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Engaging Asia's Biggest Tiger:

Exploring the contours of a SACU–China trade deal

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1. INTRODUCTION: CHINA'S GLOBAL INTEGRATION

There is no shortage of impressive statistics and superlatives regarding China's emergence and integration into the global economy. They all indicate the same thing: that China is a global driver of change. Examples include the following: first, China's opening represents the single largest set of new commercial opportunities for foreign business in the modern era.[1] Second, China is now the world's second-most popular destination for foreign direct investment (FDI), and holds the world's third-largest FDI stock.[2] Third, China is increasingly a setter of world prices for a range of commodities and manufactures.[3] Fourth, the integration of an abundant supply of relatively low-cost workers in China (and India) is drastically altering the global division of labour. Producers of labour-intensive products all over the world have had, and are having, to adjust.[4] Finally, the implication of all this is that China has quickened the pace and altered the nature of economic integration, especially in East Asia.[5]

South Africa's trade with China has developed rapidly since relations between the two countries were normalised in 1998. But as is the case with many countries, South Africa's overall export performance does not compare with China's. Thus, while China has risen from being South Africa's 16th most

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1 Lardy N, *Integrating China into the Global Economy*. Washington D.C.: The Brookings Institute, 2002, pp. 3–4.

2 *Ibid*., p. 4. The US remains, by some margin, the world's largest recipient of FDI. See also UNCTAD, *World Investment Report 2005*. New York and Geneva: United Nations, 2005. For an interesting analysis of the impact that China's rising FDI receipts is having, see Eichengreen B & H Tong, 'Is China's FDI coming at the Expense of Other Countries?' NBER working paper 11335, available at www.nber.org/papers/w11335.

3 Kaplinsky R, 'China, Globalisation, and Neo-Liberal Dogma'. Paper presented at Queen Elizabeth House, Oxford, July 2005, p. 16. It forms part of a series of studies conducted by the Institute for Development Studies at the University of Sussex, available at www.ids.ac.uk/ids/global/asiandriversindex.html.

4 UNCTAD, *Trade and Development Report 2002*. New York and Geneva: United Nations, 2002, p. 126.

5 See for example Kobayashi H, 'The Rise of China and the Transformation of the Asian Economy', available at www.waseda-coe-cas.jp/paper/20040701_kobayashi_eng.pdf; and Lall S & M Albaladejo, 'China's Competitive Performance: A Threat to East Asian Manufactured Exports?' *World Development*, 32 (9), 2004, pp. 1441–1466.

important trade partner in 1995 to its 5th in 2004,[6] the greatest proportion of the advance has been in South African imports from China. In 1995 China comprised 1.8% and 0.9% of South Africa's total imports and exports respectively; in 2004 those figures stood at 8.8% and 2.9%. South Africa's bilateral deficit in goods trade in the same year reached $2.6 billion, over five times greater than the average between 1995–2001, and second only to that recorded in trade with Germany, even though South Africa's exports to China are growing faster than its exports to most other countries and regions.

There are, therefore, clear opportunities as well as risks involved in opening trade negotiations with China. While the opportunities seem to remain by and large in the realm of potentials, the risks have manifested themselves acutely. A free trade agreement, indeed any trade agreement with China, will almost certainly not find widespread support in SACU countries.[7] The South African government is, however, committed to establishing a viable, long-term relationship with China, which would obviously include commercial dimensions. It sees this as a vital strategic foreign policy goal.[8] Given the current forecasts of China's future economic size and political weight, the logic seems irrefutable.[9]

Many questions therefore require investigation. This report seeks to contribute in two ways. First, the paper presents a balanced assessment of what China means to SACU, to provide the proper context for the potential negotiations. This involves an overview of China's growth and the trade-related impacts of its global integration; trade and investment between SACU and China and their potential development implications; and political relations, particularly as regards China's increased presence and influence in Africa. Possible motiva-

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6 China is South Africa's third most important trade partner if the European Union (EU) is considered a single entity.

7 See, for example, 'Trade gap with China is wiping out jobs – Vavi', *Business Day*, 3 November 2005, available at www.businessday.co.za/articles/topstories.aspx?ID=BD4A108518, or 'End Chinese Abuse, urges Clotrade', *Business Report*, 27 June 2005, available at http://www.busrep.co.za/index.php?fSectionId=561&fArticleId=2601018. Trade with China in textiles and clothing has received particular attention, particularly from organised labour. See www.cosatu.org.za/news/weekly/20051104.htm#5.

8 See, for example, 'Ties with China "more vital than failing textile sector"', *Business Day*, 20 October 2005, available at www.businessday.co.za/articles/article.aspx?ID=BD4A104181.

9 Recently, however, South Africa's Minister of Trade and Industry, Mandisi Mpahlwa, has expressed doubt over the possibility of a Sino–SACU free trade agreement in the short to mid-term. See www.engineeringnews.co.za/eng/news/today/?show=80565.

tions for a trade agreement between SACU and China form a natural subtext to these discussions.

Second, the paper analyses China's trade strategy and compares it with South Africa's, with a view to assessing the likely contours of any agreement reached. The US, for example, imposes a clear and rigid set of demands upon potential FTA partners that have clear implications for the nature and content of any subsequent negotiations. Does China behave similarly, or is it more flexible? How should SACU respond?

2. WHAT CHINA MEANS TO SACU: THE BACKDROP TO POTENTIAL TRADE NEGOTIATIONS

Predictions concerning China's future growth and global significance abound. Some are implausible, but even the most conservative indicate that China will be a great economic and political power within 50 years. It is widely accepted that few companies with global ambitions can afford not to take advantage of China's 1.3 billion-strong population, which, although still poor by Western standards, is steadily getting richer.

China's size and growth, and the depth of global integration it has achieved since 1978, are impressive. But these phenomena are not without precedent in modern economic history. The emergence during the late 19th and early 20th century of the US and Germany, and then Japan after World War II – all large, rapidly-growing, export-oriented (at the time) economies – provide blueprints that China is now following in one way or another.[10] Even China's immense size is arguably not 'new' because relative to the size of the global economy at the time of its rise, the US was even more of a giant. China has accounted for about 20% of world GDP growth since 1973, and 24% since 1998. The US accounted for 25% of global GDP growth for over four decades (1870–1913).[11]

Nevertheless, even if China's emergence does not necessarily represent anything new for the global economy as a whole, it certainly is new for South Africa and SACU. At the turn of the 20th century, high transport and com-

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[10] Saxonhouse G, 'The Integration of Giants into the Global Economy', American Enterprise Institute for Public Policy Research, *Asian Outlook*, no. 1, 2006. Available at www.aei.org/publications/filter.all,pubID.23790/pub_detail.asp.

[11] *Ibid.*, p. 2.

munication costs and Southern Africa's relative disengagement from the fierce globalisation under way at the time would have muted the impact on this region of America's and Germany's emergence. And while Japan was growing so rapidly, much of Africa, especially apartheid South Africa, was experimenting with import-substitution and other protectionist policies. Because the world is now a much smaller place, and because trade and industrial policies in Southern Africa have become far more open and outward-oriented, the region is arguably much more exposed and sensitive to China's economic influence than it would have been to that of the three giants that came before.

2.1 China's growth

Why is China growing so rapidly? What are the salient characteristics of China's growth path? Is that path sustainable?

Economic growth has two primary sources: factor accumulation (more resources, capital being the most important) and productivity improvements.[12] There is disagreement over which has been more important in China's growth. The 2005 OECD survey of China's economy[13] sketches the following picture. Annual aggregate output growth between 1983–2003 averaged 9.7%. Just over half of that is attributable to capital accumulation (capital per employed worker is estimated to have grown at about 7.5% annually, suggesting substantial capital deepening[14]). Nicholas Lardy agrees: 'China's growth may be explained primarily by extraordinarily high rates of resource mobilisation rather than productivity gains associated with more efficient use of scarce resources'.[15]

The growth in China's capital stock has been made possible by two things. The first is a high combined public and private savings rate of about

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12 In China's case, one might also argue that exports have been a significant source of growth. Savings and exports have certainly been the primary strategy, but the latter are simply not possible without the relevant means at home (investment).

13 OECD, *OECD Economic Surveys: China*. Paris: Organisation for Economic Cooperation and Development, 2005, ch. 1.

14 Capital widening, on the other hand, describes the situation where capital accumulation occurs but the capital to labour ratio remains unchanged. That is, the capital stock grows at the rate of population growth.

15 Lardy, *op. cit.*, p. 13.

40% of GDP.[16] China's high savings rate is made possible by a relatively small but consistent current account surplus (which has grown significantly in recent years), and an unusually high household savings to consumption ratio, which has in fact risen slightly since the late 1990s. The second contributing factor, linked to the above, was a significant investment by the Chinese diaspora in the mainland after 1978, as well as steep rises in FDI from other sources. Such interaction provided not only much-needed physical capital, but technology, entrepreneurship and managerial expertise too.[17]

Overall, the OECD research surveys stress the relative importance of this capital accumulation over productivity growth in explaining China's post-1978 output boom. This is largely in line with Paul Krugman's classic analysis of growth in the four East Asian Tiger economies (South Korea, Singapore, Taiwan and Hong Kong).[18] For an analyst using basic growth accounting methods, it is relatively simple to show that, for the most part, output growth in these countries is almost entirely attributable to commensurate (and massive) increases in measurable inputs (capital and labour). Quoting Alwyn Young, Krugman notes that once one accounts fully for the startling rates of input growth in these countries, their perceived productivity performances fall '. . . from the heights of Olympus to the plains of Thessaly'.[19]

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16 Blanchard O & F Giavazzi, 'Rebalancing Growth in China: A Three-Handed Approach', Cambridge: Massachusetts Institute of Technology Economics Department working paper05–32, 2005, p. 3.

17 Qian, *op. cit.*, p. 299, disagrees with this latter point, arguing that the role of the diaspora in China's growth, as well as its investment in China, is vastly overstated. He reasons instead that institutional reform has played the biggest part in unlocking productivity and reducing distortions in factor allocations, thereby raising growth rates. See also Erskine A, 'The Rise in China's FDI: Myths and Realities', presented at a conference on the Australia–China FTA, Sydney, August 2004. He argues that, due to huge complexities in measurement, a high probability of false reporting and increasing evidence of a phenomenon called 'round-tripping', China's FDI stock may be lower than suggested by the data, perhaps as low as 5% of GDP (measured at purchasing power parity). Further, if the official statistics, which indicated that by 2003 China's FDI stock totalled over 30% of GDP, were accurate, China would already have surpassed the world average of about 22%, which is unlikely, given its relative under-development. As such, if the sceptics are closer to the mark, they would obviously cast doubt over the role of FDI in China's growth thus far. On the other hand, their arguments would also imply that what is now considered to be a flood of FDI into China may be only the beginning of a much bigger process.

18 Krugman P, 'The Myth of Asia's Miracle', *Foreign Affairs*, 73(6), 1994, pp. 62–77.

19 *Ibid.*, p. 72.

However, Krugman notes that Japan's and China's growth appear different from that of Singapore or Taiwan. Japan's surge in the 1950s and 60s was driven by factor accumulation *and* efficiency gains, the latter substantiated by its rapid (although as yet incomplete) technological catch-up with the US. In China, Krugman argues, pre-reform growth was dominated almost entirely by capital accumulation, *à la* Singapore, or even the former Soviet Union. But since China's 'marketisation' began, there is evidence of a much stronger role attributable to productivity gains, which spiked in the years immediately after Deng Xiaoping's reforms began to take hold in the late 1970s, but now seem to have become a sustainable trend.

This unconventional view of China's growth is explored in greater detail in more recent IMF research,[20] which argues that dramatic increases in worker productivity after 1978 have been the prime mover of China's growth. Such productivity changes have in turn been driven by two major factors: the mass migration of labour out of agriculture and into manufacturing, and the steep rise in the capital to labour ratio. Their estimates suggest that productivity growth jumped from about 1.1% annually between 1953–1978 to about 4% from 1979–1994.[21] One estimate of labour productivity growth in China between 1990–2002 is as high as 12.5%, which (if accurate) is truly outstanding.[22]

The IMF argues that by the early 1990s productivity growth accounted for more than 50% of total output growth; and that the share attributable to capital accumulation had fallen as low as one-third. Therefore, [23]

> Although capital accumulation – the growth in the country's stock of capital assets, such as new factories, manufacturing machinery, and communications systems – was important, as were the number of Chinese workers,

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[20] Hu Z & M S Kahn, 'Why is China Growing so Fast?' Paper no. 8 in an *Economic Issues* series, Washington: International Monetary Fund, 1997.

[21] OECD estimates of productivity growth between 1983–1998 concur, averaging over 4% annually.

[22] Hu A, Jefferson G & Q Jinchang, 'R&D and technology transfer: Firm-level evidence from Chinese industry', cited in Blanchard & Giavazzi, *op. cit.*, p. 5. Recent World Bank research (Kuijs L & T Wang, 'China's Pattern of Growth: Moving to Sustainability and Reducing Inequality', World Bank Policy Research working paper 3767, Beijing: World Bank Office, 2005) estimates average labour productivity growth between 1993–2004 at 7.8% annually.

