

# What to Do?

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## Commercial Diplomacy Strategies

MSc International Relations & Diplomacy

Master Thesis

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Economic diplomacy is now a standard practice. However, the strategies that countries use differ. This thesis examines if countries in the same income category, low middle, upper middle and high-income have similar strategy. It would follow from the literature that based on high-income status a more advance and integrated strategy is used. Research in this thesis concludes that especially the countries in the upper middle-income category are still traditional in their policy development and management, but when it comes to economic aid donors these countries have innovative programs in place.

## ACKNOWLEDGEMENT

This Master Thesis is the final product of two years studying international relations and diplomacy, at times a daunting task coming from a nonpolitical studies background. After two years, thousands of pages of knowledge richer, this thesis is a culmination of all past studies. Many find that the field of business and international relations are miles apart; to me they grow closer every day. The fields are interdependent of and on each other. With this thesis, I hope to contribute to the understanding of the relations to each other; economic diplomacy is the combination of both my master studies.

I would like to use this space to give thanks to people that have made the last two years possible. To the international friends that I was lucky to have met and to share experiences with, interactions with different cultures and characters enrich our lives, to the professors from Leiden University and Clingendael Institute, who challenged me and educated me. To the supervisors of this thesis, which on distance and online is not an easy task, but they still managed to support me. To the Royal Netherlands Embassy in Colombo that gave me the experience of a lifetime while at the same time allowing me a look into the inner workings of diplomacy abroad thus providing me with valuable insights. I am grateful to the expat and local staff members. Finally, I need to thank my parents who have always supported me no matter what decision I made. They were always there for me from the late night phone calls to the proof reading. Most of all I am grateful for their undying support and love.

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## ABBREVIATIONS

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BRICS	Brazil, Russia, India, China, South Africa
DAC	Development Assistance Committee
ED	Economic Diplomacy
EU	European Union
FDI	Foreign Direct Investment
FTP	Foreign Trade Policy
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
IMF	International Monetary Fund
LDC	Least-Developed Countries
MFA	Ministry of Foreign Affairs
NGO	Non-Governmental Organization
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing Power Parity
WTO	World Trade Organization

### ***Sri Lanka***

BOI	Board of Investment
CEPA	Comprehensive Economic Partnership Agreement
DOC	Department of Commerce
EDB	Export Development Board
EIU	Economist Intelligence Unit
ERD	External Resource Department
FTA	Free Trade Agreement
GoSL	Government of Sri Lanka
GSP+	Generalized Scheme of Preference
LTTE	Liberation Tigers of Tamil Eelam
MEA	Ministry of External Affairs
MED	Ministry of Economic Development
MIC	Ministry of Industry and Commerce

NAM	Non-Aligned Movement
UNHRC	United Nations Human Rights Council
<b><i>India</i></b>	
CII	Confederation of India Industry
DIPP	Department of Industrial Policy and Promotion
DOC	Department of Commerce
DPA	Development Administration Partnership
FICCI	Federation of Chambers of Commerce and Industry
GoI	Government of India
ITEC	Indian Technical and Economic Cooperation Program
MCI	Ministry of Commerce and Industry
MEA	Ministry of External Affairs
<b><i>China</i></b>	
CCIIP	China Council for International Investment Promotion
CIPA	China Investment Promotion Agency
GoC	Government of China
MFA	Ministry of Foreign Affairs
MOC	Ministry of Commerce
<b><i>South Africa</i></b>	
ARF	African Renaissance Fund
BEE	Black Economic Empowerment
DIRC	Department of International Relations and Cooperation
DTI	Department of Trade and Industry
GoSA	Government of South Africa
SADPA	South Africa Development Partnership Agency
TISA	Trade and Investment South Africa
<b><i>The Netherlands</i></b>	
EEAS	External Action Service
DGGF	Dutch Good Growth Fund
GoNL	Government of the Netherlands
MFA	Ministry of Foreign Affairs
NFIA	Netherlands Foreign Investment Agency

## INTRODUCTION

Attempting to study economic development is not an easy task. Depending on the academic field, one can choose to take either an economic or political angle. In the past however, both perspectives have neglected to look at each other's research in order to develop a more comprehensive understanding of the subject. What has become clear for practitioners in the field is that economic growth is linked to political decisions and influences, and politics itself is influenced by economics. Adding an increasingly global society and greater interconnectivity between nations into this mix, results in a complicated equation that either increases or halts economic development. Another debate concerning development is the question of 'aid' and/or 'trade'. The trade perspective argues that simply providing aid is insufficient: countries need to develop industries and require trade in order to do so. Those who argue in favor of aid over trade suggest that relying solely upon trade fails to address the many deep-rooted, underlying issues that poorer countries face, and ignores the fact that some countries are simply too poor to start industries. The least-developed countries (LDC) - the aid side argues - need injections of aid to kick start industries. A further argument proffered by aid proponents is that trade only benefits the developed countries while hurting the developing countries. Given the current economic crisis that has struck the global economy over the past few years, it is somewhat understandable that national constituencies are pressuring their governments to decrease development aid. International agreements to spend 0.7% of the country's Gross Domestic Product (GDP) on development aid are rarely realized, and the countries with the highest GDP have thus far never reached the agreed upon percentage.

Development aid comes with certain limitations: countries that move up from the LDC status and become low-middle income countries lose their eligibility for some grants and concessionary loans. These countries must then actively look for different options to contribute to their capital inflow. Likewise, developed countries are also looking for ways to increase their economic growth. They are looking at the new and up-and-coming economies to become part of their export basis. Many countries are looking for ways to combine an increased need for trade with their decreasing capacities in providing development aid.

Because of the downgrading of Official Development Assistance (ODA), countries such as the Netherlands are restricting their strategy towards developing countries. The lower middle-income countries are now the focus of an Economic Diplomacy (ED) strategy. Additionally countries such as India and China continue to classify themselves as developing nations deviate from the traditional development strategies. For them economic diplomacy is the development strategy. With economic diplomacy, becoming increasingly ingrained into the strategies of Foreign Ministries it may appear that economic diplomacy is a new concept. However, it has always existed. The first citizens that went beyond the borders of their (city) states were traders. Embassies, consulates, and honorary consuls were created to aid

these people, to provide representation and to assist in trading when necessary. Basic economic theories suggest that for countries to develop, they should specialize in producing those products in which they enjoy a comparative advantage and trade these products with other countries. What makes economic diplomacy unique are the inherent acknowledgement of political influence on economic decision making and the use of political power to further economic development.

There are various definitions, interpretations, and forms of economic diplomacy. Academically the study of economic diplomacy is nascent and much of the literature concentrates on the conceptualization of economic diplomacy and the measuring of effectiveness of trade missions and embassies. Little studied are the different strategies employed by different nations in diverging phases of economic development, which may provide some insight into how it is possible that some countries are successful where others fail. The strategy of the successful countries could provide a road map and guidelines for countries in the low middle-income group that want to enter the economic diplomacy playing field. However, it will also allow the established economic powers to better understand economic diplomacy strategies and tactics

### **Research question**

To gain a better comprehension of economic diplomacy, which could ultimately lead to a better understanding of political decision making, it is important to understand the difference the strategies that are applied by different countries. This reasoning leads to the following research question and will serve to guide the research process, in the end contributing to academia's understanding of economic diplomacy, through situational case studies. Moreover, a greater understanding of the different strategies of economic diplomacy that countries use will assist policy makers in developing economic diplomacy strategies. Furthermore, since economic diplomacy is a vast term that encompasses different elements a clear strategy overview will aid policy makers in understanding just what constitutes economic diplomacy.

The research question this thesis will answer is:

*Do the approaches to economic diplomacy differ between low-middle income countries, upper-middle income and high-income countries?*

Deriving from the main research question several sub-questions are formulated in order to guide the research process.

- What are the different approaches to economic diplomacy available to nations?
  - o What is the influence of non-state actors on the approach to economic diplomacy?
  - o To what extent does the level of development influence the approach?
- What approaches have been applied by low middle-income nations?
- What approaches have been applied by upper middle-income nations?
- What approaches have been applied by high-income nations?

### **Argument**

It would follow that countries in different stages of economic development will pursue different strategies in their economic diplomacy. At different stages of development, countries have different needs and wants. Additionally, depending on their level of development countries have different options available to offer to other countries. Developing countries may seek greater capital inflows, whereas developed countries may wish to expand their markets.

### **Outline**

The following section offers a review of the existing literature on economic diplomacy. This will be followed by the theoretical framework, in which the lens through which the cases will be studied is described and the hypotheses are formulated. The methodology, research design, case study justification, and limitations and scope of this thesis follow in the subsequent section. The main part of the thesis is the case studies: high and low middle-income countries are examined and evaluated. This thesis concludes by offering potential avenues for future research.



## LITERATURE REVIEW

Economic diplomacy is practiced by countries to advance their development. Low middle-income nations, like Sri Lanka and India, strive to move to the upper middle-income category of nations, which includes the likes of China and South Africa, who in turn wish to advance to high-income status. The last category (high-income), although having reached the highest income status as identified by the World Bank, continues to strive to increase their Gross National Income (GNI) on an annual basis. The key is that economic growth is part of the development of a country. Therefore, the first question that needs to be answered is: what is *economic development*? This concept is defined by Goldstein (1999) as “the combined process of capital accumulation, rising per capita incomes, the increasing of skill in the population, the adoption of new technological styles, and other related social and economic changes” (Goldstein, 1999, p. 555).

### **Economic Diplomacy**

The renewed interest in economic diplomacy can be found in the expansion and growth of globalization (Rana, 2007), however economic diplomacy is by no means a 21<sup>st</sup> century concept. As Okano-Heijmans (2011) mentions, the links between diplomacy and trade related disputes dates back to Peloponnesian war, when the government in Athens employed sanctions against Megara. Consular relations find its roots in the trade posts that were established in the city-states of Europe. The economic developments post-WWII, such as the creation of the Bretton Woods institutions and the increasing interdependence of economics has led to the fact that the countries have to interact with each other in the economic markets. Even states such as North Korea are subjected to a form of economic diplomacy.

### **Tensions**

In economic diplomacy, three tensions are often present. Bayne and Woolcock (2011, p. 10) identify them as tensions between economics and politics, international and domestic pressures, and government and other forces. Governments need to find some balance between these somewhat opposing issues for their economic policies to be effective. With regard to the first tension - economics and politics - as Bayne and Woolcock state, all economic objectives that states are trying to pursue are related to politics, a prime example being the United States’ (US) post-WWII Marshall Plan. By giving aid to the destroyed countries, they tried to minimize the influence of the communists while simultaneously strengthening the bond between the European countries and the US. Political decisions have consequences for economics. However, economics also has an influence on political decisions both internationally and domestically. With a new economic power rising we see that some of these countries would like to increase their political power as well. It is also noticeable that some previous economic powers are hesitant to give up crucial political seats in international organizations (Bayne and Woolcock, 2011). An example of this is the current structure of the United Nations Security Council (UNSC).

Okano-Heijmans (2011) adds to this observation that new governments are more likely to promote new economic programs and willingness to change, whereas when governments face reelection they might prefer to continue a strategy that has proven to be successful.

Internationally, liberalizing markets would create economic growth as economists state that removing trade barriers is beneficial for all countries. Removing or creating such barriers (to promote your national industry) is a political decision. This highlights the second set of tensions, international and domestic pressures governments face when making economic policy decisions, which Bayne and Woolcock (2011) see as the ultimate tension. With globalization and the interdependence of economies only increasing the world economies have grown, but also have become more vulnerable. The expression, that if the stock exchange in Tokyo sneezes, the markets in Europe are experiencing a cold, and the New York stock exchange has the flu rings true. This has made countries dependent on, and responsible to each other. The continued integration of international organizations has contributed to this. Very few countries are for example not part of the World Trade Organization (WTO). Because of this increasing dependence on each other domestic decision-making has changed. When it concerned foreign political strategies, the ministries of foreign affairs (MFA) took the lead. Other ministries handled international economic strategies with the MFA looking for ways to meaningfully contribute (Bayne & Woolcock, 2011).

During international negotiations, it becomes clear that different levels are influencing the negotiations. In its most simplistic form this relates to Putnam's two-level game, in which the domestic pressures and negotiations to reach one strategy influence the negotiations on an international level, and where the negotiations on the international level once again influence and put pressure on domestic politics.

