce that are finding themselves laid off by SOE's, with the added burden of no security that once was the defining characteristic of the Chinese State.

Eventhough most nations throughout the world need to contend and adapt to the increasingly competitive trading system, the resulting consequences are dwarfed when compared to the PRC. The problematic impact of a changing economy that was largely agrarian into a competitive international outfit is perfectly summed up by Dominic Ziegler:

"The productivity of the land – and remember that two thirds of China's 1.3 billion people still live in the country side – has almost reached its natural limits, given China's severe shortage of water. Higher productivity in agriculture will come at the price of even more people leaving the land for urban areas – perhaps 8 to 10 million a year – for whom jobs will need to be found. Another 6 million jobs need to be created in the cities just to allow for the modest natural increase in the urban population each year. Then there are the 4 – 7 million a year being thrown out of work by shrinking SOE's. That is a minimum of 18 million urban jobs that the economy must create every year for the next few years."[48]

5.5 Unemployment

The unemployment issue is accentuated by the necessary SOE reforms and consequences of WTO membership that could prove to be a potent recipe for social unrest that threatens the ruling party as well as the progress of the economy. Official figures released in the middle of 2002, state that unemployment stands at 3.6%. However researchers put this figure at around the 7% mark and roughly double (14.6%) in urban areas. This is considered as highly dangerous by researchers who believe that "social unrest becomes inevitable as people's tolerance is stretched to the limit"[49] There is already evidence of this occurring in certain areas but demonstrations have been

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[48] -------, *"Now comes the hard part"*
In the Economist, April 6, 2000. Pg. 2
http://www.economist.com/PrinterFriendly.cfm?Story_ID=299588

[49] Hsieh, D. *"China Jobless Figures Enter Danger Zone"*
In the Straits Times, June 15, 2002. Pg. 1
http://straitstimes.asia1.com.sg/

comprehensively curtailed by the government and have not resulted in violence at this stage.

In the North-East city of Liaoyang, 30 000 recently laid-off workers[50] took to the streets protesting the detention of labour leaders representing them and demanded that the government come to their aid in order to receive back pay and blocked severance packages.[51] In Daqing, the largest oilfield city in China also in the North-East, one of the largest protests took place in recent years and went on for a number of weeks. Around 50 000 workers demonstrated against "cuts in severance pay and heating subsidies promised to them when they were sacked three years ago and an increase in unemployment insurance premiums."[52] This is just one example of a SOE that was at its peak during the Maoist era, but has deteriorated as a result of decreasing revenue and has inevitably had to slash its workforce to keep pace with the changing times. The list of protests occurring will inevitably grow, but as yet no violent confrontation has erupted as protests are conducted in a peaceful manner. In the Automobile sector, the hardest hit since China's WTO admission, also faced protests at the doorstep of the government headquarters in Beijing. Around 200 retired workers protested at an automobile enterprise demanding unpaid benefits. For this to occur in the heartland of the Capital, it must imply the seriousness of the welfare gap that is manifesting itself in the PRC.[53] SOE's are unable to maintain unemployment benefits to workers that have been retrenched as well as those that have been retired in their fight for

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[50] Wingfield-Hayes, R. *"Chinese labour protests spread"*
In BBC News, Monday 18 March, 2002. Pg. 1
http://news.bbc.co.uk/hi/english/world/asia-pacific/newsid_1879000/1879463.stm

[51] ------, *"China labour protest suspended"*
In BBC News, Friday, 22 March, 2002.
http://news.bbc.co.uk/hi/english/world/asia-pacific/newsid_1886000/18886977.stm

[52] -------, *"Chinese oil workers in massive protest"*
In BBC News, Wednesday, 13 March, 2002.
http://news.bbc.co.uk/hi/english/world/asia-pacific/newsid_1887000/1870936.stm

[53] -------, *"Beijing protesters block traffic"*
In BBC News, Wednesday, 27 March, 2002. Pg. 1
http://news.bbc.co.uk/hi/english/world/asia-pacific/newsid_1895000/1895970.stm

survival in the new market economy and will require an innovative solution from the central government in order to avoid social unrest on a large scale.