[23] Hu & Kahn, *op. cit.*, pp. 1–2.

a sharp, sustained increase in productivity (that is, increased worker efficiency) was the driving force behind the economic boom.

The IMF view is by far the less common. But its conclusion – that capital accumulation has played a smaller role in China's growth than many believe – is supported, in part, by the extent of the inefficiency evident in China's investment patterns. As Martin Wolf notes: 'If an economy growing at close to 10 per cent a year generates bad loans on this scale, the misallocation of capital has to be huge'.[24] In other words, accumulation of capital is one thing, but its effective deployment is by far the more important puzzle, and one that China is clearly struggling to piece together effectively.

China's problems in this regard are attributable to a lack of financial depth; a history of state-driven investment decisions that have tended to ignore risk or profit considerations (in other words, vast amounts of capital are misused by the huge state-owned sector); a young and dysfunctional stock exchange (its problems caused by a lack of reliable company information); and ineffective or non-existent bankruptcy laws, which make lending institutions reluctant to enforce the liquidation of unprofitable ventures.

These, in turn, are the principal factors contributing to China's massive over investment in manufacturing capacity, '. . . overcapacity is reflected at the global level in a number of sectors. But it is in China where this frenzy of investment has been carried to most extreme lengths, and where growing overcapacity is becoming a major problem'.[25] [26]

Investment in manufacturing capacity, which in China often moves far

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[24] Wolf M, 'China has Further to Grow', *Financial Times*, 12 April 2005.

[25] Kaplinksy, *op. cit*., p. 15.

[26] The other main source of this overcapacity relates to the nature and politics of reform after 1978. Certain provinces were essentially experimentation grounds, having been progressively and selectively loosened from Beijing's control (in some, not all, respects). The result was that provincial governments came to regard their territories as autonomous economic regions, competing with each other for investment and favour. (A similar situation obtained across the Indian states under isolation.) This sort of duplication of economic activity would clearly create excess capacity at the national level. For an exposition of this argument see Freeman C, 'Regionalism, uneven development, and reform in contemporary China' in Draper P & G Le Pere (eds), *Enter the Dragon: Towards a Free Trade Agreement between China and the Southern African Customs Union*, Johannesburg: The South African Institute of International Affairs, 2005.

ahead of existing or even potential demand, is the main reason why some commentators describe China's current growth path as 'unbalanced' and 'unsustainable'. Given the inefficiency of this investment and the concurrent bad debt build-up, as well as the very high investment to GDP ratio (far in excess of that achieved by other Asian countries when they were as poor as China is today), it is only natural to ask how long the investment-led model can last.

Note that the answer to this question is not important to China alone. The future of China's growth, particularly in manufacturing, holds important implications for the world economy, as well as for those importing countries that are currently struggling to adjust to China's export growth. Presumably, any sort of sustained slowdown in industrial activity will bring about a slowdown in exports, in turn reducing some of the pressure on import-competing industries in other countries.

What is the likely medium-term scenario? The recent revisions to China's real GDP and real GDP growth resulting from its first-ever economic census in 2004 reveal an interesting picture. The size of the economy in 2004 was revised upward by 16.8%, adding about half a percentage point to the average annual growth rate of real GDP from 1993–2004.[27] Moreover, most of the increase is attributable to the basic services sector (restaurants, hair salons, and so on), traditionally the most poorly-recorded. In other words, China's economic structure is not as heavily skewed towards industry as was previously believed, and therefore the problem of rebalancing growth – and the risk of its slowing – is not as big.

Is this an accurate interpretation? There are two views. One argues that because services now account for about 40% of GDP (rather than the previous estimate of 32%), that sector is already well, if not fully, developed. The 40% ratio also compares favourably with those of economies such as Thailand and Malaysia, both richer in per capita terms than China. The implication is that because manufacturing accounts for less than was previously thought, there is ample room for expansion in that sector. This in turn implies *higher* export growth, which would increase the adjustment pressures faced by the rest of the importing world.[28]

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[27] World Bank, *Quarterly Update*. Beijing: World Bank Office, February 2006.

[28] See Hongbin Q & S Xiaoping, 'China Economic Insight: Balancing Act'. *HSBC Global Research*, Vol. 25 : Hong Kong, January 2006, p. 7.

The World Bank's Beijing office disagrees. While acknowledging that the revisions mean that China's economy looks less unbalanced: 'The revised data . . . in most cases does [sic] not fundamentally alter the picture of the Chinese economy, its growth pattern, and the key concerns'.[29] It argues that the role of manufacturing remains unusually large, and that no other Asian economies, at any stage in their development, have shown a share of industry in value added remotely close to what even the new GDP data suggest is the case in China today.

The World Bank also argues that although the investment to GDP ratio is lower in the new data, the rapid rate of fixed capital formation remains unchanged, as does the inefficiency with which it is deployed. (The incremental capital-output ratio, which is high and has been rising, looks no different in the new data.) As such, investment 'over-heating' remains a significant macro-risk to output and export growth.

External risks are also important. As we know, high net export growth has been the other major foundation-stone of China's growth. Openness to trade, defined simply as the ratio of total imports and exports to GDP, reached over 65% in 2003, and has risen noticeably in that country since its accession to the WTO in 2001. Of the large economies, only the tightly-knit European Monetary Union (EMU), taken as a whole and including intra-trade, is comparable. America's trade to GDP ratio hovers at around 25%; India's at about 30%.

Does such openness and apparent reliance on exports represent a high-risk strategy? That is, could an external shock to China's export growth have significant impacts on overall GDP growth? Perhaps the best answer is supplied by looking at the effects on China of the Asian Financial Crisis of 1997–1998. By then China was already very open to trade and investment, and was trading heavily with South East Asia. As the crisis took hold, the demand for Chinese exports collapsed; export growth (in value terms) slowed to below 1%. FDI inflows also dried up, as investors withdrew from the region in general.

Furthermore, in the preceding years, China experienced record inflation, to which the authorities responded by imposing tight fiscal and monetary measures. The Asian Crisis could not have come at a worse time for China. However, while there certainly was a noticeable slowdown in its GDP growth, the effects have hardly been long-lasting. GDP growth rates in the early 2000s match any-

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[29] World Bank, *op. cit.*, p. 21.

thing achieved prior to 1998. An important implication of this argument is that China's GDP growth is probably not export-led.

Three observations substantiate such a claim further. First, the relatively weak links between the mainly foreign-owned export processing zones and the rest of the Chinese economy (more on this in section 2.2) imply that China's 'true' exposure to trade is not as high as the relatively simplistic 'openness data' suggest.

Second, if an economy is export-led, fluctuations in net exports should be closely tracked by fluctuations in GDP. This is the case in some of the smaller East Asian economies, but not in China, where the standard deviation of GDP growth is only about one-third that of the standard deviation in net export growth.[30]

Third and finally, the dominant components of the expenditure side of China's GDP are investment and consumption, averaging about 40% each. It is the behaviour of these macroeconomic aggregates and not net exports (unless the latter change massively in any given year), that is the prime driver of change in China's GDP growth.[31]

Nevertheless, the Chinese external sector is now so large relative to the overall economy that it is hard to see how, without some alterations to China's growth pattern, a significant, sustained slowing in Chinese exports could simply be shrugged off. Put differently, there are indirect but crucial links between China's export performance and its GDP growth. These are tied up with productivity considerations. Most of China's productivity gains, which have been an essential part of higher GDP growth rates, are in the economy's tradable sectors, not in the non-tradable, domestic-oriented sectors. The reason for this is simple. The latter are dominated by inefficient state-owned or heavily state-invested companies, while the latter are operated largely by more efficient multi-national companies (MNCs).

Understanding the importance of exports to GDP growth is significant, as it seems doubtful that the 30–35% export growth recorded in 2004 and 2005 is sustainable. At these rates, China's exports (totalling almost $600 billion in 2004) would double every three or so years, reaching about $2,800 billion by 2010. Without the rapid opening of large new markets to China's exports, it is

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[30] **Anderson J, 'Grasping at Straws'.** *Asian Focus*, UBS Investment Research, Hong Kong, October 2005.

[31] **Goldstein M & N Lardy, 'What Kind of Landing for the Chinese Economy?'** *IIE Policy Brief 04-7*. Washington: Institute for International Economics, 2004.

unclear how world demand would absorb such high volumes. There are also concerns over the sustainability of demand from the US, which is China's largest export market by some margin.

Therefore, to the extent that GDP growth relies on high export growth rates, Chinese policy will have to find ways to bring about a reduction in domestic savings and a concomitant rise in domestic consumption. China needs to become a globally significant consumer, not just a producer.

These two broad problems – capital misallocation and an excessive focus on exports – are just two of the economic challenges to sustained growth in China. Others that are most often highlighted include the following. There is increasing income inequality (across regions, sectors, and skill levels), which not only heightens the risk of social unrest, but has been shown in other countries to be a significant drag on growth[32] (although there is no sign of this yet in China itself). Other challenges are a relative lack of indigenous innovation and technological progress, and relatively weak social safety nets, which encourage more rather than less private saving. China has an exchange rate regime that skews production decisions away from the domestic market, and to some extent discourages consumption by making imports more expensive. It also has very high natural resource requirements; an underdeveloped private sector with relatively unsophisticated risk-management skills; a flawed banking and legal system; mass urbanisation; and so on.

Discussing all of these constraints and the risks they pose to sustainable growth falls well beyond the scope of this report. But it is reasonable to assume that a near-term collapse is highly unlikely. History suggests that the current spike in fixed investment is not likely to prove catastrophic – previous spikes have led to multi-year, gradual slowdowns in investment and GDP growth, but no worse.[33] In other words, the medium-term outlook is positive, but not rampantly bullish.[34]

However, it should be emphasised that China's growth miracle is nowhere

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[32] World Bank, *World Development Report 2006: Equity and Development*. Washington: The World Bank, 2006.

[33] Goldstein & Lardy, *op. cit.*, figure 1.

[34] See Anderson J, 'How to think about China'. UBS Investment Research, Hong Kong, January 2006, p. 147. This widely-cited report predicts that growth will slow to an average of 7–8% over the next 20 years.

near ending, and is arguably yet to realise its proper potential.[35] China's fundamental endowment-related advantages are not likely to change for two generations or more, and per capita income is still well below OECD levels (about 15% of America's), implying massive scope for continued catch-up. If astute policy planning can manage the medium-term risks effectively, the China story may just be getting started.

For the moment, it is how the pattern of growth changes that matters, to both China and those countries affected by its rise. If greater balance is achieved between production and exports on the one hand and domestic consumption on the other (stimulated perhaps by a rise in the real value of the yuan), China's demand for imports will grow and its supply of exports will slacken. In short, China's competitive impact on global input and output markets should diminish by the extent to which growth becomes more internally focused. But it should be stressed that such changes will not happen overnight.

2.2 China's impact on world and East Asian trade[36]

The foregoing sketches a medium- to long-term picture. In the recent past and immediate future, the most visible and striking feature of China's emergence is and will continue to be its trade performance, which has jumped notably since admission to the WTO in 2001 (see Figure 1). China's rapid merchandise export growth (14.8% annually on average between 1995–2004) has seen it become the world's third-largest exporter, with a global share that has more than doubled in a decade, to 6.5% in 2004. China's imports grew even more rapidly, at 15.5% on average over this period.[37]

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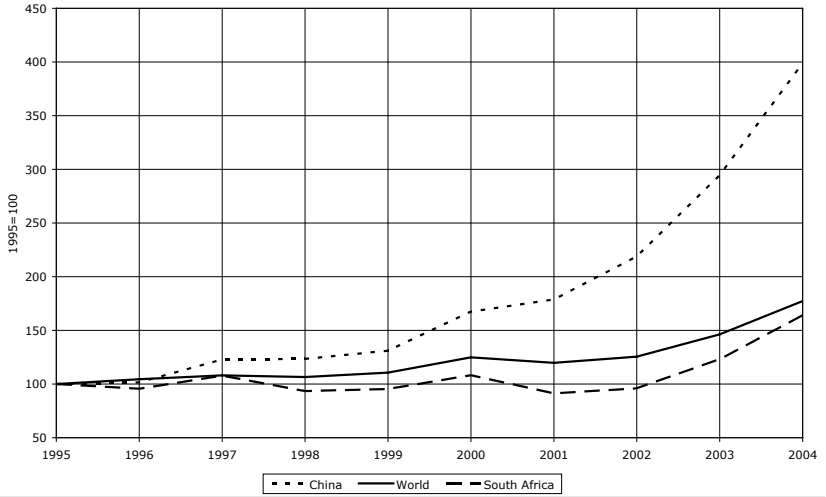
[35] Wolf, *op. cit*.

