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# THE RISK OF GLOBAL FINANCIAL MARKETS: THE CASE OF CHINA IN A DEVELOPING COUNTRY

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## Abstract

Globalization has forced many countries to rely on one another for products and services which they are unable to source locally. More so, trade is used as the channel to procure those. South Africa and China share very close relations which are boosted by South Africa's neo-liberal policy, and its membership of the BRICS bloc. Often, this relationship has been subjected to different interpretations leading to the inability to reach a consensus on South Africa's intention and exact benefits from neo-liberalization and membership of BRICS bloc. On this basis, we affirm that a notable gap exists in scholarly literature which has not provided the full-fledged understanding of the impact of Chinese manufactured goods into South Africa. We draw from the concepts of protectionism and free trade to expatiate the concerns raised by many with respect to the nature and benefits of the relationship. The paper relied extensively on secondary sources of data from which the authors then analyzed, interpreted and drew conclusions to provide a contextual explanation of the phenomenon of Chinese invasion of South African market. This method was useful for two reasons; namely its capacity to generate new insights and secondly, access to comparative studies. While the results show that South African clothing firms are increasingly shutting down because of lower prices from international competitors (especially China), and also due to structural issues of the present South African economy, we are equally aware of the extensive pressure from interest groups for the South African government to protect major local industries such as steel and textile. We argue anyway that the South African government is playing its cards carefully to avoid a backlash, especially considering its position within the BRICS bloc.

**Keywords:** BRICS, Protectionism, Free Trade, South Africa, China, Neo-Liberalism, World Trade Organisation

**JEL Classification:** D53, L41

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## 1. INTRODUCTION

The persistent interdependence of nations owing to globalization firmly places trade as the conduit for countries to sustain domestic demands for goods and services of diverse nature. Since the inception of democracy, and the adoption of the controversial neo-liberal policy in the 1990s, South Africa has reached out and engaged other nations in commerce. The overwhelming advantages of international trade that have been advanced by its proponents have not necessarily eliminated its shortcomings. For example, South Africa's neo-liberalization policy of 1994 has shown some notable weaknesses, among them are the flooding of South Africa's markets with 'inferior' and 'cheap' Chinese products especially with respect to textile and clothing industry. Arguably, the industry is a shadow of its former self owing to that (Vlok, 2006). Therefore, one can squarely situate the blame on South Africa's diplomacy and trade relations with China. As Netshiozwi and Edoun (2015) note, China's presence in South Africa has resulted in the shedding of jobs in the local textile and clothing industry while some

of the local mills and factories have been forced to close down.

China's role in South African market has been enhanced by two major factors namely (1) South Africa's neo-liberal policy, and (2) South Africa's membership of BRICS. These two factors have been subjected to different interpretations by many leading to the inability to reach a consensus on South Africa's intention and exact benefits from neo-liberalization and membership of BRICS. Therefore, a notable gap exists in scholarly literature which has resulted in a lack of understanding of the impact of Chinese export of manufactured goods into South Africa. In our view, scholarly literature has not provided the necessary framework that clarifies the complex trade relationship between the two countries which may not be said to be conclusively advantageous or disadvantageous to South Africa's socio-political economy. We are aware that some studies have tried to address these issues, yet none has duly considered the socio-economic implications of Chinese - South Africa trade relationship within the context of the textile and clothing industry. This is the gap that this paper seeks to fill.

## 2. RESEARCH METHOD

This paper explores the effects of Chinese products on South Africa's local clothing and textile industry as well as the ongoing debate among interest groups on whether to protect or further liberalize the already neo-liberal economy of the country. The paper relied extensively on secondary sources of data from which the authors then analyzed, interpreted and drew conclusions to provide a contextual explanation of the phenomenon of Chinese invasion of South African market. This method was useful for two reasons; namely its capacity to generate new insights and secondly, access to comparative studies. Furthermore, this paper benefits extensively from firstly establishing a theoretical basis that helps in contextualizing its arguments (Harris, 2001). Often thematic analysis is facilitated by secondary data. In our own case we instead undertook a review of literature that poignantly buffers our objectives of sieving constructive data from propaganda in order to carry out an "objective analysis of the messages" (Berg, 1998) in the material's consulted.

