How does the current international business environment impact South African business?

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Background

Global trade is not a new phenomenon, and we have been trading across borders since antiquity. According to the modern economic theory it is mutually beneficial for countries to specialise in producing those products in which they have a comparative advantage, and to import those products for which they do not.

Historically, the volume of world merchandise trade has tended to grow between 1.5 times to twice as fast as world GDP. But since 2012, trade has only been growing at a rate equal to or below that of GDP. In 2016, 20 of the world's largest shipping companies sold $120 billion (volume), compared to $200 billion in 2012.

After decades of increasing trade liberalism, various factors have recently influenced the seeming decline of global trade, notably the brewing US-China trade war, Brexit and other forms of protectionism.

U.S. President Donald Trump went on the trade warpath in 2018. The showdown was designed to punish countries – notably China – that he said engaged in unfair trade practices, such as disrespecting intellectual property rights, subsidising industries and underpaying workers. His tariffs, and retaliatory duties imposed on U.S. goods by other nations, shook the world economy and caused companies to reconfigure supply chains.

In the United States, the trade war has alarmed business leaders, who largely support existing trade deals. Some business groups have argued that Trump's metal tariffs and retaliatory duties that came in response have hurt U.S. industry, farmers and workers. However, U.S. economic growth has remained buoyant, with economists partly crediting Trump's tax cuts for these developments.

On the other side of the Atlantic, British Prime Minister Theresa May is battling to keep her Brexit deal alive, barely a month before Britain's scheduled March 29 exit date. Pro-EU Tory MPs want to force Mrs May's hand to prevent a no-deal Brexit, if necessary by delaying the date of Britain's departure beyond March 29. Meanwhile, the rest of the EU has almost unanimously insisted it is not going to reopen the 585-page withdrawal treaty. With all of the political uncertainty surrounding the talks, international trade is sure to suffer.

Finally, The International Monetary Fund has cut its forecast for the world economy for the second time in three months due in part to trade tensions, said in January that global growth would be 3.5 per cent in 2019.

Question

How does the current international business environment impact South African business?

Explain the impact of the current increasing trend towards protectionism on:

- South African exports
- Profitability of South African businesses
- South Africa's labour market developments
- Foreign exchange rate movements

Instructions

Write an in-depth 3,000 word essay (including references), referring to all the aspects mentioned in the question above. The assignment must be submitted as a word-processed A4 document (1.5 spacing, double-sided printed and correctly referenced). Word count should be reflected on the cover page. Penalties will apply if these guidelines are not adhered to.

1. Background

Protectionism is an economic apparatus of controlling trade between countries, through tariff imposition. Tariffs can be in the form of duties on imported products, prohibitive portions, and an assortment of other prohibitive government guidelines intended to debilitate imports, furthermore, discourage foreign take-over of local markets and organizations (Regine Adele (2012)). The policy of protectionism is synonymous to globalization and is motivated by age-old desire to curtail foreign competition. In the global village that we now survive in, economies become more closely intertwined leading to trade disputes. Government policies on some issues once considered domestic like food, safety and the environment now increasingly impinging on international trade (Stokes, B. (1999)). An example is that a European ban on genetically modified foods would discriminate against United States (US) farmers and thus trigger trade wars. Economists have suggested that protectionism is detrimental to the economy of a nation as its costs and ripple effects outweigh the benefits and it retards economic growth. The end of 2016 and inception of 2017 saw major upheavals in the world trade status quo. This period saw the exit of Britain from the European Union and ushered a new era in the US presidency as Donald Trump took over the presidency. The exit of Britain from the europen Union means that south Africa has to be prepared for new trade agreements with the United Kingdom. Trump is popular for his protectionist statements during his campaign trail in which he threatened China, Mexico and Germany with import tariffs. Trump threatened to impose 35% on Mexican imports and 45% on Chinese imports to protect American jobs and industries from unfair competition. These changes threaten to cause upheavals in the way international trade has been conducted and every country will be affected in one way or another.