The last tension that has influenced economic diplomacy is the tension between governments and other forces. Bayne and Woolcock (2011) listed as other forces, the private sector (traders, investors, and financiers), and social movements such as Non-Governmental Organizations (NGOs). The first group pressures the national governments for legislation that is favorable for growth, but it has also shown that governments are more and more looking at the markets and can feel pressured by them, delaying decision making and potentially causing governments to lose their credibility with the constituency.

The NGOs have both a positive and negative influence on economic diplomacy. On the positive side they can offer knowledge and expertise to governments. On the negative side they are “destructive and anarchistic” (Bayne and Woolcock, 2011, p. 12), seeking to stop world trade and the advancement of globalization. The riots in Seattle at the 1999 WTO meeting are an example. The ‘occupy’ movement is another example of a force that is pressuring the government. Okano-Heijmans summarizes that “economic diplomacy cannot be seen as separate from the domestic context (of both sender and receiving state) and the activities of the states as influenced by other actors, such as private business and other interest groups” (Okano-Heijmans, 2011, p. 16).

### **The New Economic Diplomacy**

Classically, diplomacy is defined as “the conduct of relations between states and other entities with standing in world politics by official agents and by peaceful means” (Bull 1995, p. 156 As in Bayne and Woolcock).

The developments in the academic field of economic diplomacy are mirrored by the developments in the wider diplomacy field. Increasingly the term “new” is used in conjunction with (public/economic) diplomacy. The major change that this indicates is that the scholars and practitioners are looking beyond the traditional diplomats. Greater groups of people are now considered diplomats, to such an extent that tourists on vacation can be considered ‘diplomats’. An updated definition is then “Diplomacy is concerned with the management of relations between states and between states and other actors” (Barston 2006, p. 1 As in Bayne and Woolcock)

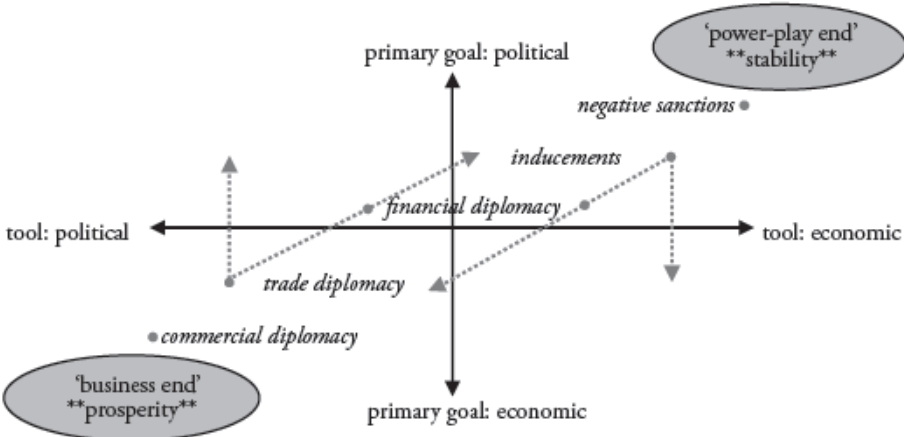
What this means is that the way states conduct business, and what affects their image is no longer solely their foreign policy, but encompasses the behavior of people and companies too. Bayne & Woolcock, Okano-Heijmans and others have in their research highlighted the tension between governments and other actors in diplomacy. In economic diplomacy, especially, these other actors play an increasingly important role.

### **Economic Diplomacy: The Power- Play End vs. The Business End**

Considering the aforementioned tensions it becomes clear that broadly speaking economic diplomacy is defined as “the use of international political tools to obtain economic objectives” (Yakop & van Bergeijk, 2011). This definition encompasses all the different strands of economic diplomacy. In one of the first works of its kind Okano-Heijmans (2011) identified that economic diplomacy has “a business end and a power-play end, and all tools of economic diplomacy can be placed somewhere between these two extremes” (Okano-Heijmans, 2011, p. 16). This is visualized in figure 1. The power-play end of the spectrum represents the actions driven by political motives and strategies by governments, for example the practices of imposing or lifting sanctions. Actions on this side of the spectrum are referred to as ‘economic statecraft’. All actions related to advancing the national economic interest, usually a joint

effort by the government and the private sectors, can be found on the business end. This end of the spectrum is referred to as commercial diplomacy. The term economic diplomacy is widely used. However, based on Okano-Heijmans’ conceptualization, it becomes clear that economic diplomacy is an umbrella term. Many times when governments speak of economic diplomacy, they actually mean commercial diplomacy. This thesis will then also focus on the commercial diplomacy and to a lesser extent on the power-play end. However, it is important to understand the wide area between the power-play and business ends. In between there are all the instruments and strategic activities of government that are a combination of both extremes. As Okano-Heijmans concludes “the distinction between the different strands is fluid and strands may overlap – implying that economic diplomacy is not linear, but more a network concept” (Okano-Heijmans, 2011, p. 17). This holds especially true when comparing the difference in strategies between old and new economic powers. The dotted lines in Okano-Heijmans’s figure then also indicate the fluidity of economic diplomacy.

**Figure 1: Business End & Power-Play End**



**Source: Okano-Heijmans, 2011, p. 18**

## Commercial & Trade Diplomacy

As explained in the previous section, commercial and trade diplomacy form part of the complete scope of economic diplomacy. Both types are leaning more towards the business end of the spectrum. Commercial diplomacy is “the use of government relations and government influence to stimulate international trade and FDI” (van Bergeijk, & Moons, 2011, p 3). This definition excludes the new actors in the diplomacy field, the private sector. Okano-Heijmans (2011) identifies the different tools that are available for the different strands for commercial and trade diplomacy, as demonstrated in figure 2.

**Figure 2: Commercial and Trade Diplomacy**

<b>Commercial Diplomacy</b>	<b>Trade Diplomacy</b>
Trade Promotion	Bilateral: FTAs, EPAs,
Investment promotion	multilateral WTO
Business advocacy	(anti-dumping) tariffs
Tourism promotion	Export or import licensing
Promotion of social responsible investing	Import or export quotas, trade and investment barriers

**Source: Okano-Heijmans, 2011, p. 20**

Parts of economic diplomacy, especially commercial and trade diplomacy are based on bilateral relationships between nations. Because of this the strategies countries use are different, depending on the current economic and political ties to their counter party (Bergeijk, & Moons, 2009). All strands of economic diplomacy, but especially commercial and trade are about a constant interaction between inward (attracting FDIs) and outward (increasing export markets) facets of diplomacy.

Especially in the business end of economic diplomacy, it is important to consider the non-governmental actors. Ministries do not solely conduct it; semi-government institutions, such as chambers of commerce and export promoting agencies, are also involved. The private sector plays an enormous role, as do think-thanks. How involved the private sector is in the country’s economic diplomacy strategy varies from country to country. However, as Okano-Heijmans concludes “Countries are more successful in economic diplomacy if they increase the number of activities, conceive of new ways to conduct economic diplomacy, or terminate activities that have proven unsuccessful” (Okano-Heijmans, 2011, p. 19)

Additionally, the internal government strategy to economic diplomacy varies. In lesser-developed countries, the government mainly conducts economic diplomacy, even though their foreign ministry usually does not have a coherent strategy that promotes exports or attracts FDI, and this is usually left to the economic development ministries with very little coordination between the different ministries. In developed countries, economic diplomacy is starting to become integrated into the foreign ministry, for example in the Netherlands, the department dealing with business promotion of the Netherlands moved from the ministry of economics to the ministry of foreign affairs. In the end, as Okano-Heijmans (2011) states “To be successful in economic diplomacy, any government must resolve such trade-offs in accordance with the balance of national interests and its foreign policy strategy at large. Careful management of linkages and continuous investigation of existing and potential economic diplomacy activities are thus of utmost importance” (Okano-Heijmans, 2011, p. 20).

## THEORETICAL FRAMEWORK

### **Economic Diplomacy Strategies**

There are four approaches to an economic diplomacy strategy: traditional, niche-focused, evolving, and innovative. Rana (2007) based these typologies of strategies on the experiences that the G77 countries have with economic diplomacy. The factors that he bases the strategies on are more concerned with the business end over the power-play end.

The difference in strategy can be found in the way they address the external management of the economy, who manages the policies, the roles that non-state actors play or are allowed to play, how they handle economic aid - either as donor or as recipient - and who handles the promotion of trade, and investment. A *traditional strategy* means that countries “have remained mired in conventional methods, only implementing slow change” (Rana, 2007, p. 15). The countries that have found a niche market and have adjusted their economic diplomacy strategy on that market are considered, *niche-focused*. The countries that “have adapted themselves to new opportunities with structural changes and clear actions” (Rana, 2007, p. 20) are considered to be *evolving*. Lastly, the countries that are *innovative* according to Rana (2007) “have moved to the forefront with cutting edge techniques and continual reform” (p. 20). Rana does acknowledge that strategies employed by governments are not as definitive as he presents them. But according to him, these strategies show a learning curve. Although Rana found the basis of his typologies in the G77, this does not exclude the developed nations from being evaluated under these strategies. Although developed nations might be familiar with commercial diplomacy, it cannot immediately be assumed that they do not have a traditional or niche strategy. For an overview of the strategies and the corresponding variables see figure 3.

To be successful in economic diplomacy several criteria need to be present. A good economic diplomacy strategy goes beyond the governmental instruments, and non-state actors are of utmost importance. Rana identified the following as stakeholders and first movers: “business units of the country, associations of industry and chambers of commerce, the financial sector, business schools and think-thanks, the tourism industry and a host of domestic actors” (Rana, 2007, p. 3). It is however up to the (semi)government to create viable public-private-partnerships. When countries are successful doing that domestically, they are more likely to be able to replicate a good relationship with non-state actors abroad.

The situation for developing countries, the lower and to a certain extent the upper-middle income countries, are faced with a situation in which the MFA’s role is diminished in foreign policies. Ministries such as defense and economics gain control over the decision-making on the foreign policies. Add to this the practices of political appointments of ambassadors, sometimes family members of the ruling party, and high military officials. Because of this, the overseas network of embassies and consulates is not used to its fullest potential.

The second factor necessary for success in economic diplomacy is the harmonization or integration of the MFA's operations and international economic management. Possible ways of achieving this have been proposed. Countries have the option to integrate trade diplomacy with the MFA policies, but the activities that fall under commercial diplomacy are handled by a separate entity, that is possibly outside of the ministry. Nations also have the option to integrate all economic diplomacy instruments within the MFA. Another option for countries is to create joined-up commissions between the different ministries. An option for smaller states is to create a regional mechanism and conduct trade diplomacy as a group. The potential consequence of no harmonization is a power struggle between the different ministries. Rana suggests that the reason why ministries in some developing countries are not harmonizing is because of the "institutional weight of traditional systems" (Rana, 2007, p.5).

Third, as countries move from a traditional to a more evolving strategy, the embassy network becomes an active player and they have to represent the whole government not just the MFA, although these will remain their direct supervisors. Developing countries have, according to Rana, work ahead of them in order to achieve a better representation of the whole government. Of course, the extent to which embassies have the capabilities to represent all ministries depends greatly on the size of the embassies and the importance of the bilateral relationships. A final ingredient to be successful in diplomacy in general is that the countries' diplomatic structure needs to have a drive, which includes or requires being staffed with motivated and qualified civil servants to move forward.

### *Hypotheses*

Based on the learning curve, combined with the GNI income classifications, as will be explained in the next section, the following hypotheses were developed. Considering that Rana built his framework on the experience of the G77 countries, it follows that countries that form part of this group and with a lower GNI ranking are lower on the learning curve and would apply the traditional approach. Countries that are up-and-coming economic powers, ranking higher on the GNI measurement would have adapted an evolving strategy to continue to grow. Whereas in contrast high-income nations have an innovative approach, as they are looking for ways to expand their markets and make optimal use of their existing networks.

