Israel-China Relations: Ideal and Reality

Dan Catarivas

This article analyzes the economic relations between China and Israel, from the establishment of diplomatic relations in 1992 until the present. On the basis of this analysis, questions regarding the future of these relations and possible directions for development will be raised, and a framework for preferred relations will be suggested. A central question is: can Israel-China relations develop in directions that are desirable and beneficial for Israel's national economic interest, and if so, how?

Since the establishment of diplomatic relations between Israel and China 27 years ago, the Chinese economy has undergone sweeping changes that transformed it from an underdeveloped country into the second largest economic superpower in the world. Today, China continues to grow and develop at a fast rate, and according to estimates, by 2032 it will be the largest economy in the world, alongside other Asian countries such as India, which are also expected to be leading economies.[1] China's impressive growth, steady and ongoing over the course of many years, has been accompanied by economic reforms to transform China from an agriculture-based economy to an industrialized economy, and from an export-based economy to a services-based economy. Under Mao's reign, China's markets were closed, but with the beginning of the reforms China became a source of cheap labor and an attractive destination for foreign investors. However, today Chinese exports are only one of the country's growth engines, and most of its production is directed mainly toward the domestic market. China's principal growth engines are now domestic consumption; domestic investment, mainly in infrastructure; and Chinese investment around the world, which is meant to ensure the supply of raw materials for Chinese industry and the developing domestic market.

These structural economic reforms led to changes in the character of the Chinese population. Early in the era of reforms in 1978, only 17.9 percent of the population lived in urban areas; today 56.7 percent of China's population is urban.[2] The reforms also brought about important changes to China's foreign policy, which led to a change in China's standing and activities in the international arena, and mainly in its economic relations with other countries. Indeed, China, which was and remains a destination for foreign investment, has now become a prominent and important player throughout the world.

Israel likewise underwent sweeping changes over the past 40 years. Economically, Israel changed from a centralized agriculture-oriented economy, in which the government had a central role, to a free market service-oriented economy. The State of Israel has succeeded in leveraging the results of the massive investment in education and in research and development in the 1960s and 1970s, and in branding itself as the "start-up nation." However, the changes that the Israeli and Chinese economies underwent are incomparable qualitatively, and even more so, quantitatively – despite the fact that the similarities and differences in the respective economic processes is a frequent topic between Chinese and Israeli professionals.

The Development of Economic Relations between China and Israel

Despite the similarities between the respective processes involving economic change, there is still no prominent reflection of these changes in the economic relations between China and Israel, which existed already before the establishment of official diplomatic relations. Even though there was no prohibition on economic relations before the establishment of diplomatic relations, the volume of economic and commercial connections was very limited. One example of the connections that did exist was the activity of international businessman Shaul Eisenberg in China, which was very substantial in the early 1980s. According to foreign reports, Eisenberg was involved in the sale of equipment, transfer of knowledge, and the upgrade and improvement of the Soviet military equipment possessed by the Chinese army.

January 1992 saw the establishment of diplomatic relations between Israel and China, and the following October, the first trade agreement between the two countries was signed. Israeli exports to China in 1991, not including military exports, amounted to $22.8 million, while imports barely reached one million dollars. But within five years, exports rose to $71.3 million and imports soared to $206 million. 2017 figures show a significant improvement in commercial relations, with Israeli exports of $3.31 billion and imports of $6.527 billion.[3] Yet despite the improvement in commercial relations between the countries, over 55 percent of Israeli exports have been in two areas controlled almost entirely by two companies: printed circuit boards (produced by Intel Israel, which sells to Intel China), and chemicals (Israel Chemicals Ltd., which sells agricultural fertilizers). If Intel and ICL are excluded, export figures over the years paint a bleak picture: Israel exports less to China than to Belgium, Switzerland, or Holland. Moreover, a review of the development of Israeli exports to China over the past 27 years and the makeup of the exports indicates little diversity of trade (figures 1 and 2). The make-up of exports has improved slightly in recent years, with the field of medical equipment playing a larger role in Israeli exports to China ($418 million, which constituted 12 percent of exports in 2016).

