



ISRAEL'S CHINA DILEMMA

How can Israel build trade and investment with China, without damaging ties with the US and Europe?

MY WIFE and I are visiting Shantou, China, where I will teach a week-long course on innovation to 80 Shantou University students.

Shantou, a city of some five million people, is smallish for China. The center of one of the country's four special economic zones where goods enter and leave freely, it is located in Guangdong Province, which has a population of 115 million. Many people from this region have migrated abroad (some to nearby Hong Kong) seeking business opportunities, which is why they are sometimes called "Jewish" by other Chinese.

My course is offered as part of the new Technion Guangdong Institute of Technology now being built within Shantou University and funded by Hong Kong billionaire Li Ka Shing, who was born in Shantou. (See *The Jerusalem Report*, November 7, 2013.)

Li Ka Shing, an eager investor in Israel's hi-tech industry, is linked with Horizon Ventures, a firm that invested profitably in the Israeli mapping company Waze, which was sold to Google a year ago for almost \$1 billion. In late April, Horizon announced

it was leading a \$10 million investment round in the Israeli start-up Tipa, a maker of biodegradable packaging for drinks.

In teaching young Chinese students how to become entrepreneurs, I face an interesting dilemma, both personal and national. On a personal level, I ask myself whether it is wise to help China become more entrepreneurial, thereby enabling it to compete with Israeli start-ups. On a national level, the dilemma is how Israel can build trade and investment ties with China, without damaging ties with the US and Europe, Israel's two biggest trading partners.

My host in Shantou, Prof. Lu Yuan, Dean of the Shantou Business School, has a clear answer.

"China's innovation will develop anyway, with or without Israel's help, since information technology eliminates boundaries and offers a borderless market to any entrepreneurship," he notes.

"Close to Shantou City, Shantou's neighbor city Jie Yang established a well known national e-bay village where over 80 percent of the population is engaged in e-trading of



commodities. If Israeli entrepreneurs take this chance to enter Shantou, it will indeed offer them great potential to develop business in China, as well as in the rest of the world."

The modern People's Republic of China



REUTERS

was founded in October 1949, more than a year after the State of Israel was born. In 1950, China and Israel recognized each other diplomatically, but the two did not exchange ambassadors for 42 years, until 1992.

President Shimon Peres visited China in

April and Prime Minister Benjamin Netanyahu took a trip to China in May 2013, the first such visit by an Israeli prime minister since 2007. In her recent Jerusalem Post Op-Ed, Chinese Ambassador to Israel Gao Yanping described Israel as “a happy

Workers process laptop accessories at a factory in Dazu, China, April 22

and innovative start-up nation with many cutting-edge technologies.”

Why should expanding Israeli trade with China irritate America and Europe? For starters, the US has severely clipped Israel's wings in all trade deals with China that are remotely related to advanced technology, fearing Israel will transfer advanced technology to America's strategic foe, tech-hungry China.

ISRAEL'S SALE to China of its Phalcon Airborne Early Warning System was cancelled in 2000 under pressure from the US and its deal to upgrade Harpy unmanned aerial vehicles sold earlier to China was cancelled in 2005 after an American ultimatum. Senior managers in Israeli defense-related companies cannot even visit China as tourists due to US pressure.

America's annual \$3 billion defense grant to Israel gives it major leverage, apart from the close strategic ties between the Pentagon and IDF. I have been told by experts that the Pentagon's war game simulations place China squarely in the center as America's primary enemy.

Dean Lu responds to this issue with Chinese pragmatism. “There are many areas for doing business with China without offending Israel's relationship with the US or Europe,” he notes, “for instance, in agriculture, food, civil engineering, and information technology.”

Last December, the business daily *The Marker* reported that the Prime Minister's Office, Foreign Ministry and Defense Ministry were all challenging America's limitations on exports of “dual-use” technology (products with both defense and civilian uses) to China. But, so far, they have had no success.

Second, there are discussions about selling some of Israel's newly discovered natural gas to China. While I find this unlikely, given the distances involved, the very idea will upset Europe, which is seeking new sources of energy to remedy its dependence on Russian supplies.

In 2013, Israel's exports to the US totaled \$17.6 billion, a full quarter of all exports. Because Israel imported only \$8.2 billion from the US, the trade surplus with America was \$9.5 billion. This surplus is crucial for Israel to balance its overall trade and is a major source of economic growth. This fact alone gives the US huge leverage over Israel.

Europe is a different story. Last year, Israel exported \$18.4 billion to the European

Union, but imported \$24.4 billion, leaving a trade deficit of \$6 billion. Similarly, Israel exported \$2.9 billion to China in 2013, but imported \$5.6 billion in goods and services. Exports to China rose 3.8 percent in 2013 with China accounting for 4 percent of Israel's exports.