**H1:** Sri Lanka and India have a traditional approach to economic diplomacy.

**H2:** China and South Africa have an evolving approach to economic diplomacy.

**H3:** The European Union has an innovative approach to economic diplomacy.



**Figure 3: Economic Diplomacy Strategies**

	<i>Traditional</i>	<i>Niche-Focused</i>	<i>Evolving</i>	<i>Innovative</i>
External economic management	Handled by the trade & economic ministries; little involvement of the MFA	Promotion concentrates on the identified niches	Some coordination between trade and MFA contestation also likely	Joined-up and other cooperative arrangement
Policy management	Limited role for MFA, frequent turf battles	Good internal coordination	Inter-ministry or cabinet level coordination tending toward improvements	Institutionalized management, strong teamwork
Role of non-state actors	Episodic, depends on personalities	Variable	New procedures, strong networking	Harmonization with all stake holders
Economic Aid: Recipient	Handled by economic agencies, seldom coordination's with MFA	Limited coordination	Networking between the aid management agency and MFA	Graduation out of aid receipt or close to that stage
Economic Aid: Donor	Unlikely to be an aid donor	Unlikely to be and aid donor	Modest program, usually covering technical cooperation	Expanding program, run by MFA in harmony with trade promotion agency
Trade promotion	Often handled by a commercial cadre, outside of MFA control	Limited focus on commercial promotion, outside the nice area	Cooperative arrangement, often integration of political and economic work	Well-coordinated activities, role model in range of activities
Investment promotion	Handled by domestic agencies, limited role of the diplomatic system	Active use of embassy network	MFA and embassies work actively with home agencies, often at individual initiative	Strong team efforts based in institutional arrangements

Source: Rana (2007)

### **Domestic/Two-level Game Approaches**

Due to the growing interconnectivity of the world's economies, and the increasing number of international agreements, the domestic pressures on governments in economic diplomacy are increasing as well. Since the publishing of Putnam's *Diplomacy and domestic politics: the logic of two-level games* in 1988, we have come to realize that there are great links between international decision making and domestic decision making: "Former Secretary of Labor John Dunlop is said to have remarked that "bilateral negotiations usually require three agreements- one across the table and one on each side of the table" (as cited in Howard Raiffa, *The Art of Science of negotiations*( p. 166) in Putnam's 1988, p. 433). 'Two-level' refers to the two levels of pressure. Level I is the international level, Level II is the domestic level. "At the national level, domestic groups pursue their interests by pressuring the government to adopt favorable policies...At the international level, national governments seek to maximize their own ability to satisfy domestic pressures" (Putnam, 1988, p. 434). Governments can also use pressure from the international level to get international agreements ratified. It follows that with increasing use of non-state actors in policy making their ability to pressure the government also increases.

What must be noted is pressure on the government is not exclusive to democratic societies. Even though the government is the central and sole decision maker in many developing countries, this fact does not exclude some influence by the private sector in the form of bribery and favors. Publically/Officially, in such countries, the private sector might have little to no influence, or the governments pretend to simply not care. However, behind the scenes a complicated network of patronage might be in place.

*Hypotheses:*

**H4:** Non-state actors play a greater role in economic diplomacy of high-income countries

**H5:** Domestic pressures have a greater influence on economic diplomacy of high-income countries

## METHODOLOGY & RESEARCH DESIGN

The literature in the field of economic diplomacy remains somewhat elementary, with the majority of the literature thus far focusing on the conceptualization and development of economic diplomacy theory. The number of in-depth case studies is therefore limited. The cases in this research are selected on the independent variable, income level, and the availability of information, issues which inherently lead to the problem of selection bias. However, because this thesis contributes to the development of economic diplomacy theory, while also providing guidance to policy makers about strategies employed by other nations, this limitation is not insurmountable.

### **Case Selection**

The cases were selected based on the gross national income (GNI) classification developed by the World Bank. To divide the world's economies the World Bank employs the Atlas method, which reduces the influence of exchange rate fluctuations. This method takes the "average of a country's exchange rate (or alternative conversion factor) for that year and its exchange rates for the two preceding years, adjusted for the difference between the rates of inflation in the country" (World Bank, 2013).

This leads to the following categories in 2012 of GNI per capita:

- High-Income: \$12,616 or more
- Upper middle-income: \$4,086-\$12,615
- Lower middle-income: \$1,036-\$4,085
- Low-income: \$1,035 or less

*High-income countries: European Union (the Netherlands)*

For the high-income category, the European Union (EU) was chosen, the region where the sovereign nation state was created and developed. The EU makes for an interesting case as the countries operate under a common market, an open border scheme, and for some even a common currency. Decisions on economic diplomacy, such as trade tariffs, are therefore not negotiated on an individual country level but at the supra-national level. The EU is the representative of the countries at the WTO, while in other economic forums such as the G-20, countries represent themselves. European countries therefore, are faced with the interesting notion of having an economic diplomacy strategy articulated at a supranational, as well as national level.

The justification for choosing the Netherlands out of the EU's 28 member states is as follows: The Netherlands is a high-income country, ranking in the top ten of the World Bank 2012 GNI index. As a small country, the Netherlands has always been a trading country, and views itself as the gate-way to Europe, with one of the world's biggest harbors. To continue to grow and develop, the Netherlands is dependent on the world market. Additionally, after the last parliamentary elections (2012), budget cuts have increased the need for the Netherlands to invest in trade with nations rather than giving aid.

### *Upper middle-income countries: China & South Africa*

From the BRICS (Brazil, Russia, India, China, and South Africa), China and South Africa were chosen in order to study how their different approaches to economic growth affected their respective economic diplomacy strategies. China prefers to see itself as a developing nation, yet it has used its substantial economic and political power in its various territorial conflicts with neighboring countries. Since the end of its apartheid regime in the 1990s, South Africa has been growing and developing. However, this does not mean that all layers of society have equally benefitted from this growth.

### *Low middle-income countries: Sri Lanka & India*

Although India is a growing economic power with increasing political and regional influence, it remains, by the World Bank's GNI standards, a low middle-income country. Societal divisions continue to plague India, with the differences in opportunities and living standards between the different castes acutely visible. Furthermore, although the country's gross income has increased, the sheer number of citizens means that India is still considered a developing nation.

Sri Lanka's economic history is complicated and highly correlated to the political party in charge. Policies that are introduced by one government are often reversed by the next. After the end of its civil conflict in 2009, the country has shown tremendous GDP growth, albeit it has slowed down in the last year. The country is currently searching for ways to increase growth and to create sustainable economic growth. Additionally, although the country has a long history of Western interference/involvement (being colonized by Portugal, the Netherlands, and the United Kingdom) it is moving away from this influence and it is strengthening its bonds with countries in the region, particularly China.

### **Method**

This thesis will apply the method of process tracing. The advantages of process-tracing are that it will allow for generating observations within the case. Process-tracing is a method to test as well as develop theories. The disadvantage of process-tracing is that a "strong basis for casual interference [can be made] only if [the method] can establish an uninterrupted casual path linking the putative causes to the observed effects" (George and Bennett, 2005, p. 222). Since the cases in the different categories are not perfectly matched, process tracing is the best option to "strengthen the comparison by helping to assess whether differences other than those in the main variable of interest might account for the difference in outcome"(George and Bennett, 2005, p. 81). Together with Mill's method of difference, this will help to establish why the two countries in the same income category have applied a different strategy to commercial diplomacy. In Mill's "methods of difference the investigator employs the logic of elimination to excluded as a candidate cause (independent variable) for the variance in the outcome (dependent variable) any condition that is present in both cases"(George and Bennett, 2005, p.156).

The dependent variable is the strategy that is employed by the case studies. The independent variables in this thesis are: External economic management, Policy management, Role of Non-state Actors, Economic Aid: recipient/donor, Trade promotion strategy, and Investment promotion strategy.

### **Data Collection**

The data for this thesis stems from previous in-depth case studies by other researchers. For the case studies of the Netherlands and Sri Lanka, data will additionally be drawn from in-depth interviews with academics, professors from the University of Colombo specializing in International Relations and Economics, senior researchers from research institutions, and practitioners in the field of economic diplomacy. These interviews provide an insight into economic development and underlying causes of development, as well as obstacles to further development that cannot be gained from articles, books, and statistics. The interviews were conducted under the Chatham House rule, allowing the interviewees to speak freely, and make predictions about the future. The Chatham House rule is necessary since the government is highly critical of people speaking out against the government and its policies. Sri Lanka is ranked 162 out of the 179 countries on the World Press Freedom Index (Reports without Borders, 2013).

Statistical information about economic development, and strategies that the countries are using was gathered from the following sources.

- Multilateral Institutions such as the WTO, the IMF, and the World Bank.
- Government sources
- Non-Governmental Organizations (NGOs) and research institutions such as the International Alert and the Economist Intelligence Unit (EIU) which provide reliable economic forecasts and information about development and economic decision-making.

### **Scope and Limitations**

The scope and limitations of this thesis are related to the lack of available case studies in order to make controlled comparisons. Once the theory of economic diplomacy is more established and tested, it will follow that more case studies will be carried out to test the theory. Thus far, economists and academics have been trying to establish whether economic diplomacy leads to economic growth. Though there is evidence that economic diplomacy leads to increased trade, and that embassies and consulates play an important role in this, the research has also shown that this role depends on the different income levels of the countries.

This thesis will focus on the business end of economic diplomacy, concentrating on the commercial and trade diplomacies strategies. Additionally, the influence of the domestic level will be researched. Despite the limitations and the narrow scope of this thesis, this research will help towards the development of economic diplomacy theories and support policy makers and practitioners in the field (embassies, consulates and ministries) to adapt the strategies of their country towards other countries.

## CASE STUDIES

### **Lower middle-income**

#### *Sri Lanka*

To understand Sri Lanka and its commercial diplomacy strategy requires understanding the recent history of the island. Former Ceylon declared independence 65 years ago in 1948. Its independence came after a long period, nearly 450 years, of colonial rule. After nearly two decades of violence, precipitated by riots in the summer of 1983, followed by multiple outbursts of violence a peace agreement was reached in 2002 with the Liberation Tigers of Tamil Eelam (LTTE), at that time the dominant military party fighting for a separate Tamil state. However, this agreement was short lived and the fighting restarted. In 2009, President Rajapaksa defeated the LTTE with a comprehensive military victory, ending the three-decade long internal conflict. This is not to say that underlying tensions are not still present: some commentators refer to Sri Lanka as post-conflict state whereas others label it a post-war state, as they believe that the current government has not taken seriously its responsibility to address grievances of many in Sri Lanka. Another important aspect of Sri Lanka's history to take into account is the two uprisings within the Sinhalese population (during the 30 years conflict), which were driven by the economic insecurities of the youth population as opposed to the ethnic driven conflict with the Tamils.

A few important families have influenced politics in Sri Lanka, as in more Asian countries. Currently the most important one is the Rajapaksa family. To a certain degree, favoritism has always occurred but the current President Mahinda Rajapaksa has increased the nepotism and patronage for the Rajapaksa family clan immensely. A total of 75 family members, immediate and extended, have taken up positions in the government. The family controls about 70% of the total Sri Lankan budget (Colombo, 2013).

The three main pillars of the current Government of Sri Lanka (GoSL) are President Mahinda Rajapaksa; also the minister of defense and finance, and ports and highways. His brother Gotabaya Rajapaksa is the defense secretary, the second highest position in the ministry after the minister. His other brother Basil Rajapaksa is the cabinet minister of economic development. Additionally, his brother Chamal Rajapaksa is now the speaker of the parliament, and before that the minister of ports and highways. His brother, Chandra Rajapaksa is the private secretary to the minister of finance (which is the president). The president's son, Namal Rajapaksa is a member of parliament for the Hambantota district, which is the home base of the Rajapaksa family. The president's extended family holds positions as the ambassador to the USA (Juliya Wickramasuriya) and to Russia (Udayaanga Weeratunga). Surprisingly, there seems to be no direct family connection between the ambassador to China (Ranjith Uyangoda) and the Rajapaksans. This concentration of power around the Rajapaksa family is a concern for the institutional stability in the long-term (Economist Intelligence Unit, 2013i). President Mahinda Rajapaksa

is expected not to run into any problems until the next elections in 2015. It is expected that he will win the next elections, based on the fact that he managed to end the conflict (EIU, 2013). Hence, the current situation of the political system being controlled by a selected few is likely to continue.

Domestically, the GoSL likes to portray that the world is against Sri Lanka, and uses the recent UN Human Right Council (UNHRC) resolutions to reinforce this. Since the end of the conflict and the resolutions, relations with the western nations have remained tense. While the current government is increasing ties with China, it seems that the century old bond with India is going through a somewhat turbulent period. India's support of the UNHRC resolutions did not aid in improving the bond. Additionally, the country has been a long-standing member of the Non-Aligned Movement (NAM). The movement's core ideology of not aligning themselves with one of the great powers still has an effect on the GoSL's position with regard to other countries (Colombo, 2013). The whole movement is quite unknown in the Western World and hardly discussed when talking about international organizations, but in Sri Lanka great emphasis is placed on their membership.