Added to the problem of laid-off workers in the urban centers, is the influx of millions of people emanating from the rural areas that are searching for better opportunities in the new China that seems to have forgotten them. Chinese authorities estimate that there are about 100 million people that make up a *"floating population"* of migrants. Almost all migrants were considered as illegal "residents" in the urban areas and were sent back to their original home district under the residence permit system (*hukou*). This was developed under Mao in order to control this massive population from migrating from place to place. Under the *hokou* system, every citizen would only accrue "welfare benefits, medical-care and schooling" in their place of origin as a disincentive to migrate.[54] This form of control has been consigned to the scrap heap by the government and will be phased out in the next 5 years as it puts " *'excessive constraints'* on labour mobility." To put China's labour market into perspective, the government has released the following figures: 150 million rural unemployed, 50 million to migrate by 2005, 30 million urban workers to be laid of by 2005 and 35 million have been laid off since 1995.[55] The government's official description of this situation in the media has been one of reserved concern. The Vice-Minister of Labour and Social Security stated that "an excessive labour supply coupled with pressures caused by obsolete job skills has resulted in a *grim* employment situation in China" This situation is set to be worsen as the oversupply of labour will continue to peak in the coming few years. A White Paper has been drafted on Labour and Social Security that will deal with mechanisms to devolve this issue.[56]

It remains to be seen whether the new generation of leaders are up to the task of managing, leading and solving pertinent issues that could put two decades

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[54] Ibid. Pg. 2
[55] Ibid. Pg. 4

[56] AFP, *"China faces grim unemployment situation"*
In the Business Day, April 29, 2002. Pg. 2
http://www.bday.co.za/bday/content/direct/1,3523,1073504-6078-0,00.html

of progress onto the scrap-heap of history if not handled with the utmost of care, sensitivity and discipline. If the leadership can answer three fundamental questions put forward by a laid-off worker recently interviewed in Beijing ("Will he get a job? Will those people who steal from laid-off workers be punished? (and) Will life get better?")[57] affirmatively, then despite the risks described above, paramount success beckons this awakening dragon - foreign direct investors would do well to ensure that they position themselves at its bedside when it does.

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[57] Op Cit. Bezlova, A. Pg. 2

Chapter 6

6.1 Conclusion

"...Seen from one position there is a vivid picture of a dynamically growing economy and the largest improvement in living conditions in human history, but with a slight turn one sees an equally vivid picture of widespread poverty, impending limits to growth because of all kind of shortages, and shameless corruption. Turn it again, and there is a picture of ruthless political repression yet another slight turn reveals a paralysed political system which cannot effectively carry out even the most elementary task of government, that of taxation"[1] – Lucien. W. Pye

The PRC has provided amazement, worry, opportunity and risk for all foreign direct investors. The sheer size of this country implies that any event that takes place will always be grand in nature, whether it is good or bad. China's success will be immeasurable in the years to come, or its problems could develop into insurmountable challenges. It is important to acknowledge that despite the challenges, the PRC has progressed far quicker than any analyst in the 1970's could have imagined.

This is a country that has consistently attracted more Foreign Direct Investment (FDI) than any other developing nation in the last twenty years. In 2002 China has again beaten all expectations and maintained its rapid growth despite the global slowdown. As the world's 6th largest trading nation, China is definitely climbing the ranks, which will inevitably lead to an enhanced position in the international economic system.