2. Effect on South African exports

In some observed case studies in Africa; Senegalese ranchers were been made bankrupt by a surge of modest imports from the EU, among others. In Ghana, local producers contributed just about 10% of poultry meat expended in that nation in 2012, as imported chicken would, in general, be 30– 40% less expensive than the neighbourhood equivalent (Hobbs, J. et. al. (2017)). To prevent such happenstances, South African poultry association advocated for a steep increase in import tariffs as a way of discouraging the dumping of poultry imports thus protecting the local industry.

An application to the International Trade Administration Commission (ITAC) advocated for an increase to the ad valorem tariff on both bone-in and boneless frozen chicken portions from levels of 37% and 12% respectively to 82%, which were approved by the ITAC. This move aggrieved poultry organizations in the US who tabled a motion with US Congress for SA to be removed from the African Growth and Opportunity Act (AGOA) an arm twisting move which resulted in South Africa relaxing its tariff stance on the US in 2016 (Hobbs, J. et. al. (2017)). Had SA gone ahead with the imposed tariffs, exclusion from the AGOA meant the country would not be granted preferential access to the US markets to 6,000 goods. The results would be decreased in exports from the automotive sector, citrus products and wines affecting not only the GDP but also threatening people's livelihoods as jobs would be lost. What can be learnt from this experience is that the developing countries do not have the economic muscle to dictate on tariff imposition or exemptions as in the long run they just end up playing to the tune and whim of the economic superpowers. Another lesson learnt from this experience is that whatever measures the government might decide it is of utmost importance to balance the need to protect the local companies; and the resultant consequences that might have far-reaching effects on international trade relations (Hobbs, J. et. al. (2017)). Tariffs though meant to protect local industries as shown by the case study above can have dangerous repurcussions on the local industry and ultimately the country's economy.

In the advent of the USA or China imposing stiff tariffs on imports into their countries, this will have severe tragic effects on the economy of SA. In 2018, SA was excluded from countries that were legible for tariff relief on steel and aluminium products. South Africa contributes 1.6% of total aluminium imports to the US and 0.98% of steel imports per annum (Mail and Guardian, (2019)). It is approximated that the export market to the US accounted for 7500 jobs and these tariffs will result in job and revenue losses. From a business point of view, the imposed tariffs will affect the competitiveness of SA steel and aluminium products in the US as compared to those from other countries, which are exempt from tariffs. In October 2018, the US decided to lift tariffs on 161 aluminium and 36 steel product, the economic effect of the decision witnessed the shares in ArcelorMittal's South African unit going up by 8% (Business day, (2019)). This gives an indication of how much damage tariffs can rage on the economy of any country more so a developing country like South Africa. As one African proverb says, “when two elephants are fighting, it is the grass that suffers”, this can be likened to the US / China trade wars with SA being collateral damage while one or both of the economic giants flexes their muscles. The “Section 232” import duties of 25% on steel and 10% on aluminium which the US imposed were mainly aimed at China and other major economies but SA was in effect caught in the crossfire (Agoa.info. (2018)). US protectionism always causes detrimental, counter productive effectes for its trading partners in terms of welfare and GDP. With USD 16.6 trillion, the United States of America is right now the world's biggest single market, with the US nationals accomplishing one of the most noteworthy overall per capita wages of USD 58,000. Because of its financial size, monetary strategy measures, specifically trade policies, have expansive harmful results on worldwide economic advancements. Another thorny issue, which could severely affect the SA economy, is the proposal by the US to impose tariffs on the imports of vehicles and their components. From March 2019, President Trump has three months to make a decision whether or not to impose these tariffs (Agoa.info. (2019)). It is reported that the US commerce department launched an investigation on the effects of cars and cars parts on the US national security. The investigation was carried out under section 232 of the Trade Expansion Act and it gives the president powers to adjust import tariffs if they pose security risks. Since SA automakers are exempt from tariffs from the AGOA agreement, a rise in tariffs could have a major effect on automotive component exports to the US.