Furthermore, the survival of Israeli companies in the Chinese market is fraught with difficulties. The number of Israeli companies active in China has remained almost constant over the years, and has not succeeded in growing significantly. Many Israeli companies try to enter the Chinese market but

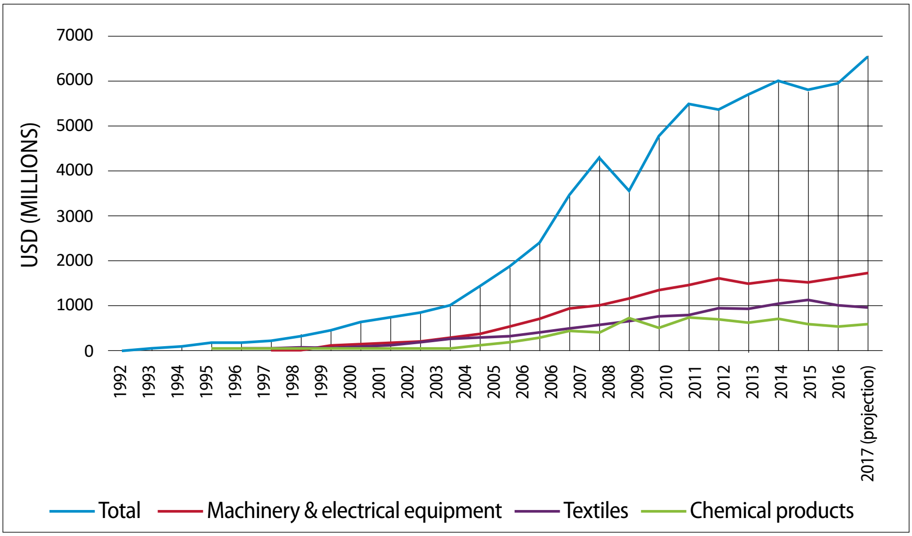

Figure 1: Import of Goods from China to Israel, 1992-2017

Source: Central Bureau of Statistics. http://www.cbs.gov.il

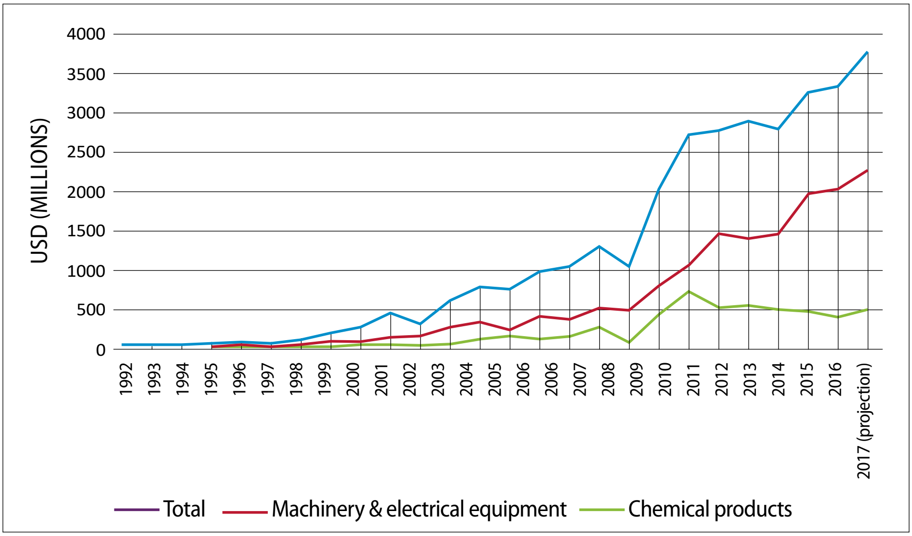

Figure 2: Exports of Goods from Israel to China, 1992-2017

Source: Central Bureau of Statistics. http://www.cbs.gov.il

do not last over time, and exit after getting worn down and losing a lot of money. This, however, does not prevent new Israeli companies from trying their luck in penetrating the Chinese market. Ideally the diversifying trend of Israeli exports to China will strengthen in the coming years, but there is no doubt that the figures are far from meeting expectations, and Israel has not fulfilled the true potential of its commercial relations with China.

The Chinese like to remind audiences that the economies of Israel and China complement one another, despite the enormous differences in size between them, and thus the two countries would do well to build a broad, diverse, and extensive set of relations. During the first decade of bilateral relations, China saw Israel as a model and central player in many fields, including agriculture, communications, and medical equipment. The Chinese sought to acquire Israeli agricultural technologies and to import agricultural knowledge about seeds, agricultural mechanization, crop growing methods, and water technologies. Indeed, Israel established an agricultural demonstration farm near Beijing in 1994 with one-sided Israeli investment.