## 3. LITERATURE REVIEW

### 3.1. China's Economic Prowess

Abraham and Hove (2011) are of the view that since China's economy became competitive at global level, it has continually encouraged free trade with subsequent increased exports of finished commodities into the Organisation for Economic Co-operation and Development (OECD) markets. Evidently, China's emergence as a major producer of manufactured products has reduced the export market shares of OECD member countries. The big deal about China's global trade penetration is that OECD member countries like most countries do not have adequate strategy to cope with Chinese competition in manufacturing industries. It is possible for China to be a major producer of manufactured products of labour intensive-industries because its population and location provide it with access to cheap labour and the necessary raw materials. African countries, like OECD member countries have become victims of the flooding of China's finished products. South Africa's membership of BRICS and World Trade Organization (WTO) has thus helped to open more space in its market for China's finished products.

Kasongo (2011), and Guillaumont and Hua (2015) explored the economic relations between Asian Tiger's economies that are fast industrializing and developing African economies. Their view is that the relationship has produced an unequal balance of power. The main thesis here is that the systematic check of trade relations between the two continents; Asia and Africa reveals speedy growth in Asian political economy while Africa is subjected to a lower level of production of raw materials for industries in Asia and elsewhere. The Asian Tiger's supply of manufactured goods to African market has grossly reduced growth in the manufacturing

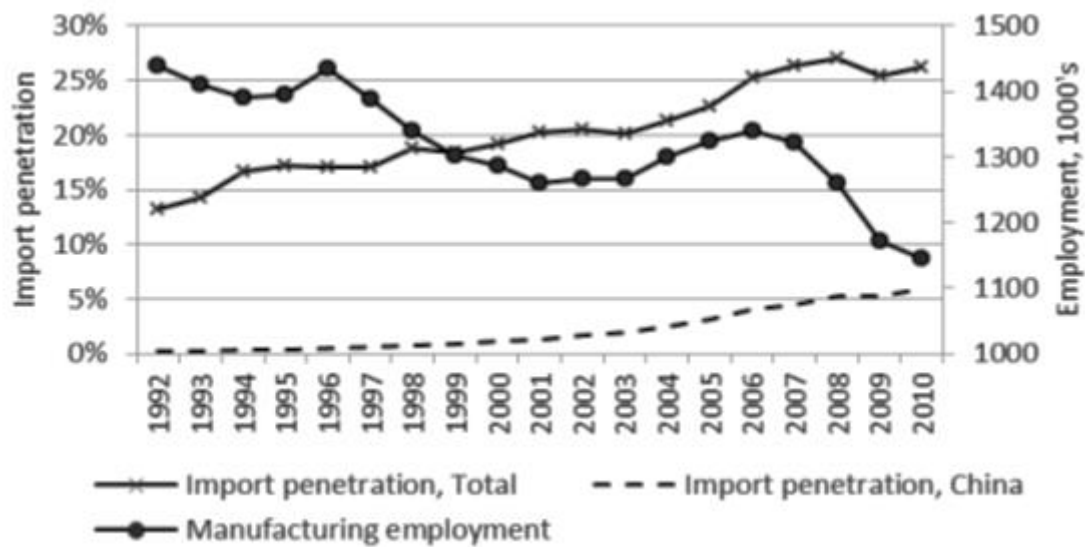
sectors of Africa while China remains a major role player in import penetration into Africa. South Africa remains the most industrialized country in Africa and like any other country in Africa (see Umezurike & Asuelime, 2015); China has outplayed South Africa in the continent's markets (Centre for Chinese Studies, 2015) resulting in the notion that South Africa is near deindustrialization.

Interestingly, China has long been a trading partner of South Africa even before the advent of democracy in 1994. However, the dawn of democracy further facilitated trade relations between the two nations. The neo-liberalization of South Africa's economy and its re-admission into the world's socio-political economy were instrumental to the enhanced trade between the two countries. Increase in South Africa's international trade was part of the signals that marked the end of its existence as a pariah state in the global affairs (Adebajo, 2007; Umezurike, 2015). Thus, China's trade export to South Africa has continued to be on the increase especially manufactured products. For example, China's top 10 exports to South Africa are finished products (Ballim, 2012).

The claim however is that African continent's strong ties to China offers the continent clearer opportunities to play a bigger role in the international political economy. It is clear however that this relationship is unequal and interestingly, both governments (i.e. South Africa and China) appreciate its structural deficiency (Ballim, 2012). Therefore, rising from the acceptance that the relationship is skewed and unsustainable, both countries have agreed to use a policy framework to correct the imbalance. Firstly, both countries have to cooperate with each other to boost value-added exports from South Africa to China, and secondly to raise China's investment in South Africa. South Africa has also put forward the quota option for Chinese products but it may not be the answer because China is against trade barriers. For instance, in 2010, China accounted for between 48% and 77% of total imports into South Africa of knitted and crocheted fabrics, clothing, leather and leather products, foot wears, household appliances, electrical lamps, and furniture (Edwards & Jenkins, 2015).