#### External Economic Management & Policy Management

To understand how policy is made in Sri Lanka one must know that the cabinet consists of 66 ministers, including the president who is himself responsible for three ministries. Out of these ministries, it has become clear that the Ministry of External Affairs (MEA) has almost no influence on the economic development policy. The development policies in Sri Lanka are based on the Mahinda Chintana Framework that was published after the president was reelected into office in 2010. "The objective of our next massive leap forward is to transform Sri Lanka into a strategically important economic centre of the world. My determination therefore, is to transform Sri Lanka to be the Pearl of the Asian Silk Route once again, in modern terms. Using our strategic geographical location effectively, I will develop our motherland as a Naval, Aviation, Commercial, Energy and Knowledge Hub, serving as a key link between the East and the West" (Government of Sri Lanka, 2010, p. 11).

The overall economic development policies are created within the Ministry of Economic Development (MED). However, the Department of Commerce (DOC) inside of the Ministry of Industry and Commerce (MIC) handles trade diplomacy. Their mission is "To develop and promote Sri Lanka's foreign trade relations at bilateral, regional and multilateral levels by the effective implementation of government trade policy, with a view to raising the standards of living and realizing a higher quality of life through the increase of total production, income and employment levels, thereby actively contributing to the overall economic growth of Sri Lanka" (Government of Sri Lanka, Department of Commerce, 2013). Under the DOC's guidance the trade officers at the embassies are instructed and guided. Two current issues in trade diplomacy highlight the inefficiency of the current government strategy. In 2010, Sri Lanka GSP Plus (Generalized Scheme of Preference) from the European Union was temporarily

withdrawn becoming permanent when the original agreement ended in December 2011. After the European Commission had made the decision, Sri Lanka had six months to contest the findings and to overturn the decision (Council of the European Union, 2010). However, the GoSL decided not to act. Since then the apparel export sector has lost around \$750 million annually. Recently, conflicting stories about the GoSL reapplying for the GSP+ have made the news. The opposition and export associations have argued that the GoSL should do so, whereas the government, through the Secretary to the Treasury (P.B. Jayasundera) has said that it will not reapply for GSP+.

The second issue that highlights Sri Lanka trade diplomacy tactics are the two Free Trade Agreements (FTA's) it has signed (India and Pakistan). India and Sri Lanka signed a FTA in 1998. To increase the value and to capitalize even more on the FTA negotiation rounds took place to expand the agreement and to come to a Comprehensive Economic Partnership Agreement (CEPA). Negotiations were finalized in 2008, and the four objectives under the CEPA are the "widening and deepening of the existing FTA, establishing an agreement on trade in services, including measures for promotion of investment in each other's countries, and enhancing economic cooperation" (Fernando, 2012). Since then the agreement is waiting to be signed and it is figuratively speaking gathering dust (Colombo, 2013). Although the opposition is arguing for the government to sign the agreement the minister of economic development Rajapaksa (Basil) went on record and said that the agreement was no longer necessary as both countries have moved on. Again, this occurred without any public statement from the MEA or MIC.

These issues and the fact that multiple ministries are involved with policy making and execution, leads to the conclusion that the external economic management is handled by the trade and economic ministries, with little involvement by the MEA. This indicates a *traditional* strategy in the Rana's framework. On the policy management side, in the GoSL there is unquestionably a limited role for the MEA, indicating a *traditional* strategy as well.

#### Role of Non-State Actors

The role of non-state actors as an influence on the government has fluctuated. In the past, under the more liberal governments, academics and think-tanks had more influence on policy making, and the government would consult with them (Colombo, 2013). Under the current government, with only a selected few making the decisions, the think-tanks and research centers publish reports and critical papers, but the government does not seem to take these into account. The private sector's influence is also minimal: this however, does not stop it from discussing how to improve Sri Lanka's economic development or offering solutions to try and urge the government to look critically at the export and investment strategy. The export sector would like to see the GoSL reapply for the GSP+ scheme, and they understand the economic losses that Sri Lanka has incurred since its removal. Formally, the government takes the opinions of the numerous chambers of commerce into account. However, whereas the oldest and



most respected chambers offer direct and clear opinions, the smaller and newer chambers are known for agreeing with the opinion of the decision-makers to ensure funding for their organization (Colombo, 2013).

Taking the above into consideration it becomes clear that Sri Lanka under the current government is not considering non-state actors, let alone allowing domestic pressure to influence their international decision making. Advice will be asked and to a certain degree influence policymaking, but the two-thirds majority that the government enjoys means that any decision the top influencers would like to take will be pushed through. Sri Lanka in that sense follows a *traditional* strategy to commercial diplomacy.

### Economic Aid

In 2006 the Sri Lankan government manipulated its economic figures to move up from low-income country to low-middle income country status (Colombo, 2013), meaning that much of the development cooperation funding was no longer available. Since then the government has approached the up and coming new aid donors more frequently. However, since these countries, mainly China, offer loans sometimes at concessional rates and at other times at market rates, the debt burden of the country has significantly increased over the past years. The loans are being used to improve the infrastructure of Sri Lanka, some projects such as the airport and the harbor have a “build it and they will come” idea, however, the locations of these massive projects are questionable. Many of the projects with a Chinese aspect have a clause that Chinese materials, and sometimes labor needs to be used (Colombo, 2013).

The economic aid coordination is handled within the Ministry of Finance, by the External Resource Department (ERD), which is “responsible for mobilizing and coordinating foreign assistance to Sri Lanka” (GoSL, External Resource Department, 2013). They do this on the basis of the policy set out in “the Development Policy Framework of the Government of Sri Lanka; “Sri Lanka – The Emerging Wonder of Asia”” (GoSL, External Resource Department, 2013). The department is responsible for all aspects related to aid, from negotiation of the loans and grants, implementation, monitoring, to the management of the expats and volunteers, and evaluation. Through this comprehensive approach, they are in coordination with the necessary line-ministries. However, little coordination with the MEA seems to be present. Considering the lack of coordination with the MEA and the fact, and that the management and control of the foreign assistance strategy is left to the finance ministry, it is possible to conclude that Sri Lanka applies a very *traditional* strategy to economic aid as a recipient as suggested in hypothesis 1.

### Trade Promotion & Investment Promotion

Two institutions are responsible for promoting exports and attracting investments. FDI's are considered to be a vital component of the economic development strategy as laid out in Mahinda Chintana. The Board of Investment (BOI) is the government agency responsible for attracting foreign investments. The BOI was created as a one-stop-shop for foreign investors, cooperating with the different

ministerial departments and the private sector. Corporations that sign contracts with the BOI are guaranteed to remain valid, meaning that succeeding governments will not be able to change the terms. The BOI, although responsible for attracting investor into the countries, promotes the fact that the companies that form part of the BOI are responsible for 65% of all exports. The BOI is tasked with attracting investments in targeted sectors, and currently they are focusing on companies that are export oriented in manufacturing and services. However, they also target the tourism, infrastructure, higher education, agriculture, agri-food, and fish industries, as well as dairy development projects, clearly indicating that the GoSL is lacking a clear vision on which industries it has the comparative advantage in for foreign companies to invest in.

The Export Development Board (EDB) has the responsibility of developing and promoting exports from Sri Lanka. Additionally, the EDB has an advisory role to the GoSL. Interestingly where the GoSL is increasingly looking for development cooperation from/with the non-traditional donors, the most important export markets where the GoSL sees growth are the EU and the USA. The EDB has identified seven sectors in which they feel that Sri Lanka has a comparative advantage, namely: apparel, tea, rubber and rubber based products, diamond, gems and jewelry, ICT/BPO/KPO, food and other beverages, and spices and allied products (GoSL, Export Development Board, 2010). These key sectors currently make up for 80% of the exports (GoSL, Export Development Board, 2013).

The diplomatic network is supported by the MIC, their officials “take part in facilitating, strengthening and establishing Sri Lanka’s Commercial and Investment interests in foreign markets. Trade representatives abroad assist Sri Lankan enterprises to develop their business capabilities and find adequate overseas partners” (GoSL, Ministry of Commerce, 2013).

Based on the BOI and EDB, and the role of the MIC in trade and investment promotion, the following conclusions can be drawn. Trade promotion is handled outside of the control of the MEA, the EDB is a commercial cadre, this gives Sri Lanka a *traditional* strategy. A domestic board handles investment promotion, BOI, there is a role for the diplomatic network but this is not coordinated by the MEA but by the department of commerce, once again the GoSL follows a *traditional strategy*.

### Conclusion

Overall, the GoSL is unquestionably practicing a *traditional* strategy towards commercial and trade diplomacy, as policy and external economic management is mostly done outside of the remit of the MEA. Economic development aid is coordinated through the ministry of finance. Trade and investment promotions are done by agencies outside of the MEA. By overall applying a traditional strategy Sri Lanka as a case study for low middle-income countries confirms hypothesis 1.

## *India*

Like Sri Lanka, India has a colonial past. Since 1947, the country has been independent and has since then become the seventh largest economy in the world based on GDP, and the third with regards to PPP (excluding the EU as a whole). With a population of 1.2 billion (2010), India is known for its inefficient public sector apparatus (EIUd, 2013). The global crisis of 2009 also affected India, but the country was not as badly affected as other Asian countries were. To continue to grow, the government will have to become more market-friendly in the coming years (EIUe, 2013). Similar to other developing countries, India continues to import more than it exports. To improve its economic growth, the Indian government has emphasized the importance of FDI.

India and China are both powerhouses on the Asian continent, and although ties between the two are improving tensions will to a certain extent continue to exist, mainly over each country's strategic influence over neighboring countries (EIUd, 2013).

### External Economic Management & Policy Management

India shows how hard it can be to coordinate the external economic and policy management between the different responsible ministries. The Ministry of External Affairs (MEA) seems to have little to do with either the development of economic diplomacy strategies or the management of them. Within the ministry there is however a division, 'Multilateral Economic Relations', that handles "all matters relating to the multilateral economic relations of India" (Government of India, Ministry of External Affairs, 2013a). As well as that in June 2013, in the fourth India-US Strategic Dialogue, talk about further economic collaboration took place (GoI, Ministry of External Affairs, 2013c). In the 2011 publication of India's foreign relations documents, economic diplomacy is mentioned only once, in the context that it should be used to "managed political risks involved in international trade, business and investments for Indian business" (Bhasin, 2011, p.25). This indicated that to a certain extent the MEA is involved but only on a very small scale.

To the contrary, the Department of Commerce (DOC), which falls under the Ministry of Commerce and Industry (MCI), has a clear mandate with regards to commercial diplomacy. Their directive is the "regulation, development, and promotion of India's international trade and commerce through formulation of appropriate international trade & commercial policy and implementation of the various provisions" (GoI, Department of Commerce, 2010). "The Department formulates, implements and monitors the Foreign Trade Policy (FTP) which provides the basic framework of policy and strategy to be followed for promoting exports and trade... the Department is also entrusted with responsibilities relating to multilateral and bilateral commercial relations"(GoI, Department of Commerce, 2010). The Department of Industrial Policy and Promotion is responsible for the other aspect of commercial diplomacy inward investment. This department is responsible for all aspects of FDI, the policy

formulation and implementation, the promotion of India as a FDI destination, as well as the approval and facilitation of FDI's (GoI, Department of Industrial Policy and Promotion, 2008).

Rana (2011) as a practitioner and former ambassador to various embassies concludes that the coordination within India's government ministries "has been uneven, and sometimes notably absent. India has shown the complexity of economic management: with policy-making fragmented, and the Ministry of External Affairs confined to a small role, the operation of economic diplomacy has not always been in synch with political objectives" (Rana, 2011, p. 100). An example that Rana mentions is that when India was negotiating with ASEAN about a FTA, it was the ministry of commerce that presented the first draft. Rana contends that the MEA, and other parties that should have been consulted, were not (Rana, 2011). However, it does not mean that the MEA stood completely on the sidelines. When the regional organization BIMSTEC was created it was the MEA that stood at its basis. The MEA is also, according to Rana, the principal contact between the Indian government and international economic cooperation such as the BRICS.