[36] China's impact on global FDI flows is not discussed in detail, as it is generally less well understood. There are two basic views on the matter. The conventional one is that China, particularly since joining the WTO, is attracting FDI that in the past would have gone elsewhere, probably to other countries in East Asia. This is often referred to colloquially as 'the giant sucking sound'. Alternatively, 'China's rapid growth and attraction also encourages flows into other East Asian countries, as if producers in these economies belong to a common supply chain' (Eichengreen & Tong, *op. cit.*, p. 1). These authors also note that most FDI diversion to China, to the extent that it is happening, is at the expense of OECD economies, not those of other developing countries.

[37] See the appendix for data sources.

Figure 1: World, Chinese and South African total export growth, 1995–2004



Source: WTO; TIPS.

For the time being, therefore, the impact China is currently having on the world economy is the most relevant aspect – to other countries – of its rise to prominence. These effects are ubiquitous, and in some senses highly predictable: all else being equal, the volumes traded with China have increased and will continue to expand (particularly in labour-intensive goods, albeit probably not at the rates witnessed recently), and trade-related production in most countries will continue to be redistributed.[38]

The 2005 Report to Congress of the US–China Economic and Security Review Commission stated that 'US manufacturers in a broad array of industries are under increasing competitive pressures from domestic and foreign-invested China-based manufacturers . . . China is accelerating and shaping the global shift in manufacturing'.[39]

Australia is another country adjusting to China's emergence. It also happens to be committed to concluding an FTA with that country. Australia's

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38 Lardy, *op. cit.*, pp. 134–135.

39 US–China Economic and Security Review Commission, Annual Report to Congress 2005. Washington: Federal Government of the United States of America, 2005, p. 27.

booming resource exports and imports of cheap manufactures have given that country its most favourable terms of trade since the 1970s. The Reserve Bank of Australia estimates that this contributes 1–2 percentage points to Australia's growth in national income per year, and is reflected in 'strong business investment, high company profits and rising share prices'.[40]

However, as is the case in the US and many other countries, competitive pressure from China in third markets and at home is proving problematic. In a 2004 survey of Australian manufacturers,[41] more than two-thirds said they were being affected by China, whether in product or input markets. The survey found, unsurprisingly, that there is relatively widespread opposition to the FTA process amongst manufacturers. This is counterbalanced by support from other parts of the economy, notably companies in services, agriculture and resources.

East Asian trade is most greatly affected by China's impact.[42] East Asia is a region in which there are a number of developing countries that are historically reliant on labour-intensive manufactured exports. Evidence suggests that China's exports of final consumer goods are displacing those of many South East Asian (ASEAN) countries, particularly in the US market.[43] Yet between 1990–2000 this region, and every country in it, bar Singapore and Hong Kong, turned a large deficit in trade with China into a significant surplus. These surpluses continue to grow.

Does this turnaround offer lessons for SACU countries? There are two main reasons for the surplus China's neighbours show in trade with that country. The first certainly applies to SACU, as it concerns China's great demand for natural resources. Those economies in South East Asia with significant natural resource endowments are all reaping the rewards of higher commodity prices

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40 Marcelo R, 'Australia may raise rates to curb inflation', *Financial Times*, 17 February 2006.

41 Australian Industry Group. 'China and Australian Manufacturing: Opportunities and Challenges', 2004.

42 Bransetter L & N Lardy, 'China's Embrace of Globalisation', NBER Working Paper 12373, Cambridge, Massachusetts, 2006.

43 *Ibid.*, pp. 50–51. As these authors explain, the literature has yet to reach consensus on this issue. Some find evidence of displacement, particularly at the product level; others find the opposite (i.e. that China's export growth is positively associated with ASEAN export performance). In aggregate, however, it seems clear that the more China's export profile matches that of another country, the more third-market competition becomes a problem.

and export volumes. And, as we know, the resource-rich countries in SACU are benefiting similarly.[44]

But the bigger part of the story unfortunately holds no lessons for SACU. Unlike China's trade with most developing countries, its trade with its East Asian neighbours is diversified, owing to the maturity of the Japanese economy and the healthy development achieved by the four Tiger economies. Trade between China and countries in East Asia is dominated by technologically complex goods, such as home appliances and electronics. Furthermore, East Asia, through the activities of MNCs, boasts highly-integrated production networks. Many MNCs (particularly Asian ones) have transferred the final stages of their production processes (mainly assembly), which are highly labour-intensive, to China.[45]

Nowadays half to three-fifths of China's manufactured exports originate from assembly operations, and over 60% are controlled by foreign-owned firms (as discussed later, manufactures comprise over 90% of China's total exports).[46] This has for some time been a cause for concern to the Chinese authorities, who would prefer more local value addition and innovation. Nevertheless, 'since most high technology trade [in East Asia] is likely to be part of MNC networks, complementarities between China and its neighbours are more significant than direct competition'.[47] Furthermore, the bulk of the finally assembled products is not destined for re-export back into the region, but is intended for the American, Japanese and European markets.

An important implication of this pattern, besides the positive ramifications for China's neighbours, is that SACU, as with the rest of the world, increasingly

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[44] However, as noted in the introduction, South Africa's deficit with China is large. This contrasts with other resource-rich (non-oil) exporters outside the East Asian region, which all record surpluses in trade with China. These include Brazil, Argentina, Australia, Chile and New Zealand. This raises the following serious question: are South African resource exporters performing anywhere near potential? The aggregate data, which show very slow growth in primary product exports during the 1990s and the early 2000s, as well as the contrasting performances of the countries mentioned above, suggest that there is ample room for improvement.

[45] Lall S & M Albaladejo, 'China's Competitive Performance: A Threat to East Asian Manufactured Exports?' *World Development*, 32(9), 2004, pp. 1441–1466.

[46] Lardy, *op. cit.*, p. 51, and data gathered from the Institute of World Economics and Politics (IWEP), Chinese Academy of Social Sciences. See www.iwep.org.cn/english/.

[47] Lall & Albaladejo, *op. cit.*, p. 1455.

imports from China products that it used to obtain directly from other countries. This trend is significant, as is shown by changes in the pattern of US imports from the rest of East Asia: while the growth in US imports from China has boomed the growth rate of exports from East Asia to the US has actually declined slightly in recent years.[48] While this is not yet happening with SACU imports from non-China East Asia dislocation caused by increased trade with China specifically may not be as large as the latter's overall export surge suggests.

Obviously the story in Asia is not so one-sided. China *is* displacing production in, and exports from, other East Asian countries. In low-technology goods (which comprise mainly clothing, textiles, footwear, leather and toys), the hardest hit, as measured by changes in the world market shares of these countries, have been the four Tigers. However, even this requires qualification[49]: . . . if we take into account the fact that the mature Tigers were already losing competitiveness in low-technology products, and that a significant part of Chinese exports of such products is handled by their enterprises and uses inputs made by them, the competitive loss appears much smaller. In fact, compared to a counterfactual where they lost to low-technology producers elsewhere, they are net gainers.

For the mature Tiger economies, and Japan for that matter, the real competitive threat from China is still to come, in more complex items like automotives, machinery, chemicals and electronics. But this will probably take a long time, and the goalposts clearly will not remain fixed. As is always the case in advanced economies, technological progress and industrial upgrading will continue.

The second-tier economies in South-East Asia (Malaysia, Indonesia, the Philippines, and Malaysia) all currently have higher wage costs than China, and are not necessarily capable of justifying the difference with better (innovation-and/or quality-based) productivity levels.[50] The same certainly applies to SACU countries. Both therefore face significant threats from Chinese competitiveness in low-technology exports. This threat is particularly acute now that

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[48] This is the case particularly in labour-intensive products. In the late 1980s, South Korea and Taiwan accounted for almost 60% of all US footwear imports, while China accounted for almost none. By 1999 those figures were almost exactly opposite. The same goes for US imports of toys, games and sporting goods. See Lardy, *op. cit.*, pp. 160–161 (figures 5.1 and 5.2); Bransetter & Lardy, *op. cit.*, pp. 46–47; and 'Some Assembly Needed: China as Asia Factory', *New York Times*, 9 February 2006.

[49] Lall & Albaladejo, *op. cit.*, p. 1457.

[50] *Ibid.*, pp. 1457–1458.

the Agreement on Textiles and Clothing has been phased out, although the two arrangements secured with China by the EU and the US may provide some temporary relief in third markets.[51]

But one cannot overstate the importance of balancing the threat China poses with the opportunity it offers. International trade is not a zero-sum game. When the world's giant economies are growing rapidly, most developing country exports grow too. China is a giant, and is increasingly becoming a key driver of world growth. Furthermore, although some producers in SACU countries will be displaced, others will respond to the increased competitive pressure by specialising further and becoming more efficient, growing in the process.

Thus, 'the trade balance effect [of China] on most Sub-Saharan African (SSA) states is likely to be positive – despite the well rehearsed problems of clothing exporters'.[52] And the benefits extend beyond just being able to export more to China. Efficiency gains made by that country (and excess manufacturing capacity) are exerting downward pressure on the prices of Chinese exports, to the advantage of consumers – especially poor consumers – everywhere.

2.3 What about the exchange rate?

As noted recently by Morris Goldstein, no issue in international monetary economics has received more attention in the past three years than China's exchange rate and related policies.[53] In what ways are China's currency policies relevant to trade between it and SACU? What are the most important consequences of the current arrangement? Is it likely to alter significantly in the future, and what might the implications of a stronger yuan be?

Estimates of the extent of yuan undervaluation vary considerably, but no

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[51] See www.ustr.gov/assets/Document_Library/Fact_Sheets/2005/asset_upload_file813_8339.pdf for details of the US deal and www.eurunion.org/News/press/2005/2005062.htm for the European version. Both restrict imports from China in a certain number of clothing and textile products for three years. The EU's agreement runs until the end of 2007; America's from 2006–2008. The restrictions should provide some 'breathing space' for other Asian exporters, but only temporarily.

[52] Stevens C & J Kennan, 'Opening the Package: the Asian Drivers and Poor Country Trade'. Sussex: Institute for Development Studies, University of Sussex, 2005.

[53] Goldstein M, 'Renminbi Controversies', paper prepared for a Cato Institute conference on Monetary Institutions and Economic Development, Washington D.C., 2005.

studies have found the yuan to be overvalued. On balance, the evidence suggests that the yuan's undervaluation vis-à-vis the US dollar ranges between 20–30%,[54] providing two distinct advantages to Chinese exporters. The first is most obvious: an undervalued exchange rate improves the price competitiveness of Chinese exports, which are in any case relatively cheap. But more importantly, the fixed (or quasi-fixed, after the 2005 changes) peg provides financial certainty to the entire Chinese export sector. There is no need either to worry about currency volatility or to manage the associated risks.[55]

But is an undervalued yuan crucial to Chinese GDP growth? To assess that one needs to investigate changes in China's real effective (that is, trade-weighted) exchange rate (REER), which is the product of the (fixed) nominal exchange rate and the ratio of domestic Chinese prices to a weighted index of prices in trade partner countries. A real appreciation is associated with a reduction in the profitability of producing for export relative to the domestic market (commonly interpreted as a 'loss of competitiveness'), while a real depreciation is associated with the opposite. The evidence suggests that since 1994, China's REER has appreciated by about 30%.[56]

Over 10 years, this is a gradual change, but in some years the adjustments have been relatively large and abrupt (13% in 1997 and 8% in 2000). Given that China's GDP growth has not slowed over this period, it is difficult to argue that an undervalued RMB in real terms is an essential component of that growth. And, by implication, it is also difficult to argue, as many have, that significant real appreciations in the future would, all else being equal, contribute to a major slowdown in GDP growth.

A revaluation would, however, reduce export supply in China. Switching to a free or even managed float would also introduce volatility and uncertainty, which would further dampen interest in exporting. This would necessarily result in a world-wide easing of the competitive pressures – at home and in third markets – generated by China's export growth. It would also make Chinese imports cheaper, implying further increases in Chinese demand for

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54 *Ibid.*, p. 4.

55 Note, however, that Chinese exporters are penalised by the weak exchange rate because the costs of import requirements (inputs and capital equipment) are inflated.

56 Goldstein, *op. cit.*, p. 5.

SACU's (and everyone else's) exports. Finally, Chinese foreign investment in SACU and elsewhere is likely to be stimulated as foreign currency-denominated assets become cheaper. But beyond these things, would a revaluation prove a significant boon to SACU producers and exporters?

For that to be the case, two other conditions would have to be fulfilled. First, other East Asian countries would have to follow China's lead. If they didn't, they would take up a large portion of the 'slack' introduced by a yuan revaluation, reducing the extent to which competitive pressures are eased. Second, and more important, SACU currencies (South Africa's in particular) would need to depreciate and become more stable in real terms. Currency strength and volatility, amongst other domestic constraints, cause SACU exporters more problems than a weak yuan does.