### 3.2. The Impact of Cheap Chinese Clothing Imports in South Africa

Edoun and Netshiozwi's (2015) study of the impact of Chinese imports on employment in South Africa's textile and clothing industry found that the rise in imports from China brought about a decline in employment levels in the industry. The textile and clothing industry, according to Edwards and Jenkins (2015) has lost well over 150,000 jobs. In the face of this, clothing and textile imports from China are estimated to have surged to 110% since 2003 (Nevin, 2010). There is no doubt that the influx of Chinese textile and clothing materials into South Africa is not without consequences to domestic textile and clothing industry.

**Figure 1.** Manufacturing employment and import penetration

Source: Edwards, Flowerday, Rankin, Roberts and Schöer (2014)

The figure above shows that increase in Chinese products in South Africa ultimately leads to decrease in employment in the manufacturing sector. Nevin (2010) thus suggests that South Africa should devise a strategy to break the impasse as local industries are fast losing grip in the home market due to cheap China's goods including especially importation of inferior and pirated goods. The Department of Trade and Industry's plan to protect the textile and clothing industry through the enforcement of a quota system did not yield positive results (Business Day, 2014). Nonetheless, some analysts view Chinese incursion into South Africa differently. Nevin (2010) reports of academics who claim that increased Chinese import into South Africa is beneficial because (1) owing to its affordability, more sales are generated hence more sales assistance jobs are created; and (2) the high sales volume also results in more taxes especially value added tax (VAT) which capacitates government to deliver more services. It therefore suffices to say that because lower income earners get their preferred products at lower prices, the tendency is that they may have more resources saved for other needs such as food, transport, education and several other needs. On the other hand, Vlok (2006) maintains that although the principal cause of lower growth rate in the textile and clothing industry may be structural, the view of many is that the crisis is largely caused by a high increase in imports, particularly from China. The survival of the industry is thus seriously threatened and it is doubtful whether the local producers will survive the surge on the long run.

### 3.3. Structural Issues in the Textile and Clothing Industry

Beside the cheaper imports from China, other factors influencing its triumphant existence in textile and clothing industry in South Africa may involve the following: mechanization and automation, research and development, skills and expertise base, quality orientation and, the near

removal of import quotas (Ramdass & Pretorius, 2011). In addition, the following can be associated to the decline in the industry in South Africa: lack of resources to adapt to changes in the industry, ineffective management techniques and poor leadership qualities, conservative approach to business, and lower investment. Other factors include shortage of versatile knowledge and skills, proper training techniques, lack of strategic thinking and positioning, a pressurized industry, and local politicking by home companies (Adewole, 2005, in Ramdass & Pretorius, 2011).

These problems have led to lower levels of productivity as well as the lack of capacity to compete with Chinese products. Ramdass and Pretorius (2011) believe that local garment producers should understand the factors that make the market environment complex so as to improve production. It is therefore necessary to use the right techniques to understand the complexities that surround the textile and clothing industry. It goes without saying that if the composite elements are understood, there is a better chance for South Africa's textile and clothing industry to reasonably compete with manufactures from outside its borders including China. According to Ramdass and Pretorius (2011), Adewole (2005) suggested the following as areas that facilitate a better understanding of the complex nature of the industry.

- Throughput time per unit: This means the required time needed to accomplish a single unit of production activity versus the time to accomplish the next task;
- Inventory of processes: This is used to buffer stock, machine breakdowns, and line balancing;
- Critical path: This underlines the need to arrange things in parallel or in series to enhance production activities;
- Bottleneck operations: This refers to the identification of necessary actions to be taken without delay in order to ensure enhanced production in the industry;

- Plant utilization: This means estimates of effective use of resources to enhance production in the factory;
- Minimum order size: This affects the set-up costs for the production processes and has a bearing on cost per unit;
- Change-over/setup: This is the loss in production when there is a change in techniques of production; and
- Rejects and repairs: This means the capacity to evaluate loss through repairs and costs lost through damage.

### 3.4. Protectionism and Free Trade Policy

It is common knowledge that nowadays nations may not be able to exist in isolation; regardless of its affluence, it would still need other countries in one way or the other. Therefore, the need for international trade is not questionable rather the manner in which a state engages in international trade and policies that surround it. A question often asked is, should a developing country such as South Africa embrace free trade in all cases or provide some level of protection for home companies? Our view is that there is so much debate around this issue reflecting diverse opinions. However, we provide some context using the following table.