THE COUNTRY IS MAKING A MAJOR PUSH TO TRANSFORM ITSELF FROM 'MADE IN CHINA' TO 'INVENTED IN CHINA'

So, Israel's dilemma is clear. Markets in America and Europe are stagnant but very large, while markets in China and Asia, in general, are relatively small but growing. Can Israel's trade with China be boosted, without hurting exports to the US and Europe at a time when the latter perceive China as a strategic rival? Can Israel reduce its large trade deficit with China without impairing its crucial trade surplus with America? If so, how?

Will Israel have the diplomatic savvy to become a bridge between the West and East? Will the US allow it to do so? And can Israel tap into China's enormous financial resources at a time when venture capital originating in the US is simply drying up?

If Israel needs China's huge market and its pool of money, what does Israel have that China wants and needs? Apparently, a great deal.

China is normally unforgiving to those who blemish its national pride. But despite Israel's cancellation of at least two signed contracts under US pressure, China continues to woo Israeli technology.

Under China's 12th Five-Year plan, 2011-15, the country is making a major push to transform itself from “Made in China” to “Invented in China.” In 2013, China invested \$220 billion in research and development, second only to the US. China's leadership and academic experts believe the country can learn much from Israel about fostering viral technology-based enterprise.

Here in Shantou, and earlier in Beijing, I encountered enormous curiosity about Israel's innovative spirit. China wants the recipe for Israel's secret start-up sauce. In my se-

ries of talks here, I am trying hard to explain that Israel's history and culture that drive its start-up spirit are unique, and argue that China must invent its own approach to invention.

Moreover, Israel has as much, or more, to learn from China than vice versa. The Chinese understand this, but are endlessly curious about the little country in a bad Mid-east neighborhood with a per capita Gross Domestic Product that is still three times China's.

At present, China is the world's factory for almost everything, making 91 percent of the world's personal computers; 80 percent of air conditioners; 80 percent of all energy-saving light bulbs; 60 percent of cement; half the coal; and almost half of all shipping tonnage. Virtually everything has a “Made in China” label.

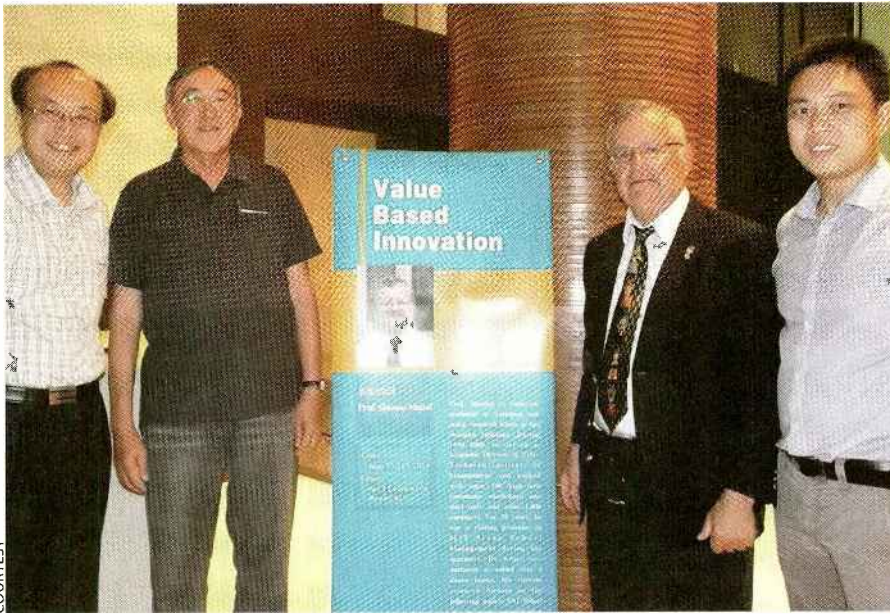
But China's leadership has a grand strategy – to move up the value chain. It seeks to invent and design its own equivalents of Apple's iPad and iPhone – not just produce them. This is why there is enormous interest in China in Israel's ‘entrepreneurvirus.’ China wants to catch it, too.

In the West, China's prodigious skill at manufacturing is widely feared, but that threat is diminishing as Chinese wages rise. According to official figures, the average annual urban wage for workers has more than tripled in the past decade from 14,040 yuan (about \$2,340) to 47,593 yuan (about \$8,000). As a result, some companies are moving their production elsewhere in Asia. Nike, the athletic equipment company, already employs more workers in Vietnam than in China.