Nevertheless, a revaluation of the yuan 'ought to take the edge out of the overall China–SA relationship and trade relations in particular', and would certainly help to improve sentiment towards China.[57] It would also make the prospects of a trade agreement less daunting, which in turn would smooth the political processes within SACU structures.

2.4 Will China alter the rules governing the world trading system?

A question connected with China's rise is the extent to which it may affect or change the ways in which international trade is governed, especially now that it has joined the WTO. 'The worry has been that Beijing would get inside the WTO and then mess up the organisation by not respecting the letter or the spirit of its rules'.[58]

China's primary stated foreign policy goal is to maintain international peace and stability as it grows and interacts more intensively with other countries. As much as possible, it does not want to appear a strategic threat or actively rock the boat, as doing so would probably have the most severe consequences for its

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[57] Van der Wath K, 'With change comes opportunity', *Business Day*, 25 July 2005, available at www.businessday.co.za/Articles/TarkArticle.aspx?ID=1548575.

[58] 'Free Trade China', *Wall Street Journal* interactive edition, 16 November 1999, cited in Lardy, *op. cit.*, p. 155.

own development aspirations. China is also an avowed multilateralist, and has sought to advertise its credentials as a good global citizen wherever possible.[59] [60]

Further evidence of China's determination not to appear belligerent is provided by the substantial concessions it agreed to under its accession to the WTO. These were widely regarded as the most stringent and far-reaching to be applied to any developing member.[61] Clearly many of the reforms required by the WTO are in China's interests, and form the cornerstone of its broader reform process. On the other hand, some provisions, particularly those regarding the special anti-dumping and other countervailing measures applicable to Chinese exports (and no-one else's), are considered by many commentators to be both unnecessary and unfair.

China's accession commitments have led to a relative lack of *pro*-activity in the current Doha Round. This is not to say, however, that China has been absent from the talks. It is committed to further trade liberalisation under the WTO, not least because it needs ever greater market access to absorb its seemingly ever greater export volumes. On issues where it has significant defensive concerns, China has been far more pragmatic and flexible than expected, given the size and complexity of the domestic challenges it faces. Overall, its behaviour in the Doha Round, and the incentives driving it, suggest that China will not '. . . like India, use the WTO as a foreign policy football'.[62]

It is therefore highly unlikely that China will seek to alter the way the WTO works, at least in the short to medium term. In international relations parlance, China is a 'system-maintainer' rather than 'system-wrecker'. But at some point it will surely become a 'system-shaper'. As it gains more self-confidence, and as its economic and political influence expand, China will, like all great economic powers, seek to alter the way international trade is governed to suit its own needs. Exactly how it will do so is impossible to know, especially considering

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59 Sally, R., 'China's Trade Policies and its Integration into the WTO', in Draper & le Pere (eds), *op. cit*.

60 One exception is China's activity in the United Nations Security Council, where it has used its influence to try and protect its interests, most recently in the Sudan. China also vetoed UN intervention in Kosovo, apparently fearing that this would set a precedent that would in future constrain its ability to interfere unilaterally in Taiwan's affairs.

61 Sally, *op. cit.*, pp. 40–44.

62 *Ibid.*, p. 47.

that Chinese officials are not particularly specific about how they would like to see the WTO evolve.

In the meantime, China's principle goal vis-à-vis trade rules is to find ways to limit the number of anti-dumping cases and countervailing duties brought against its exports. As suggested above, the special provisions in China's accession enable other WTO members to bring cases far more swiftly, frequently and effectively than would be the case for any other member.

The crucial link here is that many members have not yet granted China 'market economy status', which would make it more complicated and difficult for them to use anti-dumping and countervailing measures in trade disputes with China. This is one of the reasons why China is actively seeking bilateral trade agreements. In these negotiations it can make stronger demands that potential partners should grant it market economy status. In SACU's case, however, this does not apply, as South Africa has already given China what it wants in this regard.

3. SACU–CHINA TRADE: TRENDS AND DEVELOPMENT IMPLICATIONS

As early as 1997, manufactures (finished and intermediate) accounted for over 90% of China's total exports. Manufactures also comprise the bulk of China's total imports, although raw materials account for more than 20%. China's other major import category is intermediate manufactures (mainly in the machinery, transport equipment and chemicals categories). In absolute terms, China is increasingly becoming a major food importer. And although these are harder to measure, China's services imports are also considered by many to be substantial. Barring perhaps the latter, the foregoing are all areas in which SACU, South Africa in particular, has a strong and long-standing competitive advantage. Hence the emerging pattern of trade with China is complementary, although there are some exceptions.[63]

China therefore represents a new, massive set of opportunities for established SACU exporters. (It also presents a new series of risks and underlines an

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[63] For example, as shown below, machinery and equipment is a relatively important and rapidly growing product category in South Africa's exports to China.

old set of problems, to be discussed below.) Evidence from trade flows shows that most of South Africa's major exports to China grew rapidly between 1996–2005. The structure of bilateral trade also adjusted in ways commensurate with the complementarity discussed above. The share of simply processed goods (mainly resource-based products) in South Africa's exports to China has risen considerably since 1996, as has the share of advanced manufactures in South Africa's imports from China.[64]

Table 1 below lists South African exports to China (at the chapter level) in descending order by average share in total exports to China from 2001–2005 (column 4). Rows shaded grey indicate chapters that both accounted for 1% or more of South Africa's exports to China on average between 2001–2005, and grew in relative importance between the periods 1996–2000 and 2001–2005.

As can been seen, total export growth to China between 1996–2005 (25.5% on average per year) was well in excess of the equivalent growth in South Africa's total exports to the world (7.3%). Base metals and mineral products (rows 1 and 2) accounted for almost 73% of South Africa's exports to China on average during 2001–2005. Annually, these grew at 31% and 22.1% respectively; the latter dropped in relative importance during the 1990s, while the former rose significantly. Transport equipment (row 7) grew relatively slowly and, as a result, has dropped substantially in relative importance. Machinery and equipment (row 4), on the other hand, showed robust growth (36.4%). This has risen rapidly to become South Africa's fourth-largest export category in trade with China. Other strongly-growing chapters of significance included chemicals, pulp and paper, textiles and clothing, and live animals.

It should be noted here that there are serious discrepancies in South Africa–China bilateral trade data (see the Appendix for more details). The biggest of these is that China's recorded imports from South Africa are consistently much higher than South Africa's recorded exports to China (over 2.5 times in 2005). This margin shrinks if one adds to this South Africa's recorded exports to Hong Kong and Macau (two Special Administrative Regions of China), but by nowhere near enough to make the resulting difference negligible. Even including Taiwan does not completely remove the difference between South Africa's

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64 Willcox O & D van Seventer, 'Current and Potential Trade between South Africa and China', in Draper & le Pere (eds), *op. cit.*, Figure 7.1.

Table 1: Chapter level exports from South Africa to China

Chapters		Export value, 2005 (US$ '000)	Ave. ann. growth, 1996–2005	Ave. share, 1996–2000	Ave. share, 2001–2005	Share change
15	Base metals and articles	466,014	30.9%	16.9%	36.8%	+
05	Mineral products	534,826	22.1%	39.9%	36.0%	–
06	Chemical products	111,690	28.6%	4.8%	8.6%	+
16	Machinery and equipment	47,505	36.4%	4.4%	5.1%	+
10	Pulp and paper and articles	12,377	12.3%	3.0%	2.8%	–
11	Textiles and textile articles	32,371	21.1%	3.3%	2.6%	–
17	Transport equipment	15,311	13.5%	19.5%	2.1%	–
04	Prep. foodstuffs; beverages, spirits and vinegar; tobacco	15,998	18.6%	0.8%	1.1%	+
01	Live animals	12,887	33.0%	1.2%	1.0%	–
13	Stone, cement; ceramic products; glassware	13,170	38.4%	1.0%	0.8%	–
08	Raw hides, leather, and articles	13,655	47.6%	0.4%	0.7%	+
14	Precious metals and stones	10,498	51.9%	0.5%	0.7%	+
07	Plastics and articles	12,892	39.9%	0.2%	0.7%	+
09	Wood and articles	8,823	77.5%	0.1%	0.5%	–
02	Vegetable products	5,057	2.5%	0.5%	0.3%	–
18	Precision equipment	2,084	43.3%	0.0%	0.2%	+
20	Misc. manufactured articles	479	49.3%	0.1%	0.1%	none
03	Animal or veg. fats and oils	1,202	43.1%	0.0%	0.0%	none
21	Works of art	222	n/a	0.0%	0.0%	none
22	Unclassified	86	2.7%	3.5%	0.0%	–
12	Footwear	23	–8.2%	0.0%	0.0%	none
23	MIDP components	0	n/a	0.0%	0.0%	none
19	Arms and ammunition	0	n/a	0.0%	0.0%	none
	Total exports to China	1,317,170	25.5%	100%	100%	n/a
	Total exports to world	50,222,951	7.3%	n/a	n/a	n/a

Source: TIPS data and own calculations.

Note: This table is a modified, updated version of that found in Willcox, O. and D. van Seventer, op cit, Table 7.3. Rows shaded grey indicate product chapters that both accounted for more than 1% of South Africa's exports to China (on average between 2001 and 2005), and rose in relative importance since the 1996-2000 period.

officially recorded exports to 'China' (that is, China plus Hong Kong, Macau, and Taiwan) and China's officially recorded imports from South Africa.

This creates two potential problems. First, and less important here, is that the Chinese statistics suggest that bilateral trade is balanced. South African statistics show that South Africa's second-largest bilateral deficit (the biggest is with Germany) is with China. The second is that because China's recorded imports are so much higher, the structure and patterns of change over time could also differ widely from those revealed by analysing South Africa's export data. Fortunately, this does not appear to be a problem. Recent detailed work on China's recorded imports from South Africa indicates that just 10 HS2 headings accounted for more than 90% (in value terms) of China's imports from South Africa in 2005.[65] These were, in descending order of share size: ores; precious metals and stones; so-called 'small lines'; iron and steel items; aluminium; organic chemicals; miscellaneous chemicals; fuels; nickel; and machinery. It is clear that South Africa's mineral wealth is dominating the composition of its exports to China.

The research also notes that, relative to trade figures in 2000, South Africa has been losing its market share in China in the following product groups: ores; organic chemicals; fuels and machinery. In the case of ores, South Africa's largest set of exports to China, competition from Australia and Brazil appears to have influenced South Africa's market share. Since China applies no tariffs to imports in this category, performance in the Chinese market is solely a function of domestic production conditions and choices made by exporters and importers. This implies several possibilities: a) South African producers must improve output and export growth; b) the latter are choosing to export relatively less to China than Australian and Brazilian producers; or c) Chinese importers are turning to alternative suppliers. Whatever the case may be, because tariffs in China are already zero, an FTA clearly would not improve South Africa's chances in this product category, unless the political signal sent built confidence amongst importers and exporters (assuming that this is currently lacking relative to Australian and Brazilian suppliers).

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[65] See Sandrey R, 'South African Merchandise Trade with China', TRALAC working paper 3/2006, Trade Law Centre, Stellenbosch, August 2006 (www.tralac.org/scripts/content.php?id=4810).

Where might South Africa see gains? First, one needs a sense of the structure of China's protection as applied to imports from South Africa.[66] In 2005, the overall average duty paid by South African exporters was 3.5%, low by any standards. Forty percent of total exports entered China duty-free, while another 32.4% attracted a 'nuisance' tariff of between 1–4.5%. In other words, less than 30% of South Africa's total exports to China attracted a tariff above 5%. The majority of total duties paid, about 40%, are for items falling in the 5.5–9.5% tariff range. These products represent just over 18% of South Africa's exports to China. On the other hand, 9.3% of total duties paid are in the 30% and above tariff category, which applies to less than 1% of South Africa's exports to China. This implies some tariff peaks that could, along with the tariffs in the 5.5–9.5% range, be reduced through an FTA. Products affected by the >30% tariffs include sugar, ethyl alcohol, jewellery, truck parts and wool. Furthermore, China employs tariff rate quotas (TRQs) on a range of agricultural products of export interest to South Africa, such as wool, sugar, wheat, maize, rice, soya bean oil and cotton. The in-quota tariffs are about 15%; the out-of-quota rates are much higher, at 50%.

Adding this sort of tariff data (but not the TRQ data) to the export data above justifies an expectation of potential market access gains (by chapter) for South African firms exporting into the Chinese market under an FTA.[67] The methodology employed in the calculation of these gains is relatively simplistic, and depends on two variables: the existing average tariff, and the existing level of Chinese imports from South Africa. The higher the tariff or initial imports, the larger the gains are expected to be. Furthermore, gains are calculated on the assumption that the average tariff drops to zero, an outcome that is not guaranteed in FTA negotiations. Finally, these are only once-off, static gains; estimates of dynamic welfare gains require more sophisticated modelling.[68] Therefore, these figures should be interpreted as providing an *underestimation* of what could happen *if tariffs dropped to zero*. Also, the technique obviously

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66 All tariff analysis is taken from Sandrey, *ibid.*

67 The figures presented in table 2 are taken from Willcox & van Seventer, who base their findings on slightly older trade data than that presented in Table 1.

