Where is Globalization Headed: A Supply Chain View

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This lecture: Where is globalization headed?

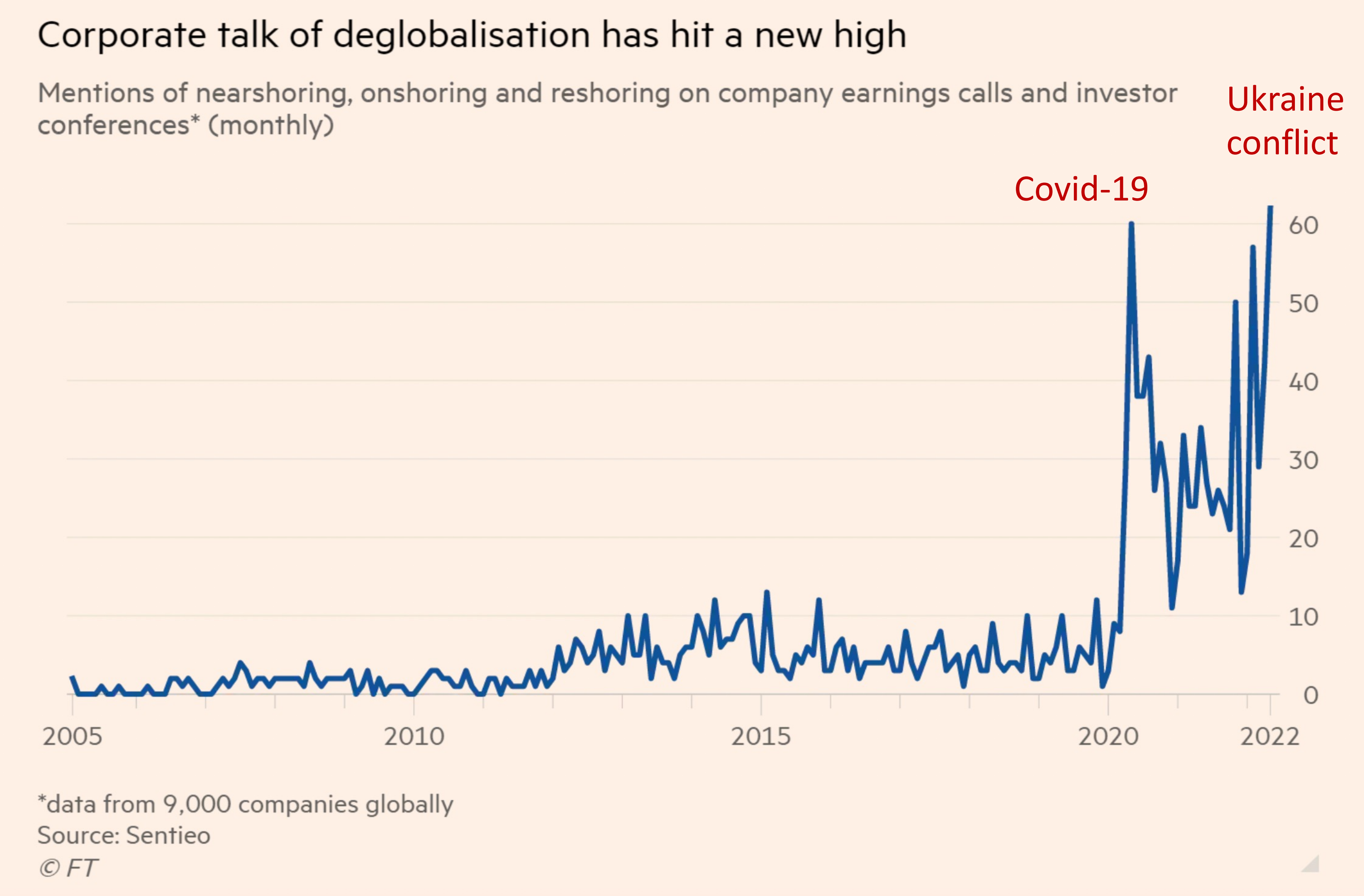
- Globalization has benefits, but also costs and risks
- The conflict in Ukraine – and earlier events like Brexit and Covid-19 – led to declarations on the "end of globalization"
- A supply chain perspective on globalization:
    1. Why do we buy from or sell to far-off places and build global supply chains?
    2. Why is globalization under threat?
    3. Are we talking about de-globalization or de-risking globalization?
    4. What does the future hold for globalization?