3. Foreign exchange rates movement

The SA telecommunications industry has not been spared in this US initiated global trade war by way of collateral damage. Newly introduced financial sanctions on Iran prevents a company which does business with Iran from doing business with the US. From SA, the cell phone service provider MTN faces the most risk as its subsidiary MTN Irancell provides about 21% of its subscribers. MTN announced that “the sanctions may limit the ability of the group to repatriate cash from MTN Irancell, including future dividends and also that US sanctions could depreciate the exchange rate of the rial and so reduce the value of such dividends as it might be able to repatriate. These sanctions might also affect SA as a country, which buys oil from Iran” (Agoa.info. (2018)). The South African economy is hugely dependent on international trade and as a result the imports play a major role in the exchange rates of the rand and other currencies. The tariffs recently set by Trump on their trade wars with China are badly influencing the margins of the trade deficit in the South African Economy since most of the imports comes from China and the United States (Fin 2019). South Africa is a major exporter of mineral resources which are in-elastic commodities since most counties can do without some of these minerals such as platinum, iron and coal whereas on the other hand SA cannot do without crude oil. There is a deficit in the trade between the United States and China which are the two biggest trade partners of South Africa, since these nations are driving the trade wars the implications of this are detrimental to the rand strength on the exchange rates markets. According to the South African markets website the deficit amounts to R13, 672bn with China alone. The foreign investments are reducing which results in a shifts in the balance of trade since most product are imported. The demand for the rand becomes very low which leads to weakening of the currency in the exchange rates (South African Market 2019).The exchange rate of the rand against the US dollar (R14: $1) experienced a dip after the announcements made by Donald Trump of the $200bn tariffs to the Chinese imports. China responded with a hit back tariffs on the US goods (Movement of rand 2019).

If trading channels were to be cut due to failure to import and export, then companies will retrench their employees (Businesstech. 2018). South Africa as an emerging market relies on the United States and China for its growth and the current focus between these two giants is to make the best out of the trade wars, some speculations are saying that companies from China are deporting imported asserts in order to set themselves for further trade wars. If China decides to focus its trade on countries that are within vicinity, then this will have a negative impact on SA since it is one of its biggest trading partner (BizNews 2019).

Fund investors are opting for safer investments in the likes of gold reserves in place of emerging market currencies like the rand. The emerging markets are so much dependent on trade and trade wars poses a great risks to these markets, with South Africa under recession the rand is at very high risk. The South African Rand is one of the most used currencies in the emerging markets and it has depreciated by more than 15% to the American dollar as a trend observed with all other emerging market currencies due to the repercussions of the China –US trade wars with an exception of the Mexican Peso (Business live. 2019). The 80% depreciation of the Turkish Lira against the US dollar scared most foreign investors against the emerging markets. Turkey lacked enough forex to avoid the Lira depreciation, and as stated earlier if exports from South Africa to the US and China are reduced as a result of the trade wars, the Rand can find itself in the position of the Turkish Lira due to lack of foreign currency (Money control. 2019).

South Africa transformed into an open economy post-apartheid era and this leaves it very vulnerable to trade wars that involve its biggest trading partners. Investors will prefer to pull out of the emerging markets to safer havens due to the trade wars which mounts a lot of pressure on the currencies thereby affecting the exchange rates in the process. The rand has been very responsive to the trade wars and it has dropped drastically in the last few years during Donald Trump's tenure as the US president (Lundberg, L. 1995).

The exchange rate of the Chinese yen dropped by more than 8% against the dollar and this talks directly to the rand yen exchange rates. The Chinese Governor Yi assured the IMF steering committee that there won't be any manipulation in the yen exchange rates to the dollar. Donald Trump has previously blamed China for manipulating their currency in order to gain an advantage in trading since their products will be very cheap to consume (iol, 2018).