68 See *ibid.*, p. 210 for more details.

cannot account for entirely new trade that might emerge from the reduction of tariffs that are currently prohibitive.[69]

The important feature to note is which product groups stand to gain the most, not necessarily how much they gain. Note that Table 2 below excludes chapters showing negligible gains.

Table 2: Potential market access gains: South African exports to China ($'000 and %)

Chapters		Market access gains	% of total gains	China's import-weighted ave. tariff
15	Base metals & articles	43,429	39.8%	4.3%
14	Precious metals & stones	24,746	22.7%	3.6%
06	Chemical products	12,052	11.1%	7.2%
11	Textiles & textile articles	8,725	8.0%	19.5%
16	Machinery & equipment	5,587	5.1%	5.7%
07	Plastics & articles	4,552	4.2%	9.9%
17	Transport equipment	4,222	3.9%	15.9%
05	Mineral products	2,531	2.3%	0.4%
04	Prep. foodstuffs; beverages, spirits & vinegar; tobacco	2,531	0.9%	9.1%
	Total	108,375	98%	

Source: Willcox O & D van Seventer, op. cit., Tables 7.15 and 7.23.

As suggested by the export data shown earlier, the biggest gains are likely to come in natural resource-intensive products: base metals, precious metals and chemicals. Interestingly, textiles and textile articles also stand to make gains in the Chinese market. Given the problems and pressures these industries are experiencing in SACU at the moment, this comes as something of a surprise.

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[69] This question has been addressed in Sandrey, *op. cit.*, p. 2 and pp. 23–26. The author concludes that South Africa's exports to China of some automotive and aircraft products, as well as apples, apricots, pineapples, avocados, chocolate products, processed fish and meat products, titanium oxide and other ores, and some iron and steel products, are being 'chilled' in trade with China. This could be attributable to tariff peaks or, in the case of some of the agricultural products, tariff rate quotas.

The explanation rests on three factors. First, textiles and textile articles are distinct product groups. China's real competitive strength is in the latter, as this chapter uses labour far more intensively than the former. Second, China became a net importer of textiles in 2002, and statistics for the years since then suggest China will remain so.[70] And third, China's chapter-level import-weighted average tariff on these items is high, at 19.5%. It is thus not necessarily the case that SACU's *textiles* manufacturers will be disadvantaged if an FTA with China is negotiated. Indeed, significant restructuring of the textiles sectors in both Australia and New Zealand occurred in the 1980s in response to Chinese competition. As a result, New Zealand's exports of high-value textiles have surged globally.[71]

With some analysts predicting China's manufacturing output will surpass that of the US by 2011, opportunities in the Chinese economy will continue to grow strongly.[72] This is one of the fundamental underpinnings of South Africa's, indeed most countries', desire to become better integrated with the Chinese economy. However, market access gains may be limited, for two main reasons. One is that China's tariff structure already favours its industrial structure. That is, restrictions are already low on imports of the resources and intermediate inputs it most needs to fuel its industrial boom. And two, China is negotiating or has recently completed bilateral and regional trade deals with up to 20 partners (more detail on this is given below), many of whom are both geographically closer to the Chinese mainland than SACU (which reduces freight costs), and are more competitive suppliers of many of the same products.

Furthermore, SACU and China are not a perfect match. SACU countries are all grappling with the twin problems of poverty and high unemployment. One way to provide greater employment opportunities, thereby helping to alleviate poverty, is by strengthening and growing labour-intensive light industries such

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70 Lardy, *op. cit*.

71 Interviews in Australia and New Zealand with both business and government sources.

72 On China's growth prospects and potential resource demands, see, *inter alia*, Hale D, 'China's Economic Takeoff: Implications for Africa'. Johannesburg: Brenthurst Foundation discussion paper 1/2006.

as those producing apparel, plastics and furniture.[73] Experiments with import-substitution, preferential trade arrangements with some developed countries, and historical multilateral restrictions on trade in certain products have all contributed to the development in SACU countries of relatively substantial capacity in light industry (clothing and textiles in particular). Because of their employment benefits relative to other more capital-intensive activities, these light industries are undeniably important.

Table 3: Potential market access gains: Chinese exports to South Africa ($'000)

Chapters		Market access gains	% of total gains	SA's import-weighted ave. tariff
11	Textiles & textile articles	148,991	38.9%	31.7%
12	Footwear	86,668	22.6%	21.9%
16	Machinery & equipment	45,523	11.9%	3.5%
20	Misc. manufactured articles	16,898	4.4%	7.4%
08	Raw hides, leather, & articles	16,766	4.4%	28.5%
15	Base metals & articles	15,744	4.1%	7.1%
13	Stone, cement; ceramic products; glassware	10,966	2.9%	13.6%
07	Plastics & articles	10,598	2.8%	10.8%
06	Chemical products	6,239	1.6%	2.6%
02	Vegetable products	6,180	1.6%	5.1%
04	Prep. foodstuffs; beverages, spirits & vinegar; tobacco	4,125	1.1%	11.5%
17	Transport equipment	3,878	1.0%	7.2%
01	Live animals	3,723	1.0%	9.8%
	Total	376,299	98%	

Source: Willcox O & D van Seventer, op. cit., Tables 7.16 and 7.22.

[73] The ongoing Harvard Center for International Development research on South Africa's economy has concluded that growth, jobs and poverty reduction will all be best served by expanding the tradable manufacturing sector, which has in recent times seen an erosion of its share of overall output. See http://www.cid.harvard.edu/southafrica/index.html for all papers currently available. See in particular Rodrik D, 'Understanding South Africa's Economic Puzzles', CID Working Paper No. 130, August 2006.

Unfortunately, for a range of reasons, some light industries in SACU are rapidly becoming obsolescent (although there are important exceptions, such as furniture in South Africa). While trade with China is not the principal cause of these problems, it certainly compounds them.

Table 3 (page 32) gives a sense of where China's biggest static market access gains would occur in the event of tariffs dropping to zero under an FTA. As before, chapters showing insignificant gains have been excluded.

Over half of China's total gains would occur in textiles and textile articles (the emphasis probably on the latter), and footwear. Machinery, which is likely to be concentrated in electrical and electronic equipment and appliances, would also make significant inroads.

Broadly speaking, therefore, South Africa exports primarily minerals, metals and some machinery in return for textiles and clothing, footwear, and, increasingly, advanced machinery and equipment. Hence the emerging pattern of bilateral trade is not conducive to rapid job-creation in low-skill manufacturing occupations, which is seen as the answer to one of the biggest of South Africa's economic development problems. The industries that stand to gain most in an FTA with China are built around South Africa's large natural resource endowment, and are capital-, technology- and energy-intensive. Trade with, and competition from, China in home and third country markets on balance reinforces the existing growth path in South Africa.[74]

Crucially, however, it must be stressed that entrenched industries will not, as some have claimed, be 'utterly wiped out' by Chinese imports. In fact, emerging anecdotal evidence shows that South African producers are capable of adjusting to, and competing with, Chinese imports, even in the clothing sector. Justin Barnes, an expert on the clothing industry and a key figure in researching and drafting its rescue plan, has the following to say: [75]

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[74] It is worth noting that these conclusions are inevitable, as they are based on existing trade only. One could argue that the future may look very different, as new industries may grow in SACU countries in response to different conditions governing trade with China. It is reasonable to assume, however, that even the most explosive response from previously under- or un-traded sectors would not fundamentally alter the broad pattern of trade, which is determined by differences in relative endowments.

[75] Bisseker C, 'A New Outfit', *Financial Mail*, 23 June 2006.

> About two-thirds of clothing firms are doing badly but they're the ones who moan the loudest, which is why you have this image of a dying industry. It's a complete fallacy. . . Some clothing manufacturers have doubled in size in the past two years [when the rand strengthened noticeably and imports surged] because they're able to meet their customers' requirements. They're the ones who've upgraded plant and skills and are running leaner structures. The industry is reorganising to emulate their success.

Three further issues should be borne in mind. One, production effects are not the only matter trade policymakers should concern themselves with. Both welfare gains to poor consumers from lower prices and production gains from cheaper inputs help to offset losses in manufacturing output and employment. There are far more poor people working outside the clothing industry than within it. Two, retail and wholesale activities benefit directly and indirectly from increased activity, again because of lower prices on items imported from China. And according to Statistics South Africa, retail prices on clothing and other textile items have come down in recent years, despite the well-rehearsed trade union argument that retailers are only increasing their profits and not passing on gains to consumers. Figure 2 below shows clearly that since 2000–2001, when Chinese imports into South Africa began to grow more rapidly, clothing and footwear prices began to drop in absolute terms (that is, we have seen prices *decrease* rather than simply a slowing of inflation). By mid-2006, these prices were almost halfway back to the levels of 1990.

Although these effects are hard to quantify, they are likely to be very important in the informal sector, from which the poor purchase many of their basic necessities: [76]

> "China City sells to small traders from all over the country, propping up the countrywide informal sector economy, and, equally important, it sells to traders in other African countries. This is the other side of the story that Chinese imports are destroying local jobs."

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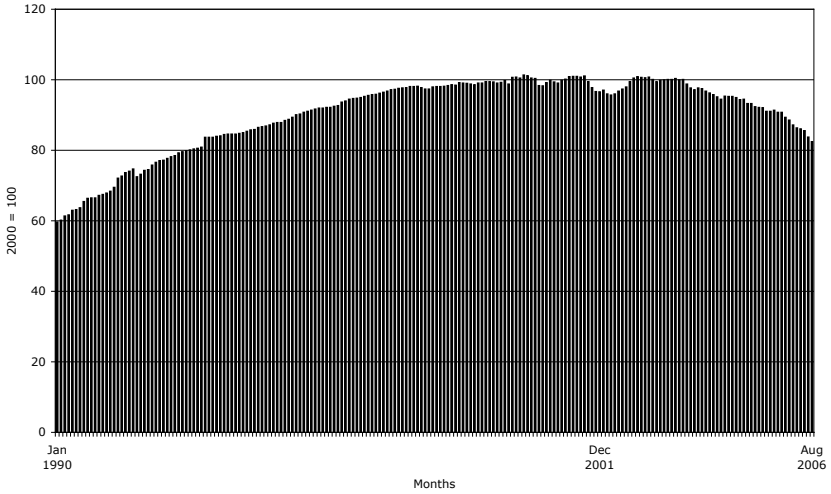
[76] Wilhelm J, 'From China with Love', *Mail&Guardian*, 9 January 2006. The article is based on Wilhelm J, 'The Chinese Communities in South Africa' in Buhlungu S, Daniel J, Lutchman J & R Southall (eds), *State of the Nation: South Africa 2005–2006*. Cape Town: HSRC Press, 2006.

Figure 2: Consumer price index, clothing and footwear, metro areas, 1990–2006 (monthly data, 2000 = 100)



Source: Statistics South Africa, Table P0141.

Three, SACU's farming and other natural resource output gains must not be ignored or downplayed. Quite the contrary – they should be growing much more rapidly than they are, and better supported through more rapid upgrading of infrastructure, particularly transport-related systems. In a country where balance of payments constraints rapidly emerge during high-growth phases, there can be no doubt that improved primary export performance is essential. China is providing the motivation to do so.[77]

Further, one cannot ignore the long queue of resource-rich countries negotiating or about to negotiate FTAs with China. Why are they so eager? Geo-politics aside, the primary reasons stated are to earn more revenue from resource exports, and to reduce the import bill. This helps countries to achieve greater macroeconomic stability, and provides governments with funds for much-needed hard and soft infrastructure, including education and health. More

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[77] See Klopper V & D Newman, 'Exports to China: food for thought', *Business Day*, 5 July 2006, for an interesting look at how South Africa's farm exports to China, especially in fruit and vegetables, are underperforming, despite South Africa's revealed comparative advantage *vis-à-vis* China in many of these products, and its having excess domestic production capacity (http://www.businessday.co.za/articles/topstories.aspx?ID=BD4A226950).

fundamentally, however, closer integration with China will accelerate restructuring processes, helping to improve both economy-wide productive efficiency (lowering costs) and allocative efficiency (committing scarce resources to the activities to which they are best suited).

4. SACU–CHINA INVESTMENT: MORE THAN JUST RESOURCES, BUT STILL EMBRYONIC

In general, we know that China, mainly through state-owned or state-invested enterprises (SOEs and SIEs), is investing heavily in Africa's under-utilised natural resources. Is the same true in the case of SACU? And are SACU companies investing in China?