“The Russian invasion of Ukraine has put an end to the globalization we have experienced over the last three decades [1990s to 2020],” *Larry Fink (2022)*

- “Russia’s aggression in Ukraine and its subsequent decoupling [the “economic war” on Russia] from the global economy is going to prompt companies and governments worldwide to
  - Re-evaluate their dependencies and
  - Re-analyze their manufacturing and assembly footprints
- …something that Covid had already spurred many to start doing.”

Source: L. Fink, 2022. Chairman’s Letter, March 24, https://www.blackrock.com/corporate/investor-relations/larry-fink-chairmans-letter

Deglobalization: Corporate talk of nearshoring, onshoring, and reshoring – changing the manufacturing footprint



Terminology

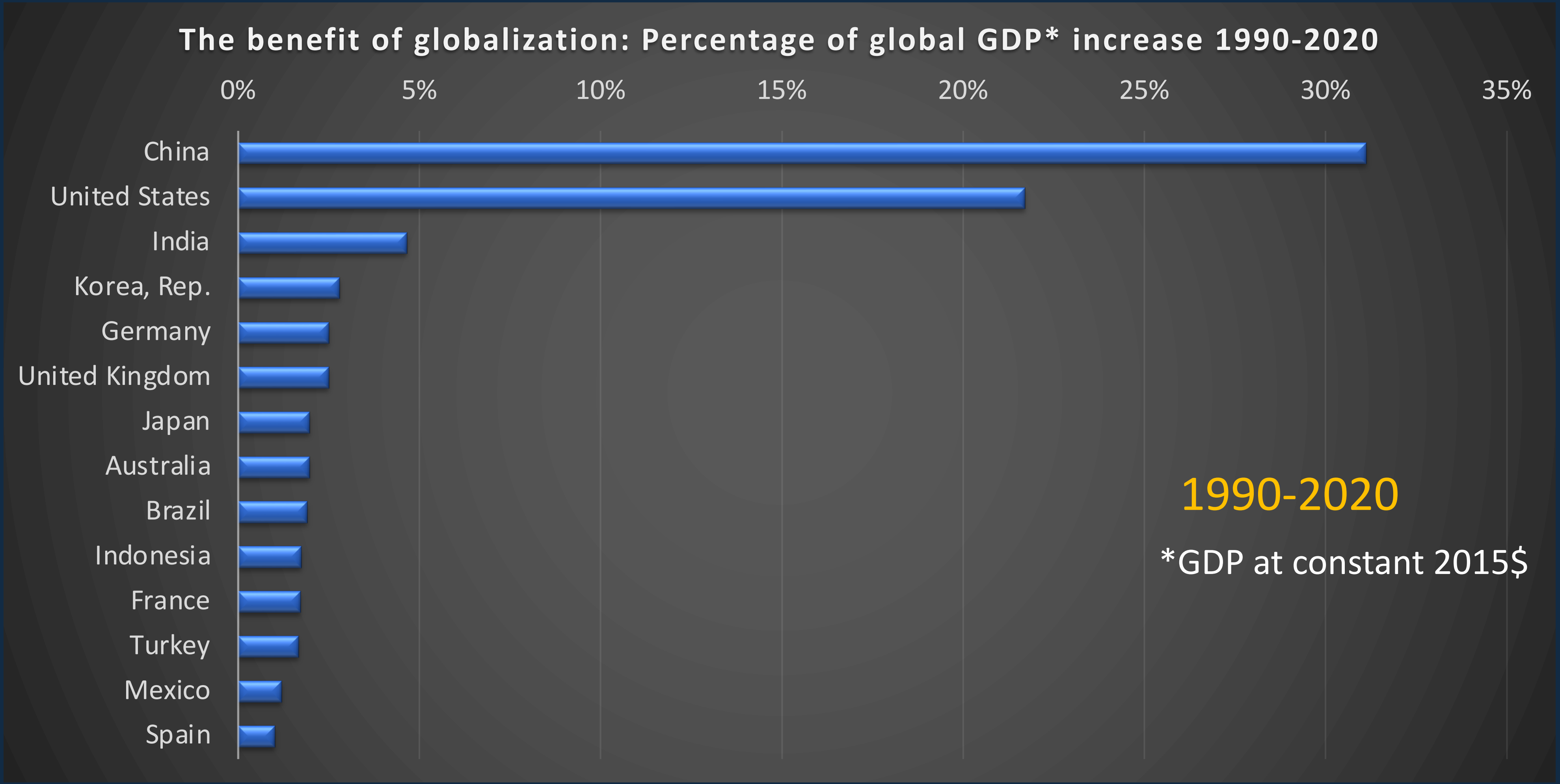
- Globalization here involves increasing trade between countries and companies in different countries, particularly those far away…Offshoring fits this view
- Deglobalization here reduces such trade; near-shoring, onshoring, and reshoring bring operations closer to the home country
- Supply chains are how raw materials, components, semi-finished goods, and finished goods move from one company or country to another.