**Table 1.** Aggregate employment losses owing to free trade. Chinese imports in South Africa

|                                       | 1992-2001 | 2001-2010 |
|---------------------------------------|-----------|-----------|
| Loss of employment to Chinese imports | -24,117   | -77,751   |
| Loss of employment to all imports     | -144,734  | -710,318  |
| Productivity growth                   | -352,617  | -113,467  |
| Change in employment                  | -179,457  | -113,467  |
| Gain from export to China             | 2,585     | 4,080     |

Source: Adapted from Edwards and Jenkins (2012)

Table 1 shows that the loss of job from 1992-2001 was 24,117, but after China became a member of the WTO on 11 December 2001, the loss of jobs jumped to 77,751 between the period 2001-2010. China's membership of WTO signified her deeper integration into the world economy and allowed Chinese goods free access to South Africa's market. The free access meant more competition for local industries that had to adjust by laying off workers thus escalating the unemployment rate in South Africa. A critical look at the industries that were most affected include clothing, knitted and crocheted fabrics, footwear spinning and weaving and furniture. One would deduce that the reason for the successful penetration of Chinese products into South Africa's market is the cheap labour that helped reduce cost of production in China and hence lower export prices.

However, the unemployment rate in South Africa slightly decreased to 26.6 percent in the June quarter of 2016 from 26.7 percent in the three months to March. The number of those without employment dropped by 1.6 percent while employment went down 0.8 percent. This 'positive' scenario of unemployment rate was as a result of improved employment in the manufacturing

industry (+4.1 percent), with private households contributing +3.1 percent, while construction contributed +1.9 percent and utilities contributing +0.6 percent (Kazemi, 2016).

The next section of the paper discusses major traditional arguments put forward in support of and against protectionism.

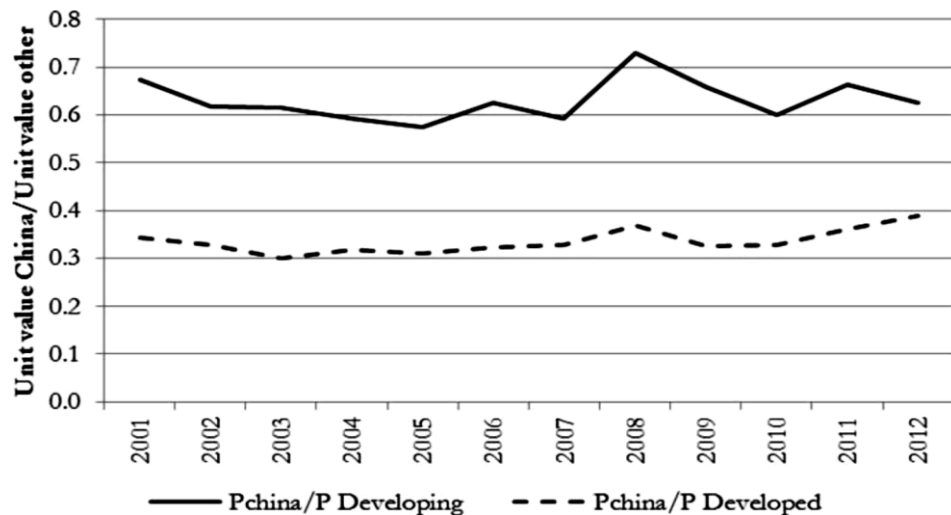
### *Protectionism policy*

Protectionism refers to any measure designed to provide advantage for local industries over foreign competitors. Protection of local industries and their employees may be delivered through guided policies around tariffs (taxes) on imported goods, and quotas (limiting the quantity that could be imported) (Xinhua, 2012). These trade control measures or otherwise barriers may broadly be categorized into tariff barriers (various forms of taxes) and non-tariff barriers (exchange controls, import licensing, locally assisted projects, regulations, import quotas and embargoes). State regulation may require suppliers to purchase from local firms thereby excluding foreign competitors from certain state deals (Bonciu & Ghibutiu, 2011). Government may also grant export subsidies to local companies in order to create advantage for home industries. Apparently, this makes the locally produced commodities more competitive on the global market. These tools are designed to achieve the objectives of protectionism.