Official data on bilateral investment between China and SACU are not consistent. For example, South Africa's Department of Foreign Affairs (DFA) claims in one document that by 2004, cumulative Chinese FDI into South Africa amounted to about R500 million, while in another, published in mid-2005, the DFA claims that cumulative FDI from China stood at $200 million (about R1,27 billion, using the average 2005 exchange rate). Since rand–dollar exchange rates were stable at about R6–R7:$ over that period, and Chinese FDI into South Africa is unlikely to have more than doubled in under 12 months, one or both of these numbers may be incorrect.[78]

There is more agreement on South African FDI in China, which amounted (cumulatively), to about R4.5 billion by mid-2005. This is substantially higher than either of the figures quoted for Chinese fixed investment in South Africa.

4.1 Chinese companies in South Africa[79]

The majority of Chinese companies in South Africa are subsidiaries of SOEs. Their presence in South Africa seems to be motivated by two factors: South

[78] See www.info.gov.za/speeches/2005/05091910151002.htm and www.dfa.gov.za/docs/2004/chin0621.htm, respectively.

[79] The following stems from SAIIA-commissioned research. It incorporated media searches, statements from embassies and local company representatives, and other existing research reports on the subject. The findings are oriented around companies and sectors. It should be noted that Chinese companies were generally reluctant to divulge financial details regarding their operations or initial investments.

Africa is a relatively attractive, sophisticated market in its own right, and, more importantly, it provides a useful base for operations serving the African market.

Chinese companies in South Africa have invested in the following sectors: commercial banking, consumer electronics, telecommunications equipment, shipping, light manufacturing, automobiles, mining, mining accessories and housing construction.

Of the four Chinese banks in South Africa, the China Construction Bank has the largest local operation, with almost R1 billion in assets. Both it and the Bank of China have a significant majority of their deposits denominated in foreign currency. The greater portion of both banks' lending activity is also denominated in foreign currency, which is extended to the South African Reserve Bank, non-resident banks and non-resident clients. The remaining two banks, Export/Import Bank of China, a state-owned trade financing institution, and China Everbright Bank, a commercial bank with some private ownership, have representative offices in South Africa but no formal operations. The Export/Import Bank has made loans totalling approximately $2.5 billion in Zambia and Angola over the past two years. The extent of the South African operation's involvement is not known.

China's consumer electronics are not as well established globally as companies such as LG or Sony. They therefore struggle to compete in developed world markets. However, they are price-competitive, and as such appeal to consumers in developing economies who have lower levels of disposable income. The Chinese consumer electronics firms Hisense, SVA and XOCECO have established manufacturing facilities in South Africa, where certain products are assembled from semi-knockdown kits. Other products in their range are imported fully assembled from China. As Chinese brands gain recognition and a reputation for quality and durability, these firms will be well positioned to penetrate other segments of the South African market.

One of the options for Chinese companies wanting to build a global presence is to buy established brands from other multinationals. Lenovo, China's biggest computer company, purchased IBM's personal computer business for $1.8 billion in December 2004, and has subsequently opened an office in South Africa.

Huawei Technologies, on the other hand, is an entirely home-grown diversified electronics company, and perhaps is China's most globally dispersed. It

has 30 branch offices in Africa, and over the past two years has secured contracts for supplying telecommunications equipment worth over $400 million to Kenya, Nigeria and Zimbabwe.

Chinese involvement in the South African light manufacturing sector is through the SOE Shanghai Industrial and its local subsidiary, Shanghai Industrial Investment Corporation (SIIC). This company invested in 14 other enterprises, the majority of which were in KwaZulu-Natal. These ventures have generally been unsuccessful, something that is arguably attributable to a lack of market knowledge and the use of unsustainable business models. Incentives were offered by the KwaZulu-Natal government, but these advantages were not sufficient to overcome 'the lack of international business experience that Chinese SOEs possess'.[80]

The largest joint venture operation involving a Chinese company is ASA Metals in Polokwane. The Chinese company Sinosteel, a raw materials supplier and sales agent for major Chinese steel mills, has become the partner of the Limpopo Province Development Corporation in a project that is mining 400 000 tonnes of chrome ore per annum and producing 120 000 tonnes per annum of ferrochrome from an on-site smelter. This operation is primarily a response to China's growing demand for industrial inputs from the world's extractive industries. It also reflects the realities of South Africa's bilateral trade with China.

Recently, however, the South African ferrochrome producer Xstrata Alloys has bemoaned the growing amount of unbeneficiated chromite ore exported to China, which, the company claims, is causing a decline in ferrochrome exports. Xstrata's claims are supported by the data, which show South Africa's share of the global ferrochrome market as reportedly dropping from 50% in 2004 to 42% in 2005. China places no tariff on chromite ore imports, but does tax the importation of ferrochrome. This is classic tariff escalation in a bid to protect Chinese value-added. Reducing the barriers to the export of ferrochrome to China through an FTA would help reverse the downward trend in market share.[81]

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80 All information on the SIIC's activities in South Africa has been taken from **Davies M,** 'Engaging the Dragon Economy: South Africa's Commercial Relations with China', in le Pere G (ed.), *China Through the Third Eye.* Johannesburg: Institute for Global Dialogue, 2004, ch. 9.

81 See 'Raw ore exports to China throttling South Africa's ferrochrome prospects, local producer warns', *Mining Weekly Online*, 28 July 2006. Available at: http://www.miningweekly.co.za/min/utilities/search/?show=90244.

COSCO, a Beijing-based global shipping company, and First Automotive Works (FAW), a 2005 Fortune 500 vehicle manufacturer, are two examples of Chinese companies using South Africa as a base for regional activities. COSCO Africa has a 55% share in a joint venture with Rennies called Cosren Shipping Agency, and also manages COSCO Group's operations in Southern and Western Africa. FAW has an assembly plant in Gauteng, where it assembles trucks and buses for the SADC market. Its sales programme extends as far as Uganda. FAW South Africa's company slogan is 'China's Gateway into Sub-Saharan Africa', and while this is typical of most mission statement idealism, it is possibly a useful approximation of the thinking of quite a few of China's multinationals.

China's investments in South Africa therefore extend considerably further than natural resources industries. As long as South Africa remains the most hospitable sub-Saharan African country in which to do business, it is safe to assume that it will remain the first port of call for future Chinese (non-oil) investment.

4.2 South African companies in China

South African corporate involvement in China is more multilateral than bilateral because some companies that are associated with South Africa control their Chinese operations from headquarters or affiliates that are based overseas. The mining giant BHP Billiton deals with China through its Australian operations, while the beverages company SABMiller, the insurance company Old Mutual, and the diversified mining conglomerate Anglo American all have their headquarters in London. The financial services provider Standard Bank manages its Chinese operations through Standard Bank Plc (also in London).

Of the companies based in South Africa, Naspers (media) and Kumba Resources (mining) have been the boldest movers into China. Naspers has invested in an instant messaging service and a large Beijing-based newspaper; it is also developing an online sports data business. However, Chinese business is responsible for only a small percentage of its total revenues. Like many corporations, Naspers intends to be well-positioned to service China's rapidly-growing consumer base, and to offer products that respond to the demand trends associated with rising levels of disposable income.

China's iron ore imports have increased tenfold, from 14 million tonnes to more than 200 million tonnes between 1990–2003. Kumba's foresight has placed the company in a strong position to benefit from this growth. In 1994 Kumba invested $10 million in an iron ore terminal at the Qingdao Port in China, and in 2003 it shipped $130 million worth of ore (8.3 million tonnes) to China. This figure is projected to double by 2008. Kumba is also involved in a zinc mining and refinery project in Inner Mongolia.

Anglo American's sales to China increased from $700 million to $1 billion from 2002 to 2003. All eight of the Anglo American group companies and affiliates are represented in China. Some, such as Kumba, Anglo Paper and Packaging and Anglo Industrial Minerals, started operating there as early as 1994. Various prospecting and exploration projects are under way, but the bulk of the opportunities are presented by an industrialising China's demand for metals and minerals. There is also a growing market for jewellery. BHP Billiton, for example, currently derives about 10% of its revenue from sales to China.

SABMiller is now China's second-largest brewer, having entered into a joint venture that currently has a stake in 33 breweries.

Of the South African financial services providers, Standard Bank is the most active in the Chinese market. It is predominantly involved in project finance and risk trading for the resource sector, although resource trading is conducted through its Hong Kong office. Old Mutual and Alexander Forbes are waiting for further deregulation of the insurance industry before they begin brokering operations. In the interim they have established representative offices and are engaged in strategy formulation and market research.

Landpac is perhaps the most successful of the smaller South African companies that have a presence in China. The civil engineering applications of their patented soil compaction technology have meant that they have carried out various construction projects in 14 provinces. Their entry into the Chinese market in 1999 allowed them to capitalise on the massive growth in Chinese infrastructural development, for example roads, housing and airport construction.

Currently, Sasol represents the biggest potential expansion of a South African firm into China. China has vast reserves of coal and a growing reliance on imported crude for petroleum products. Sasol's coal-to-liquids (CTL) technology, which is cost-effective when crude oil prices are high, is therefore of great interest to strategic thinkers in Beijing. Mutual interest in establishing plants

near China's coalfields has reportedly been strong for some time. The deals between Sasol and the Chinese government were confirmed during Premier Wen Jiabao's visit to South Africa in June 2006. There are feasibility studies under way for two 80 000 barrel per day (bpd) plants, one in Shaanxi Province and one in Nigxia Hui Autonomous Region. Both are inland, and situated 650km and 1 000km west of Beijing respectively.

The biggest risk to Sasol's success in China is intellectual property theft. Sasol recognises the dangers, and has reportedly carried out an exhaustive due diligence survey of China's intellectual property environment. It claims to be satisfied that its investments will be protected. However, Sasol also concedes that it is depending on a second line of defence – that even if the technology is stolen, the process is still extremely difficult to perfect, and relies heavily on the knowledge and experience of Sasol engineers. This indicates that the issue remains a concern.[82]

Some of South Africa's biggest companies are now active in China. If the data discussed earlier are reliable, they have invested significantly more than Chinese companies have in South Africa. This may reflect three motivations. One, China has a much larger economy than South Africa, offering more investment potential for SACU investors than SACU does for Chinese investors. Two, some of South Africa's biggest outward investors are in mining, a sector in China that holds enormous potential. And three, one must not forget that the large asymmetry between China's presence in international trade on one hand, and its presence in international investment on the other, is something common to many Asian countries.

Overall, therefore, trade with China will remain much more important to bilateral economic relations than investment. This feature has also been noted in Chilean and Australian analyses of their commercial engagements with China. It is certainly unfortunate, as increased two-way investment forms a critical part of a stable and long-term process of economic integration. But China is still very much a developing country, and does not constitute a diversified or large source of outward investment, at least when compared with the EU, the US or Japan. So although the negotiation of an FTA will raise interest levels in

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[82] See Moneyweb interview with André de Ruyter, head of China operations for Sasol, available at http://www.moneyweb.co.za/moneyweb_radio/mny_power_hour/577146.htm.

both China and SACU, and although issues of investor protection, business risk and national treatment are clearly important, the consequences for trade flows – and output – should remain the uppermost consideration.

5. FURTHER CONSIDERATIONS: SOUTH AFRICA AND CHINA IN AFRICA

Bilateral trade initiatives are intrinsically political processes. South Africa–China political relations since 1994 have evolved rapidly and without major trouble or incident. (Even South Africa's difficult transition to recognising a single China in 1998, thereby cutting ties with Taiwan, was managed well.) South Africa, as mentioned earlier, recognises that China's rise will culminate in an altered world order, and is thus eager to cement a more meaningful diplomatic relationship.

A significant potential challenge on the political front is China's engagement in Africa. South Africa's vision for Africa, detailed in the New Economic Partnership for Africa's Development (Nepad) document, is characterised by improved public and private governance and associated heightening of accountability; deeper commitments to constitutional democratic reforms and the embedding of a human rights culture; and a rebuilding or accelerated development of African economies. Nepad's ultimate goal is to spark Africa's renaissance.

These are all vital, worthy initiatives. But critics have pointed out that some of these objectives are being undermined by the nature of China's involvement with Africa. China wants many things from Africa: more access to African markets for its exports and investments; strategic partnerships with African countries, particularly the bigger ones, with the aim of increasing co-operation in international fora and, importantly, further isolating Taiwan; and the desire to present a benevolent, flexible and co-operative front, largely through symbolic forms of diplomacy, untied development aid, and other forms of assistance.[83]

But more than anything, China needs and wants more natural resources, particularly in energy, and more secure access to them. This makes Africa's oil-producing states (Nigeria, Angola and the Sudan being principal among them)

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[83] Alden C, 'China–Africa Relations: The end of the Beginning,' in Draper & le Pere (eds), *op. cit.*, pp. 138–143.

a top priority for Beijing and the SOEs it controls. Unfortunately, China's dealings with these and other African states (like Zimbabwe) have not contributed to greater transparency and better resource management in Africa. The best example is China's involvement with the military regime in Sudan, which has been accused of genocide in the western region of Darfur. Rather than use its influence and leverage to persuade Khartoum to take other directions, China, according to Human Rights Watch, has supported it with financial and military assistance. China also succeeded in delaying and weakening the UN Security Council's attempts to intervene.[84]

It is becoming increasingly obvious that China does not seek friends in Africa; only the furthering of its strategic interests.[85] The means by which it does so has negative implications for Nepad's stated aims, and South Africa's corresponding vision for Africa.