Recent years have been challenging for globalization…

- Strategic rivalry with China – “the world’s factory” – from the US perspective, but potentially heating up now…
- Covid-19 jammed up global supply chains and continues to do so
- The Russian invasion of Ukraine and an “economic war” – as Fink puts it – by the west on Russia

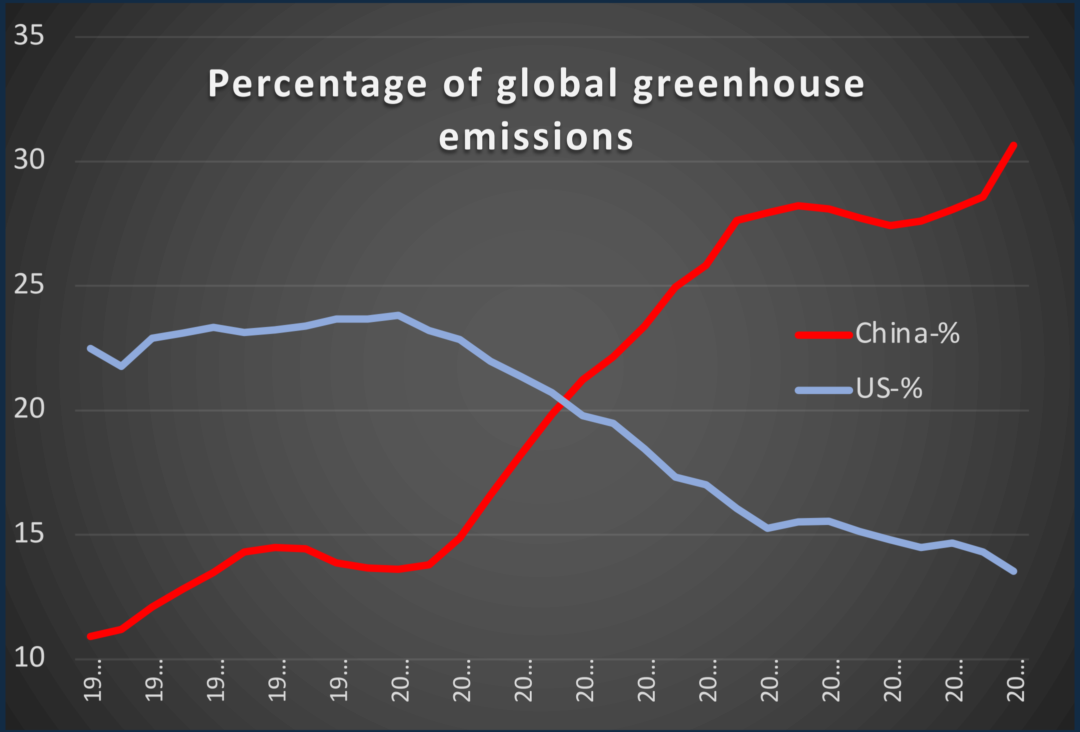
…but 1990-2020 have seen many other challenges, both natural and manmade