The real economic threat to the West may lie in China's fierce determination to innovate and usurp the place high on the value chain now occupied by Western technology companies such as Apple and Microsoft. To this ambitious goal, China brings enormous resources (some \$4 trillion in foreign-exchange reserves), massive numbers of science and engineering graduates, and huge ambition.

CHINA DOGGEDLY keeps its currency undervalued at six yuan per dollar, when its currency's buying power justifies a rate of about four per dollar, to keep its exports competitive. China does this by buying dollars massively. In contrast, Israel's strong shekel is overvalued, at NIS 3.50 per dollar, hampering exports.

Recently, the financial weekly *The Econ-*



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Cooperation: (Left to right) Prof. Lu Yuan, Dean of the Shantou Business School; Dr. Moshe Marom, deputy site director for the Technion Guangdong Institute of Technology; Shlomo Maital and Dr. John Liang, Lu's assistant

omist published a chart showing the world's "economic center of gravity" – the point at which the world would balance, if each country's Gross Domestic Product represented the country's weight. For 1,500 years, the world's economic center of gravity was in Asia as China led the world in technology.

Inexplicably, an emperor decided to dismantle China's naval fleet and close its borders, perhaps fearing the instability technology brought. The economic center of gravity then moved westward, during the First and Second Industrial Revolutions, as China stagnated.

Now, notes *The Economist*, the center of gravity is on the move again, this time back toward Asia. China is already the world's second-largest economy and reportedly will replace America as the world's largest economy by the end of this year. And, in just a decade by 2025, the economic center of gravity will be securely back in Asia, taking just 75 years to retrace a path home to Asia that originally took 500 years in its outward journey.

With China's economy growing at 7.4 percent, while the European Union's growth is virtually zero and America's economy grew less than 2 percent in 2013, that center of gravity is quickly zipping home to Asia.

This is why China, and Asia in general, are so vital for Israel's future economic interests. And it is why Israel, too, is vital for China's

innovation initiative.

China understands well that in order for it to sustain its startling growth rates as wages rise, it can no longer rely solely on manufacturing. China must innovate, and it thinks Israel knows how.

AT INNOVEX 2014, a Tel Aviv innovation conference I co-chaired in January, I interviewed Prof. Dongmin Chen, Dean of the School of Innovation and Entrepreneurship at Peking University. Before a large audience, I asked him how Israel and China can do business together. He pointed out a "rabbit-and-elephant" problem: Chinese firms are accustomed to doing business with large organizations, but Israeli technology firms tend to be tiny start-ups so there is a big mismatch since rabbits and elephants rarely mate successfully. He suggested Israeli firms join together to approach China, but fiercely competitive Israeli entrepreneurs may find collaborating much harder than innovating new products.

Israel's political leadership seems utterly preoccupied with the failed negotiations with the Palestinian Authority. Even Naftali Bennett, the Minister of Economy, despite his start-up background and message that Israel needs to focus its energy on the economy rather than failed attempts at diplomacy with the Palestinians, has failed

to walk the walk and seems more focused on politics than on industry. This emphasis on short-term "urgent" vs. long-term "crucial" is crowding out the necessary time, effort and attention that Israel's China policy requires.

China must become Israel's top priority. Building long-term relations with China and other fast-growing parts of Asia will take huge patience, diplomacy and wisdom. I quickly learned here in China that, unlike in the West, business deals are driven not by legal contracts but by mutual trust built painstakingly over time. We Israelis are rather impatient – China, with its 5,000-year history, takes the long view.

The potential payoff for Israel is very large. I hope China will not become another missed opportunity fumbled by inept politicians. Even though Beijing is in the northeast corner of China, it is more than 1,000 miles closer to Tel Aviv than New York. China is the only major nation in the world that has never persecuted Jews; indeed, some of our family friends survived the Holocaust by fleeing east to Shanghai, where they were protected by China.

Across from the Forbidden City in Beijing, once home to Chinese emperors, there is a restaurant. It claims to have a big pot of soup that has been cooking continuously for 700 years – constantly renewed with meat and vegetables. This mixture of very old and very new characterizes today's China, as well as Israel, where Biblical prophets and leaders are, for many, vividly present in everyday life. This bond – two ancient cultures forging ahead with super-modern technology – is one of many that link tiny Israel and massive China.

My main message to my Chinese students, budding entrepreneurs, and to those who are building curricula on innovation and entrepreneurship is simple.

Here, I will say, are some things we've learned in Israel about start-ups, and here are some of the mistakes we made; here are a few of the ideas that worked and here are a few of the tools that can help; here are a few stories about ordinary Israelis who have done extraordinary things.

Think about it, but then follow Frank Sinatra – do it your way, the Chinese way, based on your long history and ancient culture. In the end, when you succeed, I will tell them, and so will Israel. ■

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