Yet because of China's policy of non-interference in the affairs of sovereign states, the fact that it offers a credible counterbalance to Western hegemony in a host of spheres (including international organisations), and is actively involved in developing the necessary infrastructure to exploit Africa's under-utilised resources, many African states, particularly those like Sudan and Zimbabwe who are increasingly isolated, welcome China's eagerness to engage. There is a sense in which many African states favour China's involvement in their countries over South Africa's.

Since 1994, South Africa's commercial and political footprint on the continent has grown dramatically. South Africa's stock of FDI in the SADC region is now greater than that of both the US and the UK combined.[86] It is also far more diversified, as the vast majority of developed world investment (and China's, for that matter) is in resource extraction. But this process has not been without

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84 Africa: China's Great Leap into the Continent', IRINnews.org, 23 March 2006. Available at www.irinnews.org/report.asp?ReportID=52405&SelectRegion=Southern_Africa&SelectCountry=AFRICA

85 This idea is taken from a Benin diplomat quoted in Alden, *op cit*, p. 151. The full quote reads as follows: 'We're [Benin] a socialist-Marxist state, we've had 30 years of relations with the People's Republic of China and yet they bypassed us to go to Gabon. This tells me that China has no friends – only interests'.

86 Daniel J, Naidoo V & S Naidu, 'The South Africans Have Arrived: Post-apartheid corporate expansion into Africa', in Daniel J, Habib A & R Southall (eds.), *State of the Nation: South Africa 2003–2004*. Cape Town: HSRC Press, 2003.

tension, and South Africa is often accused of being a 'big brother' rather than a 'partner in development'. South Africa is also accused of double standards in the trade arena, of promoting liberalisation on the continent while protecting key interests in its own economy.[87]

Therefore, as China and South Africa penetrate further into the African continent, the prospects for more diplomatic and commercial tension will increase. Can South Africa afford to 'let' China undermine its drive for better governance and accountability in Africa? Will China come under greater pressure from Western governments and international organisations to improve its record in Africa? And will African governments – the most important players in this unfolding relationship – try to regulate Chinese companies more effectively? None of the answers are easy to predict, but all have implications for the South Africa–China relationship and, by extension, the terms of, and commitment to, any potential trade agreement.

6. TRADE STRATEGIES COMPARED: THE LIKELY CONTOURS OF A SACU–CHINA FTA[88]

6.1 South Africa's post-1994 trade negotiations

South Africa has undergone sweeping changes in trade and industrial policy focus since the 1980s. During the apartheid era, policies were based on import-substitution and the perceived need for strategic self-sufficiency. South Africa under the ANC, however, is striving for sustainable international competitiveness and deeper integration into the global economy, in the expectation that liberalisation and sound macroeconomic management will generate more rapid export and GDP growth, more jobs, and an improvement in the quality and quantity of FDI.

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87 For a detailed review of these matters see Draper P & N Khumalo, 'Friend or Foe? South Africa and Sub-Saharan Africa in the Global Trading System', in Draper P (ed.) *Reconfiguring the Compass: South Africa's African Trade Diplomacy*, Johannesburg: The South African Institute of International Affairs, 2005.

88 This section holds no discussion of Chinese trade policy-making, or China's WTO accession commitments and their implementation. The reader is referred instead to the exhaustive account given in Sally, *op. cit*.

This great shift in policy trajectory is barely 10 years old, and was forged amidst uncertainty and scepticism regarding South Africa's political and economic future. However, it was clear that if South Africa was to integrate effectively into the global economy – and benefit from doing so – commercial ties with other countries had to be deepened and strengthened. Signing on to the 1994 Marrakech Agreement, which concluded the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) and formed the WTO, was an important step in that direction.

After 1994, trade liberalisation under the new ANC government continued, and economic policymakers turned their attention to South Africa's key bilateral partners. The two most obvious were the EU and the Southern African Development Community (SADC) states. The results of these engagements were the Trade, Development, and Cooperation (TDCA) agreement between South Africa (not SACU as a whole)[89] and the EU, which is a comprehensive agreement in goods trade; and the SADC Trade Protocol, covering most SADC member states. Both entered into force in 2000.

Since then, the Doha Round, a potential FTA with the US and, recently, a scheduled review of the TDCA (which may result in the addition of services and investment to further commitments made on goods trade), have occupied centre stage.[90] However, and in line with the momentum gathering behind South–South co-operation initiatives, India, The Common Market of the South (Mercosur), and China have also emerged (amongst others) as priorities. A preferential trade agreement (PTA) with Mercosur is very near completion. It is limited to goods trade only, applies to a relatively small number of tariff lines (about 1 000 out of around 10 000), and covers relatively small preferential tariff swaps. It has been criticised both for lacking any real commercial meaning, and having

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89 The reasons why South Africa negotiated the TDCA on its own are not discussed here. The important result, however, is that the subsequent (and new) SACU Agreement (2002) stipulates that all engagements between the five customs union partners and third parties on trade issues will be undertaken together, without exception. The fact remains, however, that South Africa's interests dominate and continue to drive the SACU trade agenda.

90 The Doha Round is coming under increasing pressure to break numerous deadlocks; important deadlines loom in the coming 12 months. Similarly, the US FTA negotiations have faltered, in this case due to seemingly irreconcilable differences over the negotiating agenda itself, as well as certain substantive issues on it.

been motivated by political and strategic concerns rather than sound economic logic.[91] Nevertheless, a similar deal will probably be sought with India.[92]

There are two principal reasons for such tentativeness in both cases. First, India and the Mercosur economies do not complement SACU in the same way that Europe, the US or China do. There is no 'natural fit', which reduces the possibility of substantial and mutually beneficial gains from trade (from a standard comparative advantage point of view).[93] Second, these potential partners are new. SACU businesses have relatively little experience in trading with, or doing business in, most of these countries. Hence (official and unofficial) non-tariff barriers (NTBs), which have been cited as real challenges in India and the Mercosur economies,[94] present obstacles that are not necessarily present (or at least are easier to overcome) in dealings with Europe, Africa or the US.[95]

Hence the approach taken by SACU officials as regards potential Southern FTA partners has been incremental. They plan to assess and re-assess periodically, and to take decisions regarding further liberalisation on a case-by-case basis. Whether or not this proves beneficial to commerce remains to be seen.

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91 See 'Where's the beef on the SACU–Mercosur trade deal?' *Business Day*, 7 November 2005, available at www.businessday.co.za/Articles/TarkArticle.aspx?ID=1763424.

92 Alves P, 'Understanding Indian Trade Policy: Implications for the Indo-SACU Agreement'. SAIIA Trade Policy Report No. 5, Johannesburg: The South African Institute of International Affairs, 2004. The paper argues that even if SACU did seek a comprehensive agreement with India, India's economic history and track record in trade negotiations suggest that this would not come about.

93 Notwithstanding considerations of dynamic comparative advantage, imperfect competition, and intra-industry trade, which are all relevant in trade between ostensibly 'similar' economies. See Roberts S, 'Reflections on Approaching an FTA Negotiation with Mercosur: A Review of Key Issues'. SAIIA Trade Policy Report No. 6, Johannesburg: The South African Institute of International Affairs, 2004, pp. 4–7, for a succinct overview of the relevant literature. On balance, it seems that mutually beneficial trade between 'similar' economies is generally only likely if both are relatively well diversified and have numerous products and services that they can sell to each other. Many Southern economies are not diversified, tend to sell similar products to Northern markets, and sell little to each other.

94 See Roberts, *op. cit.*, p. 11 on Mercosur; for ample detail on non-tariff barriers in both India and Mercosur, see Du Plessis F, Jordaan D, Kotze F, Moeng E & L White, 'The Effect of the Proposed SACU–Mercosur States and the SACU–India Trade Deals on the South African Automotive Industries'. Report prepared for NEDLAC, May 2005, pp. 141–162.

95 Africa is a notoriously difficult place in which to do business, especially for outsiders (see, for example, *Doing Business in 2005: Obstacles to Growth*. Washington: the World Bank and Oxford University Press, 2005). But SACU businesses arguably have more experience in Africa than in India or Latin America.

China also obviously presents many of the problems associated with non-tariff barriers and unfamiliar business practices.[96] But its economy is much larger than India's or Mercosur's (especially in terms of industrial value added), and, as already described, offers a far higher degree of complementarity with SACU economies. This would suggest that the approach taken in the Mercosur and Indian cases should be altered for China.

6.2 China's FTA thrust

Even if a comprehensive, WTO-plus agreement with China was attractive to SACU, what would China's approach be? Will China insist on a comprehensive agreement? China is an aggressive liberaliser, and is committed to pursuing its interests multilaterally. However, it evidently sees no problem in simultaneously steaming ahead on the regional and bilateral fronts. By analysing what China is doing and with whom, we can develop a better sense of what SACU might expect.

Table 4 is an attempt to organise China's 20 or so FTA endeavours. The three main divisions are 'implemented', 'negotiated but not yet implemented' and 'proposed'. Within each division, the current or potential partners are ranked according to their share in China's total trade in 2003.

It is clear that East Asia is China's top priority. China is some way off supplanting Japan as the region's economic hegemon (but it is much more open to trade with the rest of East Asia than Japan is). Japan's approach seems to centre on FDI, which reportedly exceeds China's in the region by some margin. Thus, while Japan is (and will remain for some time) the key economic anchor in East Asia, its historical favouring of the idea of 'regionalisation without regionalism' has provided China with space to manoeuvre. China is the undisputed 'regionaliser' in East Asia.

Although Table 4 lists under the 'proposed' category separate potential agreements between China on the one hand, and South Korea and Japan (together or separately) on the other, the most frequently discussed long-term vision is the vaunted 'Association of South East Asian Nations (ASEAN) Plus

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[96] See, for example, Van der Wath K, *Doing Business in China: the System and the Strategies*. Beijing: The Beijing Axis, 2004, ch. 6.

Table 4: China's FTAs

Partner	Type of agreement	Year	Two-way trade, 2003 (US$ millions)	Percentage of China's total trade, 2003
Implemented				
Hong Kong SAR and Macao SAR	Bilateral, CEPA (goods; services; some investment provisions)	2004	88,859	10.4
Thailand	Bilateral, PTA (fruit and vegetables only)	2003	12,655	1.5
Negotiated but not yet implemented				
Chile	Bilateral, FTA (goods thus far, comprehensive coverage, implementation due to begin in late 2006. Services currently under negotiation)	2005	3,532	0.4
Proposed				
Asia-Pacific	Regional (APEC), ?	1989	596,882	70.1
East Asia	Regional (Japan, S. Korea, China), ?	2000	284,173	33.1
Japan	Bilateral, ?	2005	133,557	15.7
South-East Asia	Regional (ASEAN), CECA (goods only; two EHPs are in force thus far)	2002, 2005	782,454	9.2
Korea	Bilateral, ?	2005	63,223	7.4
Singapore	Bilateral, ?	2004	19,349	2.3
Gulf Co-operation Council	Regional, ?	2004	16,876	2.0
Australia	Bilateral, ?	2005	13,564	1.6
South America	Regional (Mercosur), ?	2004	11,504	1.4
SACU	Regional, ??	2004	11,504	1.4
India	Bilateral, BIPA	2004	7,595	0.9
Mexico	Bilateral, ?	2004	4,944	0.6
Pakistan	Bilateral, PTA (goods, low coverage, EHP in force)	2005	2,430	0.3
New Zealand	Bilateral, ?	2004	1,826	0.2
Peru	Bilateral, ?	2004	1,114	0.1
Iceland	Bilateral, ?	2005	68	0.0

Three'. This initiative sees the ASEAN Free Trade Area (which is slowly working its way towards free trade in goods, a process that has been complicated by the addition of Cambodia, Laos, Myanmar and Vietnam to the original six ASEAN members) expand to encompass China, Japan and South Korea.

China no doubt supports this initiative, and is already on its way to freer trade with ASEAN. The deadline for completely free trade in goods between China and ASEAN is 2010 for the original ASEAN members, or ASEAN-6, and 2015 for the four more recent additions. One early harvest programme (EHP) has been completed; a second, signed in 2005, is under way.

It has been argued that free trade between ASEAN and China will either take some time to bring about, or that whatever deal is struck will be patchy. Two reasons have been given. First, ASEAN lacks any common institution mandated to conduct trade negotiations with third parties, making initiatives between it and third parties extremely cumbersome. But more important is the second: there are considerable defensive concerns in South East Asia, as discussed earlier. It will thus be up to China to maintain the pressure to realise a meaningful agreement in the time specified.[97]

The Hong Kong SAR and Macao SAR CEPAs are the most comprehensive of the few Chinese trade agreements currently in force. They include almost completely free trade in goods, significant services liberalisation, and initiatives to promote cross-border investment. The rules of origin are also relatively liberal.