The current relations between South Africa and the PRC have accelerated since diplomatic ties were established in 1998 and do not seem to be receding. As discussed in Chapter Two, it is an opportune moment for South Africa to propel itself into more comprehensive economic engagement as relations on the diplomatic level have been maximised. According to the South African Minister of Foreign Affairs Nkosazana Dlamini-Zuma, South Africa is

[1] Pye, L.M in Nemerius, P. *"Daring to fight tigers? – Anti-corruption work in contemporary China"*
Published at the Department of Political Science
at Stockholm University
1 June 1997. Pg 40

"looking at China as both a market and an investor."[2] While this is true, the reality is less convincing. The South African government has not pursued opportunities for greater economic links with any great affirmation. To date, a Free-trade agreement has not been signed, nor has any victories for South African companies been won, in order to cement their place in the PRC. While President Mbeki was accompanied by his key Ministers of trade and industry, agriculture, tourism, defense and technology,[3] one year later, for the exception of tourism, there seems to have been no real advancement and entrenchment of relations paving the way for the future success for both countries. While the building blocks have been put in place, "South Africa's challenge is to transform this political goodwill into commercial return."[4]

The Bi-national Commission set up between the two Presidents should be used as an effective vehicle for further progress. Trade volumes between the two nations amounted to US$2.2 billion in 2001 and is projected to rise by 10% in 2002.[5] China was South Africa's 10 largest export market in 2001.[6] According to the Ministry of Foreign Trade and Economic Co-operation of the PRC (MOFTEC) for the year 2001, South African Companies had thirty-one projects on the go in China with a Contractual Value of around US$2.6 billion and actual input of US$836 million.[7] This indicates that there is a prominent South African presence in the PRC, but it is by no means at its potential levels.

Corresponding investment in South Africa has been negligible; Deputy Minister of Foreign Affairs Aziz Pahad has raised this issue at an official

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[2] Fabricius, P. (a) *"Mbeki touches down in China for key visit"*
In the Star. Monday December 10, 2001. Pg. 5

[3] Ibid. Pg. 5

[4] Davies, M.J. *"After the diplomatic honeymoon"*
In the Star, Wednesday, January 16, 2002. Pg. 14

[5] -----, *"Chinese Premier, South African President Hold Talks"*
Xinhua News Agency, September 6, 2002. Pg.1
http://www.xinhuanet.com/english/

[6] Op Cit. Fabricius, P. (a) Pg. 5

[7] *"Statistics - Foreign Direct Investment in China classified according to the Sources of funds during Jan-Dec, 2001"*
Figures released by the Foreign Investment Department of Moftec. 25 March 2002.
http://www.tdctrade.com/report/stat/020303.htm

level. However, the Chinese Ambassador to South Africa Mr. Liu Guijin has largely attributed this to three main reasons: Firstly, the manufacturing sector in China has not been meeting demand locally and have had little time exploring investment opportunities outside China. Secondly, the instability and depreciation of the currency in the last year has not allowed Chinese firms to recoup their returns in US Dollars – their primary currency of investment. Lastly the crime situation in South Africa has discouraged investors from China, as a result of prominent Chinese companies and businessman being robbed at their factories and homes. The Chinese ambassador advocated that South African companies should focus more on exports, as the local Chinese market is set to demand imported manufactured goods and commodities to the tune of R14 trillion by 2005.[8]

South African Companies such as SAB have reaped great benefits from China. SAB is currently involved in 25 Breweries with its Joint Venture partner China Resource Enterprise and is currently the largest and most successful brewery in the PRC.[9] SASOL has just recently increased its stake in a chemical group to 100%.[10] While first entering China utilising Joint Ventures as its vehicle of entry, the Petrochemical giant is confident enough to stand alone in the Chinese economy. The media technology company United Alliance Media has also set its sights on China in order to position itself for the Beijing 2008 Olympics. Its motivation for acquiring a majority stake in a Chinese company is to attain a media license.[11] The Beijing Games in 2008 will prove to be lucrative for any foreign company entering China in the next 6 years considering that China has a middle class of around 400 – 500 million[12]

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[8] Fabricius, P. (b) *"Crime and ailing Rand slow Chinese-SA trade"* In the Star. Wednesday December 5, 2001. Pg. 5

[9] Davies, M.J. *"The Challenge of Marketing in China"* In The Future, Volume 2, No. 13, 2001. Pg.22

[10] Sapa, *"SASOL lifts stake in Chinese group"* In the Business Report, Thursday, October 10, 2002. Pg. 3

[11] Suzaki, N. *"UAM sets its sights on expanding into China"* In the Business Report, Friday, September 28, 2001. Pg. 4

[12] Op Cit., Davies, M.J. *"The Challenge of Marketing in China"* Pg. 20

who are fast becoming the worlds largest pool of vibrant consumers in a single country.