However, the field of military exports, which saw prominent deals, has been a disappointment. The famous Phalcon (July 2000) and Harpy (2005) affairs led to a serious crisis of confidence between the two countries, and this harmed the development of economic relations over the past decade. In both of these cases, Israel sought to sell military systems to China, the United States vetoed, and Israel bowed to the American dictates and canceled its deals with the Chinese. The United States claimed that the Israeli military equipment included American technologies, and that the sale to China would endanger overall American interests, as well as the security of Taiwan and other US allies. This dual crisis, between Israel and China and between Israel and the United States, led to the imposition of strict rules regarding the export of Israeli military and dual use equipment in general, and to China in particular. Following these crises, the Defense Export Control Agency (DECA) was established within the Ministry of Defense, and since then export of military and dual use goods to China has ceased entirely, even if the goods are intended for civilian use only.

The definition of dual use goods is quite broad, and this deters Israeli technology companies operating in the American market from operating in the Chinese market. In addition, Israeli companies with dual use technologies and goods are deterred or intentionally refrain from establishing economic relations with Chinese customers. Many other Israeli technology companies are not interested in developing relations with the Chinese due to the special and strong connection that they enjoy with the American market. Furthermore, DECA's safety margins for providing permits for export to China considerably limit and impair the export of Israeli technology products. There is no doubt that the crisis of confidence between Israel and China significantly changed China's attitude towards Israel, and negatively affected the continued development of economic relations between the countries.

It is remarkable that many companies without a military connection are completely absent from the Chinese market, due to concerns about Chinese entities copying their products and knowledge, because of the lack of protection of intellectual property in China and enforcement of such regulations. In recent years, the Chinese government has made a serious effort to improve the protection of the intellectual property of foreign companies operating in China. Nonetheless, China's image on this issue continues to lag, and it is seen as a problematic country in terms of its ability to protect the intellectual property of foreign companies operating there.

Despite these crises, over the past decade considerable efforts have been made to develop civilian economic relations between the countries and to create tools to assist Israeli exports, such as signing financial protocols, creating an agricultural demonstration farm, opening Israeli trade missions in Shanghai, Chengdu, and Guangzhou, posting trade representatives at consulates, and strengthening the economic mission in Beijing. In addition, agreements have been signed in the field of industrial research and development with a large number of provinces in China, and many actions have been taken by the Ministry of Foreign Affairs Agency for International Development Cooperation in training thousands of Chinese in Israel, as well as running many courses in China. However, all of these actions have not yet led to a significant breakthrough in Israeli exports to China.

Looking Ahead

The most important change in economic relations between the countries would be a change in the attitude of the Chinese, who crave Israeli technology and innovation. China is fully aware of its economic power, and following its transition from an economy exporting cheap labor to a superpower that invests in other countries and is interested in developing original goods and technologies on its own, it is investing extensively in research and development in accordance with a new vision that places it at the center of developing the world's most innovative technologies. The Chinese value Israeli innovation and technology, and see Israel as a source for acquiring technologies to upgrade Chinese systems. China's current leadership, and especially the economic vision of China's President Xi Jinping, have been and will be represented in the development of relations with Israel, particularly as part of the Belt and Road Initiative (BRI). This was demonstrated by Netanyahu's successful visit to China in March 2017, which symbolizes a new era in relations between the two countries. During the visit, the new framework of relations between the two countries, which is now defined as an Innovative Comprehensive Partnership, was set in place, and it is the basis for further developing relations between the two countries. Furthermore, a visit by Chinese Vice President Wang Qishan in October 2018 marked another step forward in the relations, as he is the highest ranking official to visit Israel since 2000.

It is thus absolutely clear that the Chinese are interested in achieving technologies and connecting to the innovation "stream" flowing in Israel. In contrast, Israel's aspirations in its relations with China are less clear. There is no doubt that Israel, as a small country with a small market that is dependent on globalization processes, cannot ignore the China phenomenon. Israel should connect to the Chinese economy; the question is whether this is possible. Israel's experience over the past 27 years shows that developing business with China is no simple matter. In order to succeed in China, Israeli companies need a long term business horizon, patience, and the willingness to invest considerable capital. These are qualities that do not characterize the Israeli business or government sectors. Even though the Israeli government created a tool for assisting exporters and even established a special task force for developing economic relations with China within the Prime Minister's Office, no defined and measurable objectives have been set. It is still not clear if there is an overarching policy with clear goals that can be achieved.