The external economic management and policy management in India is mainly handled by ministries other than the MEA. The example of the minister of commerce presenting a document that is not approved by the minister external affairs makes this clear. Paradoxically, the MEA is taking the lead on the regional organizations, which are currently purely economic cooperation in the start-up phases. Sridharan (2002) offers the same conclusion as he concludes "the MEA and the MOC<sup>1</sup> are definitely the key players, but beyond that the contours of decision making are not identifiable" (Sridharan, 2002, p. 66), he also quotes from Malik (1998) work in which a former special secretary in the MEA says that it is accepted that more coordination needs to occur, but that in practice this is not occurring "arising out of consideration of turf and personal ambitions" (Sridharan, 2002, p. 66). Based on this it seems that India is still applying a *traditional strategy* toward commercial and trade diplomacy. Recently, through an investment promotion agency, Invest India, the two ministries have set up a joint-initiative, a good sign of further coordination and cooperation.

#### Role of Non-State Actors

With its vast population, India has been called the biggest democracy in the world. Ever since its independence the country has been a democracy. India's democratic institutions are respected and entrenched into society, and power transfers are accepted and occur in a way that is also the norm in western countries. A complete collapse of the democratic system is less likely compared to some of the other Asian countries (EIUd, 2013). The federal government, because of the importance of regional parties, has become a coalition. The regional levels of government have a great influence on the national

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<sup>1</sup> Before the Ministry of Commerce and Industry was created, a sole Ministry of Commerce existed.

policy levels, delicate issues for example the relation with Sri Lanka can be swayed based on political influence on a regional level (Colombo, 2013).

The EIU (2012) concludes that the government still controls and monitors nearly every single aspect of the economy and business dealings, although they have come a long way since economic liberalization was started in the 1990s. However, non-state actors such as the trade unions and employees are according to EIU looking at this liberalization with some suspicion, as they fear lay-offs or job losses, as before liberalization it was government policy to take over businesses that were failing. Companies still need government permission if they want to close (EIU 2012).

Academics have concluded that the role of think-thanks, especially the four located in New Delhi, will increase. Because of the growing economy, and the moving up in income categories growth needs to be achieved through other options besides liberalization. Shah (2013) states that the Indian government lacks the capacity to do so, hence the think-tanks are taking on this role. Currently Malik and Medcalf concluded that they are “mostly quasi-governmental organizations, and it is not difficult to find mixed reviews of their research and policy inputs, including from officials. Indian business has in some ways helped to fill the gap. The two leading chambers of commerce – the Confederation of Indian Industry (CII) and the Federation of Chambers of Commerce and Industry (FICCI) – are among the more streamlined and intellectually resourceful private entities in India” (Malik & Medcalf, 2011, p.6).

Malik and Medcalf (2011), indicate three influences on Indian foreign policy, even though it is established that external affairs has little to do with the formulation of commercial diplomacy policies, these influencers are likely to play a role in the department of commerce as well. They identified Indian business, the Indian diaspora, and the news media to be of influence. Malik and Medcalf state that sometimes businesses (commercial diplomats by some definitions) precede official government relations, “the flag follows trade” (Malik & Medcalf, 2011, p. 5), and sometimes the chambers of commerce have already established offices before a strategic dialogue between nations had started. The diaspora is of influence because some of them still have strong connections to their regional state and are able to influence and lobby at that level. The news media, although the government says it does nothing more than publish tabloid television, does reach millions of people.

For commercial diplomacy this means that as Indian businesses expand more and more, their influence will also likely increase. Combined with the influence of the chambers of commerce it seems that India currently exists is between a *traditional* and an *evolving* strategy.

## Economic Aid

For the longest period of time India was solely an economic aid receiver, but recently it has started to also become an economic aid donor. This section will first highlight the current economic aid India still receives, before turning to discuss the aid programs India is managing.

As mentioned India is now a low middle-income country, but it is also still the home of about one third of the poorest people in the world and has one of the most socially divided societies in the world, thanks to its caste system (European External Action Service, 2007). The funding from the European Union is directed towards the sources that require the aid, little coordination with ministry of external affairs is present, the Aid, Accounts, and Audit Division within the Department of Economic Affairs in the Ministry of Finance, is responsible for the management of aid, and the debt servicing of various loans (GoI, Department of Economic Affairs, 2013).

The MEA set up India's economic aid donor program, Development Administration Partnership (DPA) in 2012. The ministry is responsible for all phases of the different programs: concept, launch, execution, and completion. Three divisions within the program handle different tasks, DPA I handles the appraisals of projects, and the lines of credit. DPA II handles disaster relief, capacity building and the Indian Technical and Economic Cooperation Program (ITEC) (this program was established in the 1960, and operates in many different countries), and DPA III is tasked with the implementation of projects. DPA credit lines are extended towards sub-Saharan regions in Africa. The grant projects focus on Bangladesh and Sri Lanka, with current implementation of projects in Afghanistan, Maldives, Myanmar, Nepal and Sri Lanka. Under the ITEC 10,000 trainings-slots (1,500 defense and 8,500 civilian positions) are available to 161 countries. Under DPA II, grants are available to countries in Southeast – Central – West Asia, and Latin America countries (GoI, Ministry of External Affairs, 2013b).

As an economic aid recipient India is still very much following a *traditional strategy* as the management of the funding is handled by the department of economic affairs, it is kept out of the MEA. With regard to the economic aid program, India is between *evolving and innovative* strategy. The DPA program is currently modest, and has the ITEC component, but they are expanding it and it is run by the MEA. However, thus far no coordination with the trade promotion agency is visible.

## Trade Promotion & Investment Promotion

Trade promotion is handled by the DOC, and the different chambers of commerce that India has. As well as that several trade promotion agencies are available but they are organized by sector.

Structurally more attention is paid to investment promotion. The agency is working towards the streamlining of the FDI process. Invest India was created because there was a need for an organization that could provide services to the smaller companies wanting to invest in India as well as to promote India as an investment destination in a structured manner (Invest India, 2013). It is the official semi-

government organization as the Federal India Chambers of Commerce and Industry (FICCI) (51%) hold a majority, the department of industrial policy and promotion (35%), and the state governments own the remaining percentage. Invest India “provides granulated, sector-specific, and state-specific information to a foreign investor, assists in expediting regulatory approvals, and offers hand-holding services” (Invest India, 2013). Besides inward investment promotion, Invest India’s mandate also includes “assisting Indian investors to make informed choices about investment opportunities overseas” (Invest India, 2013). Recently Invest India has also become the agency that is responsible for carrying out the first joint-initiative between the MEA and the MCI, the India Africa Gateway. The agency has also started to partner with the diplomatic network to provide information to companies that are willing to make the move towards India.

Considering that, the DOC with little involvement of the external affairs ministry handles trade promotion and that the investment promotion is done by Invest India with little external affairs coordination, the exception being the recent India Africa Gateway initiative, leads to the conclusion that in trade and investment promotion India is applying a *traditional strategy*. India thereby, follows a strategy as suggest in hypothesis 1.

### Conclusion

It would be too simplistic to say that because of India most often applies a traditional strategy the overall strategy is traditional as well. On the management side, India is traditional, but the acknowledgement that more coordination needs to occur is present. The role of non-state actors is leaning towards evolution. As an economic aid recipient India is still traditional. However, as a donor, India is going towards an innovative strategy. Trade and investment promotion is however traditional. Overall, institutionally the country is still *traditional* but signs towards an evolving strategy are visible, and should be expected in a couple of years.

## **Upper middle-income**

### *China*

The world's most populous country has, in the first decade of the twenty-first century, become the biggest economy, based on incremental GDP (IMF, 2013). However, due to the sheer numbers of people China remains a middle-income country, albeit in the past decade it has managed to become an upper middle-income country. With the biggest economy in the world, comes power, and responsibility. Considering that normative values in China differ from the traditional powers this creates tension. Additionally, to an extent that China still sees itself as a developing nation, while simultaneously it is expanding its aid program, or as they refer to it, economic cooperation, in Africa and Asia. Due to its one-party communist political system, and the language barrier, China remains for many an enigma. The following section's analysis is based on available information, and will try to dissolve parts of the mystery.

### External Economic Management & Policy Management

The Ministry of Commerce (MOC) handles external economic management and policy creation and management, and it is tasked with the management of the economic relations and the disbursement of development aid. Until 2002, the Ministry of Foreign Trade and economic cooperation, a very powerful ministry, handled these tasks. The Ministry of Foreign Affairs (MFA), officially responsible for China's diplomatic relations, is not involved, with trade and investment promotion handled externally by a commercial entity (Rana, 2011). Overall, strategic decisions are made through the party system. According to Rana, the efficiency of the Chinese government systems depends on the level of decision-making: strategic decisions it brings together the party's top leaders and key-ministers under the guidance of the Politburo, a system which works very well. At the lower levels of decision-making, coordination between the ministries occurs through the vice-ministers, but actual policy coordination on a policy advisor level and meetings between the different ministries is not occurring (Rana, 2011).

Ultimately responsible for economic policy is with the State Council, besides the already mentioned Politburo (whose leading group of foreign affairs experts is tasked with foreign policy decisions), the Communist Party, and the international department (Campbell, Wheeler, Attree, Bulter, & Mariani, 2012). Other key of influences on economic diplomacy are the ministry of finance, the China Development Bank (state-owned) and the China Export Import Bank (Campbell et al., 2012).

Under its mandate the MOC is accountable for commercial and trade diplomacy, "To formulating development strategies, guidelines and policies of domestic and foreign trade and international economic cooperation, drafting laws and regulations governing domestic and foreign trade, economic cooperation and foreign investment, [and] devising implementation rules and regulations" (Government of China, Ministry of Commerce, 2006). Regulating the import and export quotas, the ministry also has the



responsibility for negotiations on both a bilateral and multilateral level (WTO) about economic cooperation. The ministry also handles the domestic implementation with the line ministries, and signs the treaties. The ministry is also responsible for “steering the work of the commercial branches of China’s Permanent Mission to the WTO, to the UN and other relevant international organizations, as well as Chinese embassies in foreign countries. To keep in touch with the representative offices of multilateral and international economic and trade organizations in China and the commercial functions of foreign diplomatic missions in China” (GoC, Ministry of Commerce, 2006), as well as the training of these civil servants. The ministry is also in charge of China’s efforts to provide aid to foreign countries and regions, by formulating and implementing China’s foreign aid policies and plans, and signing the relevant agreements: compiling and executing annual foreign aid programs; supervising and inspecting the implementation of China’s foreign aid projects: managing China’s foreign aid fund, concessional loans, special funds and other foreign aid funds of the Chinese government (Ministry of Commerce); and guiding “the work of the chambers of commerce for import and export and other relevant associations and societies” (GoC, Ministry of Commerce, 2006).

As has become clear the MOC is the driving force behind China’s commercial and trade diplomacy. Applying this to Rana’s framework leads to the conclusion that, with regards to external economic management China follows a *traditional* strategy. In a traditional strategy, the MFA play at least a small role in policy management, but in China, the ministry appears to play no role. Turf battles do not seem to occur because it is clear from the responsibilities of the ministry of commerce that they handle economic relations. Overall, in policy management China applies a *traditional* approach.

#### Role of Non-State Actors

The role of non-state actors in Chinese politics is rather limited. The MOC “guides” the chambers of commerce. This does not mean that think tanks and academics are not increasingly becoming more important, as, like India, China is looking for innovative approaches to continue to grow (Campbell et al., 2012, Abb, 2013). Provincial levels are becoming more important, as these regions are now also actively participating in regional diplomacy, and advocating that business invest in their region (Campbell et al., 2012). Public opinion, remains of little importance to the Chinese government. However, the government increasingly is aware of the objections raised online (Campbell et al., 2012).

The Chinese government is currently also battling corruption on a local level. Meaning that non-state actors can influence politics through corrupt government officials, but the traditional non-state actors are not yet capable of significantly influencing the government.

Although some improvement is noticeable, the role of non-state actors remains very small in China. In this regard, China follows a *traditional* approach.

## Economic Aid

Even though China is the biggest economy in the world, this does not mean that there are not major discrepancies between the rich and the poor. For past years, China has continued to borrow at the World Bank (World Bank, 2013). China continues to receive aid from the European Union, for 2007-2013 this was a total of 128million euros, aid is focused on areas that are covered by the EU-China policy dialogues, but also on climate change, and human resource development. In 2012, China received a total of almost 2.2 billion USD from Development Assistance Committee (DAC) members (OECD, 2013a).