In the mining sector, apart from BHP Billiton's presence, Gold Fields, the worlds fourth largest gold producer has also taken a 40% stake in a mining company in China called Sino Gold. China is the world's sixth largest gold producer and is opening up the industry to foreign investors.[13] While a number of South African Companies that are investing in the PRC is increasing, China's entry into the WTO will certainly give more impetus to increase investment on a far larger scale as protection in key industries begin to fade away in the new Chinese economy.

In Chapter Two, the study identified the solid relations that have been established between Pretoria and Beijing, as well as in the wider context of *'South-South'* Co-operation between two developing nations. With this solid base and China's entry into the WTO, the opportunities for South African companies potentially investing in this vast market are ever-increasing as the might of 1.3 billion people take China to unknown heights (See Chapter Three). While the PRC provides a large base of consumers, entry into this market is more complex once delved into at a deeper level and has proven to be one of the most difficult business environments to succeed in. Eventhough protective barriers will be gradually reduced and foreign corporations will be allowed to take part in a number of previously closed sectors, the difficulties that lie ahead should not be underestimated.

This study has also identified the various modes of entry in Chapter Four, ranging from Wholly Owned Foreign Enterprises (WFOE's), to Equity Joint Ventures and Contractual Joint Ventures (CVJ's), to name a few. Each investment vehicle has its merits. For first time investors, EJV's are the safest option in order to gain an understanding of the market with an experienced local partner. WFOE's are the preferred option of those companies who are

[13] White, D. *"Gold Fields buys 40% of Chinese mine"*
In the Business Report, Thursday, October 10, 2002. Pg. 4

already well established in the market or for those who seek to closely guard their intellectual property and technology out of fear of being swindled by a local business partner. For the Small and Medium Sized Enterprises (SME's) in South Africa, a leaf from the book of most Taiwanese companies who are similar in size, should be taken in order map the journey of entering the Chinese economy (See Chapter Four).

One of the most important facets of conducting business in China that have an impact on the success of any venture are the relationships (*Guanxi*) that are personally developed by foreign businessmen and their Chinese counterparts. The cultural complexities that exist in China should not be taken for granted and should be fully understood (See Chapter Four).

While China is ranked as the number one Foreign Direct Investment destination, Companies should pay careful attention to the potential areas of risk that could undermine the success of any company in this market. With the current leadership giving way to a new generation of leaders, and the Chinese Communist Party undergoing an ideological change, foreign direct investors should keep a close eye on political developments. Other areas for concern include the ever increasing problem of corruption and the rising unemployment rate as China transforms itself from a centrally planned economy into a market-based economy. With the reform of State Owned Enterprises and the reduced protection of certain sectors of the economy, millions of workers are being laid-off, without the protection of the State (See Chapter Five).

Despite these key challenges the PRC has proven its worth in dealing with all the challenges it has faced in the last two decades since embarking on economic reform. There is now doubt that the Twenty First century will belong to China – and those companies that are directly involved in its economy.

Laurence J. Brahm succinctly captures this assumption:

"In the coming century, there will be no other industrialized or industrializing country so poised to grow and expand as China. Given its sustained high rate of growth and mammoth export potential, China's competitiveness as an international trading partner will be formidable. Projected levels of consumer spending, based on current savings, and a population which is one quarter of the world's total population, makes China's market ever more seductive. For multinationals everywhere, the equation is pretty clear: not to participate in China's economy is not to participate in the world's economy in the century ahead." [14]

[14] Brahm, L.J. *"China's Century – The awakening of the next economic powerhouse"* John Wiley & Sons, Inc. New York. 2001. Pg. 3

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