4. South Africa's labour market developments

On the effects of tariffs on labour productivity, Harding et. al (2010) investigated this relationship on South African industries. Using data for the period 1988 – 2003 it was concluded that a reduction in the industrial sector tariff contributed to higher labour productivities. Factors attributed to this increase in productivity include international technology spillovers, increased competition. These factors are referred to as "catching up to the world technology" and it is synonymous with an open economy (Harding, T. et. al (2010)). The tariffs on the steel and aluminium have a ripple effect in the South African economy since companies directly dependent on steel and aluminium will also struggle to cope will elevated prices due to the tariffs. This as a result leads to more jobs that are affected in the manufacturing industry. Baughman and Francois in their analysis mentioned that the services industry that is related to this industry such as insurance companies will also suffer as a result of the high tariffs affecting the Mining sector (BusinessInsider. 2019). South Africa is estimated to be contributing about a fifth of the mineral commodities in the world and trade wars mean that the largest consumers of these minerals are at a go slow which affects the production scales of minerals such as platinum, gold and coal and obviously the rate of employeemnt in the mines. The results of the trade wars have led to uncertainties in the setting of Mining Charter and this has dropped investor's confidence which drives the sector into a recessions and losses of jobs as well as the shrinking of the mining industry (Business LIVE. 2019). The article by Luyolo Mkentane in the iol publication which was released after the BRICS summit in 2018 , President Xi Ping raised his concerns against the trade wars on emerging economies and South Africa is said to be at high risk of losing major jobs in the steel and aluminum industries. About seven thousand jobs in these sectors were said to be on the line due to the tariffs (US-China tariffs, 2018).

On the other hand the South African Poultry Association tried to persuade the Government to introduce antidumping tariffs against poultry products that were imported from the United States in 2018 and this threatened serious retaliation measures from the US government. This decision came as a results of Donald Trump Government's decision to impose tariffs on aluminium and steel imports from SA (Joe 2018). Poultry industry creates close to 130000 jobs and this gets immensely affected by imports from countries such as the United States. The dumping of poultry products in 2016 resulted in closing of some abattoirs in the North West Province in South Africa since the local chicken prices usually fails to out compete the exports. Determinants such as low prices of the imported poultry products leads to high demands of the imported chicken and the opposite is true for the locally produced poultry products. In the long run the local producers can't stand the competition and they are eliminated from the market (Kevin 2016).Looming tariffs on motor vehicles imports by the United States in the next three months threatens to leave a dent in the South African employment sector The Trade expansion Act's Section 232 has previously affected steel and aluminum by 25% and 10% respectively. The African Growth Opportunity Act (AGOA) which facilitates a duty free access to the United States markets is threatened by these tariffs and companies such as BMW will be the most affected in South Africa (Linda 2019).

The cost of living for South African consumers has increased drastically due to increased VAT which is a result of increased fuel import prices and the spending of consumers contributes to 60% of the GDP. China is focusing on stabilising its economy as a result of the trade wars and this leaves South Africa in the loophole since certain potential trade deals such as exports to China had to be suspended (BusinessLIVE. 2019. Trade wars turn up the heat).

Some analysts believe the emerging markets like South Africa will benefits from the current trade tensions in the long run when markets start to recover. The drop in prices of certain commodities as a result of the trade tensions will attract more trade for the emerging markets like South Africa in future and this talks directly to a boom in employment opportunities (Fin24. 2019. US-China trade).

5. Conclusion

It is worth mentioning that in any war, there is the emergence of free riders which in the current scenerio are countries, which would benefit from the trade war. South Africa is expected to benefit from a US-China trade war in the field of fruit and wine exports only. China's 15% tax on US wine, nuts and fruit imports is expected to boost SA agricultural exports to China (Businessinsider.co.za. (2018)). However, the disadvantages of these trade wars far outweigh the benefits the SA companies might realize. Some researchers have concluded that in the even US breaches the WTO agreements, an international trade war aimed at retailiating for American aggression would be inevitable. The effects of protectionism on South Africa are:

① Reduces products competitiveness thus leading to a drop in the amount of exports
② Affects international trade relationships with SA being on the losing side most of the times
③ Depreciate the rand exchange rate
④ Jobs and skills may be lost.

Trade remedy through protectionist policies can only be justified if the financial consequences sought cannot be achieved by other means.

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