On the donor side, China makes an interesting case to study. Although the ministry of commerce makes a difference between foreign aid and economic cooperation, it is known that China uses different measures to calculate development aid, and economic cooperation is regarded as aid as well (Campbell et al., 2012). Already in 1964, China established principles for economic aid and technical assistance (Campbell et al., 2012 from China Information Office). In which it is made clear that countries should not become dependent on China, but rather that while China will help in building the economies, countries have to develop themselves. They see that economic aid needs to have a mutual benefit aspect. Projects that have been realized with loans from China often come with regulations that materials (and sometimes even labor) from China need to be used (Colombo, 2013). “The decision-making power in China regarding foreign aid lies with the central government” (State Council, 2011, p. 14),

“The Ministry of Commerce of the People’s Republic of China is the administrative department authorized by the State Council to oversee foreign aid. It is responsible for the formulation of foreign aid policies, regulations, overall and annual plans, examination and approval of foreign aid projects and management of the project execution. The Executive Bureau of International Economic Cooperation, China International Center for Economic and Technical Exchanges, and Academy of International Business Officials affiliated to the Ministry of Commerce are entrusted with tasks of managing the implementation of complete projects and technical cooperation projects, material aid projects and training programs connected with China’s foreign aid. The Export-Import Bank of China is responsible for the assessment of projects with concessional loans, and the allocation and recovery of loans. Chinese embassies or consulates abroad are in charge of the direct coordination and management of foreign aid projects in the relevant countries. The local commercial administration departments are required to cooperate with the Ministry of Commerce to deal with affairs related to foreign aid within its jurisdiction. In providing foreign aid, the related departments of the Chinese government keep in close contact and cooperate with each other. In drafting foreign aid programs and foreign aid funds plans for each country, the Ministry of Commerce communicates regularly with the Ministry of Foreign Affairs, Ministry of Finance and the Export-Import Bank of China to seek their suggestions. In order to strengthen the coordination of the departments concerned, the ministries of commerce, foreign affairs and finance officially established the country’s foreign aid inter-agency liaison mechanism in 2008. In February 2011, this liaison mechanism was upgraded into an interagency coordination mechanism. (State Council White Paper, 2011, p.14)

Economic aid that is received seems to be handled by the ministry of finance, the contact of the World Bank and the Asian Development Bank, and the ministry of commerce. The MFA seems to have little involvement. China follows a *traditional* approach. As an economic aid donor, China follows a very different path. The program located within the ministry of commerce is expanding, and although the MFA has some more control with the establishment of the interagency coordination mechanism in 2011, overall the ministry of commerce is very much in charge as the trade promotion is located within the ministry of commerce. However, considering that there is a program in place that is extremely active, China is applying an *innovative* strategy toward economic aid.

#### Trade Promotion & Investment Promotion

Oversees the trade and investment promotion is part of the responsibility of the MOC. Additionally, the MOC has set up separate sub-websites for every country they are active in. Rana (2011) does mention that embassies are now more and more starting to advocate on behalf of Chinese business, using tactics that have been used by other countries as well.

Investment promotion is handled by the China Council for International Investment Promotion (CCIIP). They are tasked with the promotion of inward and outward investment. Hence, they promote FDI into China but also look at the China's FDI in other countries. The State Council founded the CCIIP and falls under the ministry of commerce, as the single platform for investment: they work together with regional governments to improve their investment environment. Additionally, they are tasked with providing information to foreign investors. The China Investment Promotion Agency (CIPA) does trade promotion. This agency also falls under the MOC. Like the CCIIP they also have dual function, as that they "promote two-way changes and cooperation among Chinese and foreign enterprises" (GoC, Ministry of Commerce, 2013)

China, for trade and investment promotion, makes use of agencies that are outside of the control of the MFA, as the MOC is responsible for these tasks. The MOC does supply and train the economic specialists for the embassies (which fall under the responsibility of the MFA). China does make active use of its diplomatic network, yet the final responsibility lies with the ministry of commerce. For both (trade and investment) promotional activities China seems to be applying a strategy that is *leaning towards evolving*. Although the trade promotion is handled by a cadre outside the MFA control, there seems to be some elements of cooperation, especially when considering that economic aid by China is also given under mutual benefit (hence trade and investment) and the MFA is involved in this. The same goes for investment promotion, done by a cadre outside of the MFA, but the MOC makes active use of the diplomatic network.

## Conclusion

To conclude, China's overall commercial diplomacy strategy needs to be considered a major part of China's foreign policy, albeit executed by the MOC. On the government policy side, China is still very much following a traditional strategy. The role of non-state actors is traditional as well, although some changes are noticeable. As an economic aid recipient China is very traditional, but as a donor the country is innovative. Although their tactics and strategies are questioned by western countries, developing nations are willing to accept the economic cooperation because it comes with less normative strings attached compared with aid from western nations. Although trade and investment promotion is gearing towards evolving, without the substantive involvement of the MFA it will remain traditional. Because of the limited involvement of the MFA

China continues to practice a *traditional* commercial and trade diplomatic strategy. With China following a more traditional approach to commercial diplomacy, with the exception being economic aid donor, hypothesis 2 cannot be confirmed in this case. Even though China is developing and growing the government institutions are set and change seems on the short term not likely.

## *South Africa*

South Africa, the “S” in BRICS, is a nation that since the 1990s with the end of the apartheid regime, has worked to improve its economic standings. Now considered to be an upper middle-income country, the country is expected by the IMF (2013) to make the top 30 of nations based on purchasing power parity in the coming years.

Since the end of WWII, when South Africa increasing became internationally scrutinized for its domestic apartheid policy, the country has experienced the power play-end of economic diplomacy. The main focus of diplomacy in these decades was to counter the power play instruments, sanctions and disinvestments, which the international community applied to South Africa (Muller, 2002). Since the end of apartheid, successive governments have been working towards economic development and integrating South Africa into the international economy, benefitting from increased globalization. However, the country as a developing nation is faced with relatively high wages, and for FDI the country is seen as inefficient and relative high-cost (Muller, 2002).

As part of moving forward one of South Africa’s main government policies is Black economic Empowerment (BEE) (Government of South Africa, Department of Government Communication, 2012a). Under the BEE, standards are set about percentages of ownership that needs to be transferred to non-white people. These standards are set the majority of time by industry charters. Additionally, companies that have implemented and completed BEE initiatives are looked upon more favorably when it comes to acquiring government tenders (EIU, 2013f).

### External Economic Management & Policy Management

The two main ministries responsible for commercial diplomacy are the Department of International Relations and Cooperation (DIRC) and the Department of Trade and Industry (DTI)<sup>2</sup>. Muller in 2002 concluded that “a sound relationship between these two government agencies is important for the effective deployment of the country’s economic diplomacy, but they have often found themselves in competition for positions of leadership or predominance” (Muller, 2002, p. 1).

The DIRC has a clear focus on the African Continent first and foremost. In the 2010-2013 strategic plan, priority five is the strengthening of political and economic relations through economic diplomacy. In the plan it is laid out that they plan to increase the coordination between non-state actors, the capacity in economic diplomacy in the diplomatic network needs to be increased, and expand the bilateral relations that would contribute to the economic development of South Africa (GoSA, International Relations and Cooperation, 2010). In the 2011, white paper on South Africa’s foreign policy economic diplomacy is a central theme. “South Africa’s economic diplomacy will therefore be focused on providing guidance to the government and the business sector on economic developments and markets,

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<sup>2</sup> Ministries in South Africa are referred to as departments

pursuing market access for South African products, attracting investments and tourism, removing barriers to trade, and supporting the development of larger markets in Africa... Central to South Africa's economic diplomacy is the pursuit of a fair and equitable rules-based international trade regime that accommodates the developmental interests of developing countries"(GoSA, Department of International Relations and Cooperation, 2011, p. 27). On intergovernmental coordination and inclusion of non-state actors the white paper states "Successful economic diplomacy requires a close partnership with government, business, and labor. A coordinated government-wide effort is essential to promote South Africa's economic interests in the international arena, including the use of high-level engagements. South African Missions abroad are key in these endeavors and must be adequately resourced for these purposes. In particular, they can assist South African businesses abroad by providing advice, advocacy, and market access support. The Department must therefore improve its economic research capacity to strengthen its economic diplomacy"(GoSA, Department of International Relations and Cooperation, 2011, p. 28)

The economic development strategies are laid out in the South African Trade Policy and Strategy Framework of the DTI. They acknowledge that "as trade policy and foreign policy are increasingly inter-related as both are situated at the nexus between the domestic economic priorities and external engagement, it is necessary to strengthen strategic coordination, alignment, joint planning and execution between the DTI and the Department of International Relations and Cooperation" (GoSA, Department of Trade and Industry, 2010, p. 45). It is the DTI that has developed the strategies for export and investment promotion. The DTI also has (in 2011) 45 foreign economic offices to assist South African businesses (GoSA, Department of Government Communication, 2012a).

South Africa recognizes the close relationship that is needed between the DIRC and DTI. In the past talks about merging the departments or moving the international trade division have started but where stalled when the two departments "synchronized political and economic approaches towards particular countries" (Creamer, 1996, p. 13 as in Muller, 2002, p.13). Around that same time the then foreign affairs minister was "criticized for "failing to assert himself with his own colleagues in the cabinet" and as a result allowing other ministers to "seize the foreign policy initiative"(Fabricius, 2000, p. 220 in Muller, 2002, p. 14). Currently there seems to be no initiative for closer cooperation between the departments, and the current situation is likely to continue.

Although South Africa seems to realize that cooperation between the different departments is necessary to lift the commercial and trade diplomacy to the next level, full-scale cooperation and integration is not taking place just yet. Trade diplomacy seems to be the focus of the DIRC, with input and involvement of the DTI for the WTO negotiations (Muller, 2002). However, commercial diplomacy seems to be handled for the majority by the DTI. Based on this for external economic management South Africa is truly between *traditional* and *evolving*. Some coordination is taking place but the majority still

lies with the DTI. Policy management wise, the policy on economic diplomacy is based on and written by the DTI, and although some coordination is taking place, the personalities of the ministers in the past have made it so that the DIRC was marginalized. Hence, South Africa applies a *traditional* approach. If more coordination would occur and South Africa would truly apply an evolving strategy, then it would confirm what is suggested in hypothesis 2. However, internal disagreement and turf battles hamper this development.

### Role of Non-State Actors

The government seems to be keen on incorporating more non-state actors into the commercial diplomacy sphere, as they have mentioned in the strategic policy. The EIU (2013g) warns about a possible degeneration in governance. How the government handles allegations of corruption, press freedom and the independence of the judiciary system will need to be monitored. Ulimwengu states that “African states generally mistrust NGOs and other non-state actors for a variety of reasons. These include the suspicion that many NGOs are ‘invading’ traditionally government territory, arrogating to themselves roles that are the preserve of states, thus, undermining their authority and discrediting them” (2007, p. 10). This does not mean that small scale initiatives in South Africa do not occur. Demonstrating that non-state actors do have some influence is for example the “Women’s Budget Initiative, which involves representatives of women’s organizations in national budgeting processes, and in which women have been keen to assert their views” (Ulimwengu, 2007, p. 15).

The South African government is striving towards a free-market system, but at the same time it holds a monopoly on certain sectors with state-owned enterprises (EIU, 2013f). This clearly hinders the role of the private sector as a non-state influencer on government policy.

As South Africa is becoming more aid independent, it could follow that non-state actors are not looked upon with suspicion. The government does seem to realize and consult with policy think tanks on strategic policies. However, thus far the role of non-state actors is limited, meaning that South Africa continues to follow a *traditional* approach.

### Economic Aid

Slowly South Africa is moving out of the economic aid recipient phase. The cooperation South Africa receives from the EU is to reduce poverty and inequality through employment creation and sustainable economic growth that is inclusive of the poorest. In 2011, South Africa still reached near to one-billion USD support from DAC countries and non-DAC countries (OECD, 2013c). The country has not borrowed from the World Bank since 2010 (World Bank, 2013)

South Africa is not only a receiver of economic aid, ever the first democratic elections (1994); South Africa is also a donor country. Aid was first managed through the South Africa’s Development Assistant Program. In 2000 this program was replaced by the African Renaissance Fund (ARF), this fund

would focus on countries on the African continent, placing importance on “the promotion of democracy, humanitarian assistance, conflict prevention and resolution, and good governance” (Yanacopolos, 2011, p. 2). The ARF is administrated and managed by the Department of International Relations and Cooperation. In 2011, the ARF was transferred into the South African Development Partnership Agency (SADPA), which is supposed to bring together all the aid from the different departments under one organization. “(the) South African Development Agency... intends to drive a development partnership programme in order to build innovative, proactive and sustainable partnerships to advance African development” (Yanacopolos, 2011, p. 2). Yanacopolos suggested that with the creation of SADPA, the government will increase control and development aid will be more aligned with the strategic focus and national interest of South Africa. Even though the SADPA was created in 2011, Yanacopolos’ research concluded that the mainstream media in South Africa had no mention of the agency. Additionally, the DIRC reported that it still seeks agreement from the Department of Finance.