However, Altman (2000) contends that sometimes, some sectors of the economy may experience decline (sunset industries) because of foreign competition either locally or internationally. If such industries are relatively large and relevant in the economy, the situation may lead to high levels of structural unemployment because of the activities of foreign competitors. It is mostly in view of addressing structural unemployment that governments usually want to protect these industries in order to protect domestic employment (Altman, 2000). The political implication of protecting domestic jobs critically forces governments to pay attention to protectionist lobbyist groups. For example, tinkering to labour unions or manufacturers associations so as to prolong the industrial decline process (Bussière, Pérez-Barreiro, Straub & Taglioni, 2011). Therefore, it is better to move resources from such industries into another that may be more viable despite the short-term social cost for the sake of expanding the economy.

Nations tend to protect immature sectors until such a time the local industries are fit to stand competition in the international market. With respect to the protection of an infant (sunrise) industry, government's defense is that such industry is still tender and economists may argue that they lack economies of scale advantage which is the attribute of more established industries in more competitive economies (Schaefer, 2003). This makes less established domestic producers vulnerable to imports from industries that enjoy economies of scale in their home countries. Therefore, it is necessary to protect domestic companies against foreign products, until they reach a certain level that they may favorably compete with rival companies (Reyes, 2012).

Figure 2. Unit value China/Unit value of other SSA



Source: Adapted from Edwards and Jenkins (2015)

The above figure shows the impact of Chinese products on South Africa's manufacturing sector between 2001 and 2012. In South Africa, job losses continue to loom in manufacturing sectors especially textile and clothing while workers in other BRICS countries (China and India) benefit. As a result of the continued job losses, trade unions are forced to vigorously lobby for protection. Nonetheless, other industries deserve protection as well. Some of these include agriculture and defense. The power and steel sector is vital for manufacturing products while agriculture sector facilitates food production.

Sometimes lack of protectionist policy may lead to a particular country serving as a dumping ground for another. A state may wish to use sanctions to provide safety, health or environmental standards on imported products into the country. This will provide the opportunity for imports to meet local standards. For example, the European Union (EU) had at one time blacklisted American beef owing to the claim that they were treated with hormones (Johnson & Hanrahan, 2010). Many hold the view though that sometimes standards are used as a cover to engage in protectionist policy. In many instances where countries prohibit goods on the basis of standards, the usual response of the counterpart country is to retaliate with sanctions. In the event of the EU-US beef dispute, the United States of America responded by imposing trade sanctions to the value of \$117 million on EU export to the United States of America. If the import expenditure is greater than export revenue then the country faces a balance of payment (BOP) deficit. Therefore trade barriers may be an instrument to limit growth in demand for foreign products in order to promote the overall balance of trade of products and services (Johnson & Hanrahan, 2010).

### ***Free trade and competitiveness***

In the beginning of 19<sup>th</sup> century until 1970s, the principles of comparative advantage governed international trade theories. Comparative advantage theory may be conceptualized as the idea of countries specializing in the production and

marketing of products it makes (Krugman, 1987). The view is that, nations should concentrate on the production of goods and services for which they have expertise and then trade off its surplus goods and services. This will provide opportunity for nations to purchase what they are unable to produce at reasonable cost. Through such exchange every state is better off with international trade. The proponents of free trade hold the view that growth in the global economy could be attributed to international trade. Through the making of bigger but more competitive market environment, trade limits the disorder that accompanies unhealthy competition in a closed protectionist economy.

South Africans are increasingly becoming dependent on foreign made clothes, food, domestic items including electronics and electrical. However, this dependency may be viewed as one of the benefits of international trade around the globe since people may easily acquire the items they need. Economically, it makes sense if countries may allow beneficial exchange across borders (Milner & Yoffie, 1989). The general notion of free trade is assumed to be fair trade especially because it provides consumers with options. Free trade provides more outputs in terms of commodities and services into the market environment, and at the same time makes prices lower with higher quality products because of growth in competition and ultimate benefit of consumers.

Indeed, access to a greater variety of goods and services is the purpose of trade. Imports, then, are not a sacrifice, but a necessary evil for the good of exporting. One exports so that one may acquire goods and services in return. This logic is evident on a personal level as well. A person works so that he/she has the means to acquire what they want. One does not make purchases in order to justify working. South Africa has demonstrated repeatedly, particularly over the last decade that competition leads to increase in innovation and growth (Prasad, Rogoff, Wei & Kose, 2005).