Given that Hong Kong has always been amongst the freest traders in the world, the CEPA represented mainly one-sided concessions made by China.

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[97] Sally, *op. cit*., p. 53.

The three principal sources are: Hufbauer G & Y Wong, 'Prospects for Regional Free Trade in Asia'. Washington D.C.: Institute for International Economics, working paper 05-12, 2005; Feridhanusetyawan T, 'Preferential Trade Agreements in the Asia–Pacific Region'. IMF working paper WP/05/149, Washington: International Monetary Fund, 2005; and Sally R, 'China's Trade Policies in Wider Asian Perspective'. Paper prepared for the LSE/CCER conference, Beijing, 22–23 August 2005. Updated information and extra detail gathered from media and government sources.
Note: CECA = Comprehensive Economic Cooperation Agreement; CEPA = Closer Economic Partnership Agreement (a stronger version of a CECA); PTA = preferential trade agreement; BIPA = Bilateral Investment Promotion Agreement; EHP = early harvest programme (up front list of concessions to be implemented immediately. In Asia these are frequently used as stepping stones to a complete agreement. The ASEAN–China process, for example, has had two EHPs, in 2002 and 2005.) A '?' indicates that it is not clear yet what form the proposed agreement is likely to take.

In goods trade, the percentage entering China from Hong Kong duty-free rose from 20–90% in a fairly short period. More significant is the fact that Hong Kong service providers have a three-year head start in China. No other country has a bilateral services agreement with China, and under its WTO commitments its services sector will open (although substantially so) only in 2007. But even when that happens, the qualifications and requirements for Hong Kong service providers to operate in China will be significantly less stringent than those set out in China's WTO commitments.[98] Should SACU and China agree to negotiate a deal, it would probably not happen before China's GATS commitments enter into force. However, this latter feature of the agreement with Hong Kong is something that could be highly valuable, and should thus not be ignored.

The Chile deal stands out as the only serious agreement outside the East Asian region. Unlike those made with Hong Kong and Macao, the Chilean FTA at this stage is limited to goods (as well as the rules of origin, dispute settlement provisions, standards, and other rules that underpin goods trade). At the time of writing a services chapter is reportedly under negotiation.

After the China–Chile FTA comes into force during the second half of 2006, 92% of Chile's exports will immediately be allowed to enter duty free. The same will apply to only 50% of Chile's imports from China. The rest will be phased in on different time-scales, but none will take longer than 10 years. In terms of carve-outs, 3% of Chile's imports from China will not be affected; neither will 1% of China's imports from Chile. Significantly, some clothing and textile items fall into Chile's exemption list. Finally, there has been no indication that other trade chapters such as services and investment will be negotiated in the future.

The processes leading up to the commencement of negotiations with Australia and New Zealand seem the wisest and most appropriate models for SACU's case – if the commitment to negotiate becomes a reality. Both Australia and New Zealand first signed so-called Trade and Economic Co-operation Frameworks (TECF) with China. These included two principal features: an agreement to undertake a joint feasibility study of the potential FTA (which was also done by the Chilean government in co-operation with Beijing prior to its negotiations); and, should negotiations then commence, an agreement to

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[98] Hufbauer & Wong, *op. cit.*, pp. 5–6.

grant China market economy status. In other words, FTA negotiations would only start if market economy status was granted. New Zealand did so in 2004, and its negotiations with China are ongoing. In 2005 a further 13 countries, including Australia, also granted China market economy status.[99] Like New Zealand's, Australia's negotiations with China are in progress.

These deals with China are likely to be nearly identical. Australia and New Zealand both expect comprehensive agreements which include substantial liberalisation of goods and services trade, and commitments on investment. They are likely to get these, especially considering that China's 2007 GATS deadline is likely to have passed by the time negotiations are completed (making services sector openings on a bilateral basis less sensitive). But they are both likely to run into defensive concerns over China's agriculture, particularly in dairy products. Automotive exports from Australia could also pose problems. Similarly, Australia and New Zealand will probably come under pressure from lobby groups to exclude various light industry manufactures.

China needs agreements with New Zealand and Australia. New Zealand was the first industrialised nation to grant China market economy status. It is also a small enough economy to constitute a 'test case' for China in negotiating a comprehensive FTA with a developed country. Successful engagement with New Zealand would send exactly the sort of signal China would want other countries to pay attention to – in other words, that granting market economy status and negotiating an FTA is not politically impossible or economically suicidal. Furthermore, as mentioned above, China needs Australia's minerals and other resources. These factors combined (particularly the political aspects) imply that China will probably prove a flexible and accommodating negotiating partner.

Overall, therefore, it is very clear that China is not a demanding partner in FTA negotiations, particularly outside Asia. In Asia it is more exacting, and is a far more serious FTA partner than either Japan or India. Nevertheless, as in the complex ASEAN process, China has demonstrated a willingness to be flexible and pragmatic.

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[99] According to ChinaNews (www.chinanews.cn/news/2005/2006-03-17/20349.html) some of the others include South Korea, Israel, Kazakhstan, Ukraine, Belarus and Iceland. China's three largest trade partners (the US, the EU and Japan) have not granted China market economy status.

7. THINKING ABOUT THE BIG QUESTIONS

China's rise is inevitable. As long as it remains an outward-oriented economy, China will continue to drive restructuring processes in manufacturing all over the world, particularly in countries that have until now enjoyed the advantages of relatively cheap labour. In other words, China's global integration is refining further the international division of labour, something to which other countries must find ways to adapt.

As such, SACU cannot shy away from engaging China effectively on the trade front. Concentrating solely on defensive concerns, on how to minimise China's impact in a fire-alarm fashion, will guarantee counter-productive long-run results, and ensure that the relationship evolves in ways that suit the Chinese economy far more than those of SACU member countries.

The SACU economies and China have, for the most part, highly complementary structures. Similar degrees of complementarity, combined with China's impressive size and growth and its political importance have given Australia, New Zealand, Chile and, to a lesser extent, ASEAN, good reason to commit to negotiating FTAs with China. Historically, these economies have always been connected to East Asia's relatively sophisticated, vertically integrated and MNC-controlled production networks on the basis of these complementarities. China's emergence has reinforced this pattern by deepening integration in East Asia and improving the efficiencies of its production networks. It has also generated an enormous demand for raw materials itself.

Resource exports from Southern Africa to China and East Asia will thus continue to grow, while pressure to restructure away from labour-intensive, low value-added manufactures will intensify (as long as China retains its advantages in these sectors – which seems likely to last a long while). This does not mean that entire sectors will hollow out, but rather that any chance that may have existed for countries like South Africa to become final-stage processing and assembly centres has passed, at least until most of East Asia is much richer.

China's rise therefore presents in stark and simple terms the following choice: actively seek strategies for effective restructuring now, or attempt to protect uncompetitive industries indefinitely (and in so doing indirectly harm those parts of the economy that aren't in direct competition with Chinese

exports), in the hopes that either the pressure eases or policy can find ways to help strengthen vulnerable industries. Neither of the latter is likely.

This brings to centre stage a trade agreement between SACU and China. A comprehensive deal would clarify the need to implement plans to adjust effectively now, and would provide the certainty private-sector business needs to make optimal investment decisions. On the other hand, a too rapid opening of bilateral trade may precipitate mounting balance of payments problems and hasten restructuring processes beyond what is politically acceptable domestically. Furthermore, history shows that South Africa does not restructure rapidly.

Therefore, in order to construct a stable and predictable bilateral (economic) relationship that offers net benefits to SACU, the process of market opening should include goods (with minimal carve-outs), services, commitments on investment, intellectual property protection and so on. But, crucially, liberalisation must be well-sequenced and phased in over a substantial period.

China is unlikely to push hard for the sort of deal that demands rapid adjustments. China is sure to have a wide array of offensive interests in the markets of most of the partners with which it is seeking trade agreements. But, perhaps because of its relative inexperience in the FTA arena (it has no agreements with any of its biggest trading partners), or because of its substantial defensive concerns (in agriculture, for example), or to accommodate other political considerations, China is not overly demanding, particularly when negotiating with countries outside East Asia. It does not insist on comprehensive trade agreements, being content where necessary with small, slow-moving, and patchy preferential arrangements.

Furthermore, China already gets from SACU or South Africa the two requirements that underpin its FTA drive worldwide: minerals and other natural resources; and recognition as a market economy from South Africa. Market access for its exports is admittedly a priority, but it is obvious to all that SACU markets are not huge, and will never be of key concern to China.

Seen in this context, for the proposed FTA to be more than a commercially meaningless but bureaucratically costly political gesture, SACU needs to drive the process. SACU's defensive concerns cannot be viewed in isolation. There are consumer and producer gains to be made from significantly lower final goods and input prices; there are offensive interests in manufacturing (outside

concerns relating to light industry), in agriculture and in services; and over the longer term, there should be balance of payments benefits, as there have been in other resource-rich countries. Critical to the latter is raising the growth rates of SACU's resource-based exports.

The most important advantage of all is that closer integration with China will accelerate SACU's much-needed adjustment and restructuring in what is an increasingly competitive global economy. And although doing so necessarily means a contraction in some light industries, as argued above it does not mean a total collapse. New Zealand and Australia have already shown that to be the case. South African industries are also displaying some ability to adjust. In the event of a comprehensive agreement with China, sectors already under pressure will emerge leaner and more productive. This process is in fact already under way. Removing the impetus now would simply perpetuate for a limited period industries that, in their current form and scale, are simply unsustainable.

APPENDIX: DATA SOURCES AND CAVEATS

Sources for trade statistics cited in this report are: the WTO's database (www.wto.org/english/res_e/statis_e/statis_e.htm); and UNCTAD's COMTRADE database (unstats.un.org/unsd/comtrade). In South Africa's case, Trade and Industrial Policy Strategies (TIPS) data are also used (www.tips.org.za). Trade data for the Southern African Customs Union (SACU) as a whole are not considered, because of the unreliability or lack of data for Botswana, Lesotho, Namibia and Swaziland (the BLNS countries). Note that this is unlikely to influence significantly any conclusions drawn, since, according to 2003 data, South Africa accounts for about 86% of SACU's total external goods and services trade; about 87% of its population; and over 90% of its GDP.

It should be noted that there is wide divergence between Chinese and South African bilateral trade statistics. China's show that trade with South Africa or SACU is balanced, or in SACU's favour. South Africa's show a large deficit, as mentioned. Fortunately, this is relatively easy to explain, and is not necessarily the result of gross inaccuracies in the recorded data. The reason is provided by the trade statistics of Hong Kong, and how its customs services treat what are essentially re-exports from the Chinese mainland. (The difference Hong Kong makes is significant – according to WTO data, in 2002 China's share of world

exports dropped from 7% to 4% if Hong Kong is counted separately.) China does not separate its mainland exports from Hong Kong's, while the South African Department of Trade and Industry figures record trade with Hong Kong as distinct from that with China. Hence the South African data and the bilateral deficit they record are likely to be the more accurate reflection of reality.

Deeper analysis of South Africa's exports to Hong Kong, Macau (another Special Administrative Region of China), and Taiwan seems to support this. Adding South Africa's reported exports for 2005 (according to South African Customs and Excise) to all these destinations, as well as to China, yields a figure of about $2.7 billion. China's reported imports from South Africa in 2005 equalled approximately $3.45 billion.[100] Differences attributable to freight and insurance costs cannot account for such a wide divergence in the numbers.

Even if it did, it is unlikely that Beijing would record Taiwan's imports from South Africa as part of China's total imports from this country.

Incidentally, the South African export and import data show that in recent years South Africa's exports to China have grown more rapidly than its imports from China, indicating that the deficit with China may be stabilising.

There are also good reasons to be concerned over the accuracy of some of China's economic data. For example, between 1998–2002 the Chinese economy experienced price deflation, and real energy consumption dropped absolutely in both 1998 and 1999. But official statistics stated that annual GDP growth averaged 7.8% – the highest of all the large economies for those four years.[101]

This report is therefore not concerned with precisely how rapidly China is growing or has grown in the past. It takes as given that China is amongst the most rapidly growing economies in the world. This is supported by the extent to which poverty has been reduced. An estimated 200–300 million Chinese have been lifted out of absolute poverty since the early 1980s.[102]

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100 According to Sandrey, *op. cit.*, who cites World Trade Atlas data.

101 Lin J, 'Is China's Growth Real and Sustainable?' Center for Economic Research, Peking University, 2004. See also Lardy, *op. cit.*, pp. 11–13. He cites other work, which argued that China's 1998 real GDP growth rate could have been as low as 4%. The official figure given for that year was near 8% and, which is even more puzzling, all provinces in China reported to Beijing a growth rate much higher than that.

102 Qian Y, 'How Reform Worked in China', in Rodrik D (ed.), *In Search of Prosperity: Analytic Narratives on Economic Growth*. New Jersey: Princeton University Press, 2003, ch. 11.