Based on the fact that economic aid seems to be being phased out in South Africa, this indicates an *innovative* strategy. Although the SADPA program has not yet been established, its predecessor, the ARF, is managed by the DIRC, and over the years, the economic aid program has expanded. Although currently the DTI does not seem to play a role, it can be expected that if the new agency is going to be aligned with South Africa’s interest and economic development, the department of trade and industry will be involved to a certain extent. As an economic aid donor, South Africa follows an *innovative* strategy.

On both facets South Africa is ahead of the learning curve. Hypothesis 2 suggests that the country applies an evolving strategy, however South Africa has already graduated to the innovative stage. Hence the hypothesis cannot be confirmed

#### Trade Promotion & Investment Promotion

The promotion of trade and investment is in the hands of DTI. The department has created a one-stop-shop website for potential investors (EIU, 2013f). In 36 countries, the department has opened 46 offices that support the economic development of South Africa abroad. The department supports South African exporters with information provision, financial assistance, and practical support practical matters (GoSA, Department of Government Communication, 2012a). Additionally, the department works together with the Provincial Investment Promotion Agencies, who are in charge for the different provinces.

Trade and Investment South Africa (TISA), is a division within the department of trade and industry. The purpose of the division is to increase export capacity and support direct investment flows via the implementation of strategies directed at targeted markets” (GoSA, Department of Trade and Industry, 2013), as well as manage the previously managed trade offices. The division is made up out of four units: Investment Promotion and Facilitation, “responsible for attracting foreign direct investment, as



well as developing and promoting local direct investment” (GoSA, Department of Trade and Industry, 2013); Export Promotion, “responsible for developing and implementing regional export promotion strategies” (GoSA, Department of Trade and Industry, 2013); Export Development, “to contribute to the positioning of South Africa as a reliable trade partner by expanding the exporter base of the country, thereby increasing the export supply and sales of South Africa” (GoSA, Department of Trade and Industry, 2013); and Foreign Service Management which “renders a full suite of corporate services to foreign economic offices to enhance the promotion of exports and investment in targeted countries” (GoSA, Department of Trade and Industry, 2013).

Both trade and investment promotion are handled within the same department. For both it seems that little involvement of the DIRC is present. Although the economic office of the DTI is attached to the diplomatic network, it is managed by the trade department, in the countries where no separate trade office is present the diplomatic network is tasked with implementing the trade and investment promotion (Muller, 2002). With regard to trade promotion, South Africa follows a *traditional* strategy. For investment promotion, South Africa seems to be between *traditional* and *evolving* as the diplomatic network gets more involved and cooperation between the departments improves over the coming years as they intend it to do, South Africa has the potential to apply a full evolving strategy.

### Conclusion

Overall the DIRC is in charge of the foreign policy of which economic diplomacy is a component. It is however, the DTI that executes and develops the strategies. The role of non-state actors is limited in South Africa, although they are consulted in the development of policies. South Africa has advanced commercial diplomacy strategies when it comes to economic aid. When it comes to trade and investment promotion, this is handled by the same division inside the DTI. South Africa acknowledges that advanced cooperation between the different departments is necessary to move commercial and trade diplomacy forward. In the past it has been personalities and turf battles that have kept this from occurring. Except for its approach to economic aid, South Africa is applying a *traditional* strategy that has the potential to move towards *evolving* when better and more extensive cooperation between the different departments is realized, hence hypothesis 2 cannot be confirmed in the case of South Africa currently.

## **High-income**

### *European Union:*

Economic diplomacy in Europe that is unique. Increasingly the European Union's (EU) members states are signing the responsibility for governing decisions over to the union, with more decisions being made 'centrally' and legislation being applied to the whole union. Ever since its inception the countries and the union as a supranational organization itself have been working towards further integration, only halted by the current monetary crisis that has more and more citizens of the union expressing euro-skeptic opinions.

As a union, the EU has great economic powers. All 28 countries together form the biggest economy in the world, followed by the United States and China. Individually, Germany, United Kingdom, and France make the top 10 of the world's biggest economies (IMF, 2013). However, foreign policy and economic external management are still largely left to the member countries themselves. This results in countries competing for lucrative contracts. The following section will explore the possibilities that the union has to act with one voice. It will also indicate where the current regulations are curtailing the member nations own commercial diplomacy efforts.

In the European Union, the supranational organization has taken over several forms of economic diplomacy. When it comes to the power-play end, the Union makes the decisions on sanctions, the reasoning behind this being that together the countries can make a stronger impact or political statement than acting as unilateral actors. The EU focuses mainly on the trade diplomacy, playing a facilitative role for its members states (Woolcock, 2011). Since the Treaty of Lisbon in 2009, the union is the governing body that creates policies on trade and investment. "The EU thus negotiates multilateral and bilateral agreements that seek to ensure effective access to markets that are locked by the technical regulation of other countries or by the anti-competitive behavior of companies on other market" (Woolcock, 2011, p. 85). Another major item that will, in the future, influence the commercial diplomacy strategies of member countries is that since the Lisbon Treaty the EU has the "exclusive competence...on Foreign Direct Investments" (Woolcock, 2011, p. 85). Although, the European Commission is still debating on how to implement this competence, it is clear that the ability and the scope for members states to negotiate with third country partners on bilateral investment treaties is constrained. Other trade diplomacy instruments like export credit guarantees and policies to protect developing countries against excessive usage have not yet been developed by the union, however since the OECD guidelines on this matter are part of EU law, member states are obligated to follow these, if they did not already do so.

Currently the EU is still a major economic power, however its growth is stagnating and is thus not really comparable to the growth of other growth markets. However, national economic policies will, for the time being, continue to dominate the policy choices of the member states, simply because they all

have diverging national interests. Woolcock (2011) concludes his argument with the observation that as the EU gains more exclusive competences, the ability and scope of member states to include diplomacy in commercial interests on a bilateral basis will be constrained.

Now that the EU is facing stagnating growth, some countries, even have a negative growth, it is obvious that they are searching for other new markets to export too. However, because countries are actively seeking out developing markets, they are facing increased competition with each other, highlighting the need for strong bilateral relations. This in the end does not have a positive influence on the EU to work with a common approach (Echague, 2012). Echague (2012) goes on to say that with greater use being made of bilateral agreements member countries could be giving off the wrong signals to countries. According to her this could easily have an influence on the political and the long term strategic agenda of the EU (Echague, 2012). She pleads for a unified EU commercial diplomacy strategy with a stronger voice for the European External Action Service (EEAS), and that member states adjust their national commercial diplomacy strategies to the strategic policies of the EU.

#### *The Netherlands*

Given its small internal market, the Netherlands, one of the smaller countries of the EU, but one of the biggest (top 20) economies worldwide (IMF, 2012), needs to find other markets to export too. On the opposite side the Netherlands likes to be seen as the gateway to Europe, and markets itself as an attractive destination for (European) headquarters. A favorable taxation climate has contributed to this distinction as well. However, this does not mean that on commercial diplomacy the Netherlands does everything right. Outward investments are still higher than FDI (Wilke, 2012). With a current climate of budget reductions on every level, it seems that commercial diplomacy needs to do more with less. This is certainly felt in the diplomatic network, but the large and the small embassies are effective.

#### External Economic Management & Policy Management

Since the installation of the second cabinet under/of Rutte, the Netherlands has an official Minister for International Trade and Development Cooperation. With the necessary budget cuts, the government has made the decision to focus on international trade as the heart of the development cooperation. With the creation of the new ministerial post, which is housed inside the Ministry of Foreign Affairs (MFA), the international policy department of the ministry of economic affairs was literally moved to the MFA. The director-general on external economic affairs is tasked with the advancement of the international competitiveness of the Netherlands, the creation of an open world economy, and sustainable globalization. Thus the policy management is located within the MFA, after its move from economic affairs. The executive side however, remains with economic affairs for commercial diplomacy. For trade diplomacy the MFA takes the lead role in the negotiations.

The external economic management and executing of the programs is coordinated by the NL Agency. This agency was created after the ministries of economic affairs and agriculture merged, and the several different exports and trade agencies and centers were combined into one. Currently the NL agency is housed within Ministry of Economic Affairs but is hired by the MFA, and works along the policy lines that are set out by economic affairs and MFA. “NL Agency supports sustainable joint initiatives in developing countries and emerging markets. Our programs focus on innovative pilot projects, joint investments and transfer of technology, knowledge and skills. Encouraging cooperation between Dutch and international businesses, knowledge institutions and government bodies” (Government of the Netherlands, Agentschap NL, 2012). Additionally, although a government entity, the NL Agency sees itself as an intermediary between the government and civil society. Through this method the Dutch government allows non-state actors to influence the commercial diplomacy of country.

Based on the structure that is in place for external economic management the Netherlands has joined-up and other cooperative arrangements in place. Regarding policy management the Netherlands has a strong institutionalized management and strong teamwork. This is not to say that the cooperation between the two ministries is perfect, as to some extent a difference in organization culture will always be present. But the right move was made to include the international economic division into the MFA. Therefore, based on Rana’s framework from external economic management and policy management the Netherlands follows an *innovative* strategy for commercial diplomacy and thus confirming hypothesis 3.

#### Role of Non-State Actors

That “the private sector and research institutions will continue to be major partners” (GoNL, Ministry of Foreign Affairs, 2013, p. 8), clearly indicates the importance of the non-state actors in the commercial diplomacy strategy of the Netherlands. As a liberal country, the government of the Netherlands is open to the voice of the public. Currently, voices from the private sector are urging politicians not to decrease the funding of embassies and consulates as they are for most business the first point of contact when entering new markets. This is especially true for countries where information is scarce, which is the case with the low and middle-income countries that the government is now promoting the private sector to expand into.

The government cooperates, and requests research from the various research institutions the Netherlands has. The government outsources research but also trainings to these institutions, for example the newly hired diplomats are trained at Clingendael, instilling in these diplomats already the importance of these research institutions. The government does take the domestic level into consideration, for example in 2013 a document on the modernization of the diplomatic service was published. Although this document recommended some drastic changes, it also suggested not closing down more embassies and

argued that, for the purpose of greater economic growth and a more substantial world presence, the Netherlands should maintain a worldwide presence through its embassies and consulates.

Budgets need to be cut, and some of the constituencies still have an idea that embassies are just a place for cocktails and receptions and that money needs to be taken away and put into job creation in the Netherlands. However, the government needs to do a better job in explaining to the public that embassies create export potential for Dutch companies, which could lead to job creation in the Netherlands.

To determine what strategy the Netherlands follows, since the non-state parties are actively promoting international business and NL Agency sees itself as the middle man between government and society, the number of external consultations the government has done, and the overall culture of high importance on non-state actors makes it visible that to a certain extent harmonization has taken place. Therefore, with regards to the role of non-state actors in Rana's framework the Netherlands is employing an *innovative* strategy, confirming what is suggested in hypothesis 4 and 5.

### Economic Aid

As a developed country, the Netherlands is not an economic aid recipient. However, it is one of the biggest development aid donors globally. Until the recent round of budget cut the Netherlands spent 0.8% of the Gross National Product (GNP) on aid, which will now be reduced to the internationally agreed upon 0.7%, in total a one-billion-euros needs to be cut from development programs. The new approach to aid is to tie it to trade, done to advance Dutch companies and to create growth for the Netherlands economy. The number of countries receiving development aid has, however, been reduced from 33 to 15.

For the transitional countries- those that no longer receive development aid - a new fund created called the Dutch Good Growth Fund (DGGF) is created. The fund is meant to support Dutch business while simultaneously opening up these growing markets for Dutch businesses. "This instrument provides funds for entrepreneurs in low-and middle-income countries and for Dutch companies wanting to set up ventures with them. Dutch entrepreneurs seeking funding for exports to low and middle income countries may also apply" (GoNL, Ministry of Foreign Affairs, 2013). The policy note concerning the DGGF was expected to be received by the parliament before the 2013 summer recess, however the minister in charge sent a notice that the document is to be expected after the summer, due to financial and legal requirements that still needed to be established. The fund is a revolving fund, as any funds the companies receive will have to be returned (AccountancyNews, 2013). The management and implementation of the DGGF will not fall under the responsibilities of the MFA, most likely it will follow the same structure as currently is in place now for the development and trade programs that are run by NL Agency with the ministry of economic affairs.