Is it even possible for Israel, which is a free and open economy, to set economic objectives in its relations with an important country that operates according to different economic norms, like China? After all, no such objectives have been set regarding Europe or the United States. However, it seems that the Chinese arena is different from all other arenas in terms of business, politics, and culture, and thus with China it would be best to try to set goals, objectives, suitable tools, and an overarching strategy that are different from those that serve relations with the United States and Europe. Would it be best to consider advancing Israeli relations with Japan and India alongside relations with China, or would it be best to prioritize Israel-China relations over relations with other Asian countries? Another important question is Israel's relations with the United States, and how it would perceive strengthening Israeli relations with China, in light of the change in China's global standing. Therefore, can and should China replace Europe or the United States as Israel's main economic partner in the coming decade? These are weighty questions that require internal Israeli discussion at the government level.

A number of questions arise regarding trade and investment as well. China currently invests considerable capital in Israeli infrastructure and technology, and it is Israel's main trade partner after the United States. Negotiations are underway regarding a free trade zone agreement between Israel and China, which would undoubtedly be of great significance for the Israeli economy, but have tariffs between the two countries been the barrier preventing the development of Israeli exports to China over the past ten years? Would such an agreement truly help Israeli exports and advance the removal of tariffs as well as non-tariff barriers in Chinese regulations and bureaucracy? Most of the developed countries are currently addressing the China phenomenon with one level of success or another. Thus, it would be best to share information and learn from the successes and failures of other developed countries active with China.

Furthermore, China's Belt and Road Initiative, in which Israel has a critical role due to its geographic location, could provide substantial economic benefit. How to make the most of it for the Israeli economy in the coming years demands serious thought. Israel has already seen the impact and benefits of this initiative on its domestic economy, even if not everyone agrees that China's actions in Israel are actually part of the Belt and Road Initiative, rather than separate processes. China has penetrated into the Israeli economy in many fields, from expanding and operating ports to acquiring Israeli companies such as Tnuva, Adama, and Ahava, alongside investments in Israeli start-ups and venture capital funds. This raises the question: are all of these actions independent and purely economic, or are they organized and calculated steps as part of China's overall policy toward Israel? There is currently no clear answer to this question, but there is certainly room to discuss the significance of this massive presence of Chinese companies in different aspects of the Israeli economy in the short, medium, and long terms.

Conclusions

There is no doubt that the 21st century is the "Asian century," and we are likely to see increased Chinese activity and dominance in the global economy, against the background of the decline of the United States and Europe. The main challenge for Israel, therefore, is to identify where and how it is possible to harness China's strength for the benefit of Israel's national economic interest. In short, the Israeli economic interest is continued economic growth and prosperity and heightened standard of living, with full employment, increased economic productivity, and ongoing competitiveness. But can these objectives be achieved through cooperation with China? Presumably yes, and there is no reason that it wouldn't be possible to harness China's economic power toward the benefit and prosperity of the Israeli economy.

The future of economic relations between China and Israel does not necessarily depend on increasing the trade balance between them, as Israel had a trade deficit with China and the volume of imports from China continues to grow. The future, then, depends more on the attempt to create partnerships between Israeli and Chinese companies, although most of the production and cooperation itself will happen in China, and only a small portion will remain in Israel. Chinese companies can upgrade Israeli products and technologies, but it seems that most of the profit will remain in China due to regulatory restrictions on moving capital abroad, especially since 2017. Perhaps Israel will be able to develop joint Chinese-Israeli activity in the markets of third countries such as in Africa, whereby the technologies will be Israeli but the implementation and funding will be Chinese. But again, in such a model most of the profit will be received by the Chinese side and not the Israeli side.

China's investments in Asia and the Middle East as part of the Belt and Road Initiative are an opportunity for Israel. Israeli companies would do well to try to integrate directly or indirectly with local companies along the route of the Chinese plan in Asia and the Middle East. Advancing the integration of Israeli companies along the path of the BRI is a worthwhile national project that can bring immediate economic benefit, as well as a positive and stabilizing influence on the entire region. China's involvement in the Middle East and in Israel brings new types of interaction, different from previous encounters with superpowers. The challenge of the coming years is massive, and Israel must prepare for it carefully. Israeli economic activity, both government and private sectors, must be adapted to a completely different reality in which different and unfamiliar players create new centers of economic power. Thus, Israel must learn to navigate these new channels wisely.

Notes

1 Fergal Obrien, "China to Overtake U.S. Economy by 2032 as Asian Might Builds," *Bloomberg*, December 26, 2017, https://bloom.bg/2py4lk8.

2 World Bank, "United Nations Population Division. World Urbanization Prospects: 2018 Revision," https://bit.ly/2X3NB0A.

3 See "Central Bureau of Statistics, Imports and Exports, by Type of Goods – China," http://www.cbs.gov.il/www/fr_trade/d4t26.pdf [Hebrew].