In South Africa free trade may have created opportunities for growth of businesses and keeping alive economic activities. In a free trade enterprise economy risk-taking may increase sales volume

thereby delivering profit margins, and market share. Firms can capitalize on profit margins to increase operations by going into new sectors of the economy. In general terms, free trade may be able to create middle class jobs if the economy is innovative. One may also correctly argue that free trade in South Africa's economy may have contributed in improving standard of living in African continent in general. South Africa has played an important role in foreign direct investment in Africa since neo-liberalization in 1990s.

Foreign investment allows domestic industries to develop and provide better employment opportunities for local workers. This positions foreign direct investment as one of the most important benefits of free trade for developing nations (Brett, 2000).

Many have argued that free trade reinforces the rule of law, removes factors that necessitate corruption by stimulating economic growth, create better-paid jobs as well as foster prosperity in the society. Arguably, free trade supports far more than just physical goods and services in a country, it may as well promote the transfer of ideas and values among people. In fact, free trade is an embodiment of freedom in any society since it provides people with the opportunity to attain desired goals in life. In the 18th century, a world renowned economist, Adam Smith said that free trade fosters self-confidence to people by opening up avenues for the inflow of new products, services, ideas and practices that are attached to them. Froning's (2000) argument is that free trade is an embodiment of freedom and determination to attain improved life. The point is that free trade provides opportunity for the creation of sound infrastructure in the socio-political economy. By creating this enabling environment even poorer states may create friendly markets favorable for international trade, commerce and investment.

The inter-dependence of nations may lead to drastic reduction in international conflicts. Under free trade arrangement healthy competition takes place among nations which creates incentives for firms to minimize costs and offer consumers fair prices (Howse & Trebilcock, 1996; Stiglitz, 2005).

#### 4. CONCLUSION

As a result of the influx of the so-called cheap Chinese imports into South Africa, its textile and clothing firms are closing down. The reasons for this have been carefully articulated by several analysts. While some analysts refer to the cost value derived by South Africans, others lay the blame on government's inability to adequately protect its local industries. With respect to this, there is also the claim that government is unable to regulate the influx as a result of its membership of the BRICS bloc. Again structural issues are putting local clothing manufacturers out of business which gives foreign competitors an edge in the textile and clothing industry.

Protectionism is more or less a national strategy based on cost-benefit analysis. In making or adopting a protectionist policy, nations attempt to secure more local jobs and put faith in local products. Our view is that there is still a gap in literature and to form a more concrete opinion on

this complex matter; it may require more research regarding South African current protectionist policy approach that shapes or rethinks the nation's neo-liberalization policy. Inevitably, protectionism policy may invoke retaliatory measures from partners and foreign governments. This may inadvertently reduce the benefits that could accrue to consumers and manufacturers in all nations.

The truth is that the debate over free trade or protectionism is not likely to be settled any time soon. We agree that there are many benefits attached to keeping or respecting international trade agreements; however the consequences or effects on a society may need to be re-examined. It is still not obvious if the benefits of protectionist policy are worth the risk of the consequences or whether the regulations stopping free trade are really protecting the nation as a whole or just a section that has an interest in growing their business. To say the least though, it is important to get a balanced outcome in the end. That is, the state should protect certain industries but promote free trade to the extent that it will promote national interest and cohesion. Even as we proffer this suggestion, we are equally concerned that not only are South African clothing firms shutting down as a result of lower prices of international competitors (especially China), they are also struggling owing to structural issues in the economy. Our analysis shows that while South Africa faces pressure from interest groups for what they claim is government's lack of protection for local industries, the government plays its cards carefully to (1) avoid a backlash from its allies in the BRICS bloc and (2) not be seen as stagnating its neo-liberalization policy.

Relying on secondary sources of data has its demerits. Papers of this nature often lack what the authors characterize as 'objective appropriateness'. This term has been coined from Denscombe's (2010) description of appropriateness of data. To explain further, the sources we consulted focused on objectives which may not share close and direct association to our paper's focus. Yet we drew data that seemed relevant to our own reality and therefore may have been partially influenced by them. Frankfort-Nachmias and Nachmias (1996) in fact add that such data may not even necessarily serve the objective. But Burnham, Lutz, Grant, and Layton-Henry (2008) also affirm the use of secondary data in discovering likely answers to a research question as well as highlight areas where new research needs to be done. Essentially, we call for, using a combination of several research methods, extended studies and discussions on the subject of China's incursion into South Africa to decipher how best to curb the diminishing textile and clothing industry of South Africa including the gross loss of employment. It is important to note that the shortcomings articulated above should not in any way dilute the significance of this paper as it has unearthed the myriad issues that plague South Africa in relation to its trade relations with China

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