Based on the characterizations in Rana's framework it becomes clear that the Netherlands uses an *innovative* strategy. However, one note needs to be made: in Rana's framework, it is said that the countries have an expanding program. This is not the case in the Netherlands; overall the development cooperation is decreasing. While a new fund has been created it will most likely be a restructuring of the already existing economic aid (grants and loans) options. The program will most likely be run by NL Agency, hired by the MFA. Since the minister of international trade and development cooperation will, in the end be responsible, the responsibility will lay with the MFA. These are provisional conclusions based on the experience and expectations of diplomats.

#### Trade & Investment Promotion

The Netherlands focuses its trade relations on 26plus countries<sup>3</sup>, which include the BRICS, fellow member states of the EU, as well as resource rich countries. This however, does not mean that in other countries the embassies are not given the tasks of commercial diplomacy. In Sri Lanka the Dutch embassy has made a clear shift from development cooperation to commercial diplomacy, even though Sri Lanka is not one of the focus countries.

There are two facets of the Dutch approach to commercial diplomacy: expanding the potential export market and increasing the inward investments. The new DGGF is a fund that Dutch companies could apply for when wanting to export to low and middle-income countries. The Dutch government highly encourages the private sector to internationalize and expand (GoNL, Ministry of Foreign Affairs, 2013).

The role of the embassies and consulates is the now almost a standard role in economic diplomacy, to inform the Dutch companies about market opportunities, to assist Dutch companies wanting to enter the markets, and to open doors with (local) governments. Additionally, the embassies have the role of promoting the Netherlands as a business and investment destination.

To assist the diplomatic network the government of the Netherlands has established *top sectors*, sectors the government in consultation with the private sector believes the Netherlands can internationally compete in. These are high tech material & systems, agri-food, water, energy, horticulture, chemicals, creative industries, logistics, and life sciences. The missions have the ability to tailor which sectors they find most applicable to the country they are based in. This depends on the local context and needs of the market, for example in Sri Lanka the mission is mainly focusing on the water and life sciences sector. This has paid off with various high valued contracts for hospitals.

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<sup>3</sup> Australia, Belgium, Brazil, Canada, China, Colombia, France, Germany, the Gulf States, India, Iraq, Japan, Malaysia, Mexico, Nigeria, Poland, Romania, Russia, Singapore, South Africa, South Korea, Turkey, the UK, Ukraine, the US, and Vietnam.

To increase the inward investment into the Netherlands the MFA works together with the ministry of economic affairs and the Netherlands Foreign Investment Agency (NFIA). According to the policy document the efforts will be focused “on companies that bring high-grade knowledge and technology, and thus strengthens our leading sectors” (GoNL, Ministry of Foreign Affairs, 2013, p. 50). In the past a strategic approach, in which academics and professionals worked together to establish which companies to target, has proven to be successful in the top sectors of chemical and agri-food, and needs to be applied in the other sectors as well (GoNL, Ministry of Foreign Affairs, 2013).

The NFIA in 2012 gave assistance to 170 foreign investment projects, totaling more than 930 million Euros. Additionally, these projects will lead to 5,166 jobs in the future to be realized within three years. Compared to the last three years, the number of projects has decreased since 2011, but is still higher than 2010. The number of jobs created has steadily increased since 2010. 51% of the projects initiated in 2012 had Asia as their region of origin however, 36% of the projects from a single country originate in the USA. 64 projects were related to marketing and sale activities followed by 33 projects of international headquarters creation (NFIA, 2013).

With regard to trade promotion, the NL Agency works together with the diplomatic mission and the Netherlands Business Support Offices, the latter offers the same services as the economic sections of missions, but the employees are not diplomats. They are created by NL Agency in regions where many chances for Dutch companies are present, and usually staffed with local employees. This structure resembles the structure in the Netherlands in which NL agency takes the executive function and the MFA, in this case the mission, would take a more policy oriented approach. In essence it can be argued that the MFA and mission are more involved in trade diplomacy whereas NL Agency or the business supports offices are more prominent in this places where commercial diplomacy takes place. In markets that have not been earmarked as growth markets, the support of NL Agency can be minimal, and the embassies have to push more to get funding and projects recognized. Within these small missions, the economic officers, whether local or expat are tasked with both trade diplomacy and commercial diplomacy.

When trying to place the activities of the Netherlands within Rana's (2007) framework, it becomes clear that for trade promotion the Netherlands is between cooperative arrangement, often integration of political and economic work and well-coordinated activities, role model in range of activities, hence between *evolving and innovative*. The integration of political and economic work by the diplomatic mission depends on the country that they are in. Although activities are coordinated, smaller missions find that they get less attention, understandably to a certain degree, than the big up and coming economic countries. As for investment promotion the Netherlands seems to be *evolving* for the smaller missions as the MFA and embassies work actively with the home agency (NL Agency), but this occurs on individual initiative. Whereas for the bigger missions who have more established economic relations institutional agreements seems to be in place, hence a more *innovative* approach is present as in the bigger up and coming markets the Netherlands needs to distinguish itself.

### Conclusion

Overall the Netherlands employs a largely *innovative* strategy to commercial diplomacy, with the movement of the director-general to the MFA the Netherlands managed to create a coherent policy structure, additionally by having one agent NL Agency coordinating all trade efforts good coordination takes place. The Netherlands is a prime example to confirm hypothesis 3. In all features of commercial diplomacy, the country follows an innovative approach.



## CONCLUSION

Based on the previous five case studies the following conclusions are drawn. Low middle-income countries follow a traditional approach to commercial and trade diplomacy, thereby affirming the first hypothesis. The upper middle-income countries in this study follow a traditional approach. Therefore, hypothesis 2 cannot be confirmed. The high-income country featured in this study follows an innovative approach, therefore confirming hypothesis 3. That being said, within the income categories differences can be detected based on the different independent variables. In the low middle-income countries studied whereas Sri Lanka on all independent variables follows a traditional approach, India on the variable role of non-state actors is moving towards evolving and as a donor country is implementing a program that once fully operational would classify this variable as innovative. The countries in the upper-middle income category were deemed to have a traditional approach mainly due to the governmental structure that is in place to manage commercial and trade diplomacy. Both South Africa and China operated innovative programs as economic aid donors, and with regards to the promotion variable they are moving towards an evolving status. However, to become truly classified as having an evolving status the countries will have to include their MFA (China) and DIRC (South Africa) in the policy making and management.

When considering the role of non-state actors and domestic pressure, based on the research of the five case studies, it is proven that in high-income country (the Netherlands) non-state actors play a greater role in economic diplomacy as well as having a greater influence. Out of the five case studies, the Netherlands was the only country in which the non-state actor's role in commercial diplomacy was innovative. A greater role of non-state actors also increases their abilities to influence the government. It is possible for the non-state actors in the other countries to influence the government, but this group is very small and composed of the select few. It needs to be said that the role of non-state actors is hard to determine from secondary research; thus, extensive primary research in China, South Africa, and India could alter the results of this study. The lack of integration of non-state actors into the economic diplomacy strategies could be a reflection on the inclusion of these groups in the government as a whole.

Coming back to the main research question of this thesis. It can be concluded that solely the high-income country has a distinctive different approach to all facets of economic diplomacy. Overall, the low and upper middle-income countries have a similar strategy in place. However, they differ in the strategy for each single independent variable. The differences there are found in the structure of investments and trade promotion and the extent to which the Ministries of Foreign Affairs (Ministry of External Affairs, Department of International Relations and Cooperation) are involved. With the exception of Sri Lanka, the other cases in these income categories are what we call 'new donors' this reflected by the innovative approach to economic aid. With the exception of China, the programs are run with the cooperation of the respective foreign ministries.

If the countries in the lower and upper middle-income categories continue to grow and want use their economic diplomacy capabilities to full extent, it is advisable that within the government more coordination and integration take place. The responsible trade and foreign affairs ministries should integrate their policies or at least sufficient coordination needs to occur. Additionally, because economic development has become more complex the increased involvement of non-state actors is necessary. However, it depends on the willingness of the government to include their input.

Knowing how countries apply the different commercial diplomacy strategies is important to policies makers and the diplomatic network. For the former it means that responsible ministry whether this is commerce or foreign affairs can adjusted their strategy in bilateral relations. For the diplomatic network, it means that they are more knowledgeable about the commercial diplomacy strategy in the country they are based in. The knowledge of the strategies gives the diplomatic network the opportunity to detect changes in strategy and adjust their trade and investment promotion strategies accordingly.

Since these five cases in this thesis on economic diplomacy are a first modest but nevertheless careful representation from each income category, research on a greater scale could provide a wider and deeper insight into the strategies that other countries chose to apply. This thesis should therefore be seen as a contributing first step into a bigger and more comprehensive study thus supporting the academic, commercial, diplomatic and political fields in gathering more knowledge and more possibilities for applying economic diplomacy.

## EPILOGUE

**Niets van wat ons overkomt is slecht voor ons als we weten hoe we er de vruchten van moeten plukken en er lering uit kunnen trekken.**

**- SUN TZU (544-496 v. C.) -**

At the end of this Master study, my second after my MBA, I grasp the opportunity to add the following short personal note to you the reader of this thesis. My gratitude goes to my professors who helped and guided me these two years, to the Ambassador and his staff of HM Royal Netherlands Embassy to Sri Lanka and of course to my dear family and my friends. For all of you I would like to reveal in short why I opted for this particular Master, what made me do it, what makes Marlies tick.....

As a young girl of only 10/11 years old, I lived with my family in Bethlehem (Palestinian Authorities). While my mother taught me at home, my father worked with the United Nations Mission UNTSO in Jerusalem. All of us 'working in the field' and not without danger. Since 1947, the world is looking for that agreed comprehensive peace in the Middle East. As we speak US State Secretary John Kerry initiates new talks. And today Israel announces to build new houses in the settlements.

I saw the area and the people with my own eyes in 1997/1998. I travelled together with my family through the troubled areas and witnessed the refugee camps in Sabra and Chatilla, I crossed the troubled area of South Lebanon, the disputed Golan Heights and passed non-existing borders between Syria and Israel on my diplomatic passport. I walked the destroyed city of Kuneitra (Syria). I did a four day car patrol into the Sinai Desert in Egypt and also discovered the beauty and history of Jordan.

My daily live in Bethlehem, close to holy shrines that are important to three religions, was frequently disturbed by Israeli teargas and rubber bullets against Christian and Muslim Palestinian people. Nevertheless I went for groceries with my little sister. I was kissed on the cheek on our National Queens Day by Yasser Arafat, for some a terrorist for others a liberator and freedom fighter. I was there in the Nativity church in Bethlehem on Christmas Eve. But, I have also seen Bethlehem people with keys to their houses, in distance only a stone throw away, but nevertheless since 1948 separated by fencing, check posts and soldiers with guns from what is still legally their front door. And I was in Hebron where only

four hundred orthodox Jews ‘voluntarily’ live in a kind of cage (prison) in the center of the town guarded by young secular Jewish soldiers. Because of Abraham, the godfather for Jews... and Christians... and Muslims.

That period made me realize something, only then I did not know yet what it was. It planted a seed though in me, in my heart and mind. That seed grew and I nurtured it into the plant of wanting to work later on “in the service of my country.” Serving the Kingdom of the Netherlands at Embassies, by combining my both fields of academic knowledge for the good and the benefit of my country and the host nation is now my mission in life.

I tasted the work of economic diplomacy in the fields of Colombo, Sri Lanka. Thank you, the complete staff of the Colombo Embassy, Ambassador Louis Piët: it made me hungry and it tastes for more.

To HE Frans Timmermans, Minister of Foreign Affairs I would like to say: sir, where is my next posting, I can start as of tomorrow....?

To conclude: very aware I first did my Bachelor and Master on Business Administration (cum laude) in the Netherlands and in the USA for over three years. Very conscious and directly followed by my Master on International Relations and Diplomacy at Leiden/Clingendael. All that in the pursuit of wanting and willing to work in the diplomatic field.

I did not want dream my live, I want to live my dream. That time has come now.....

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