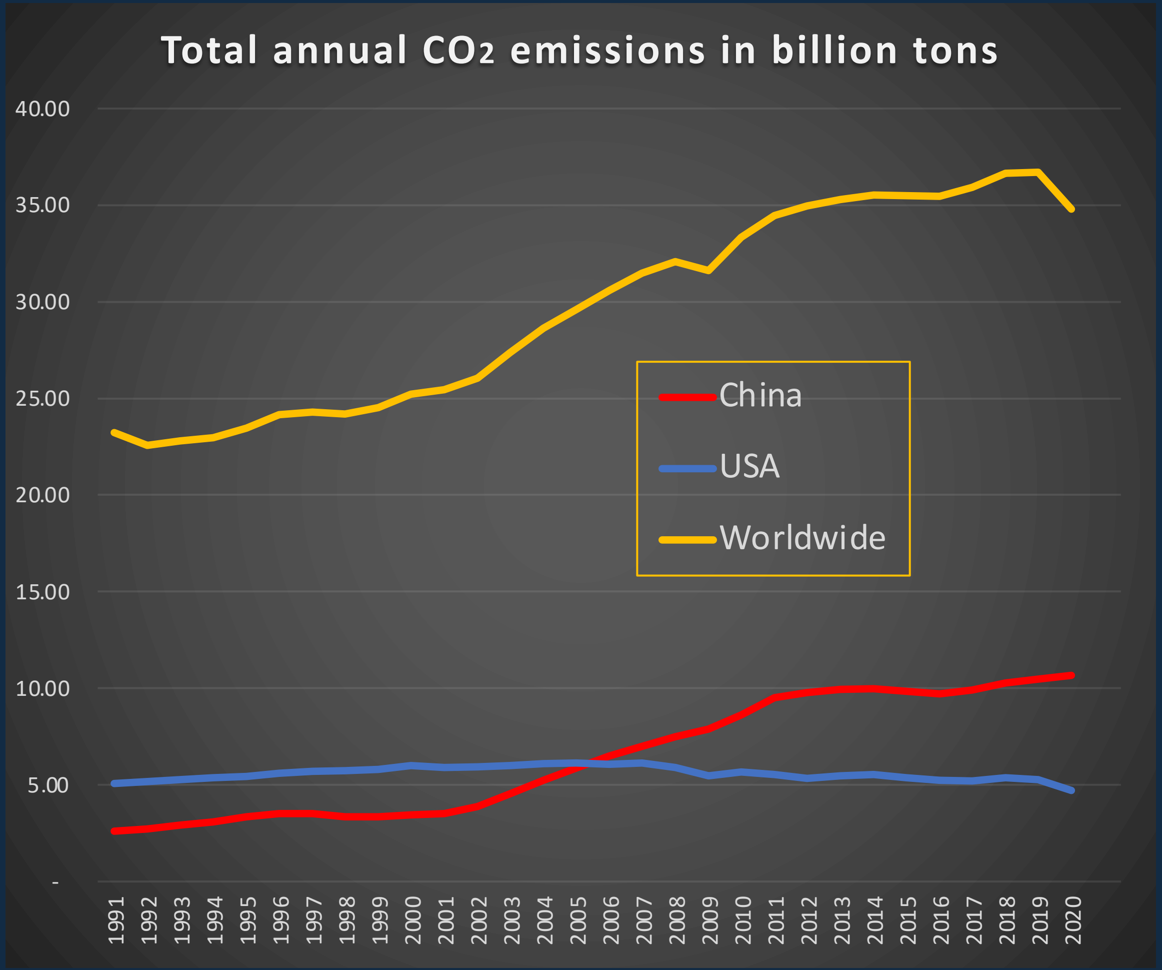
Globalization has had economic benefits, but 52% of the global increase in GDP went to just two countries: China and the US



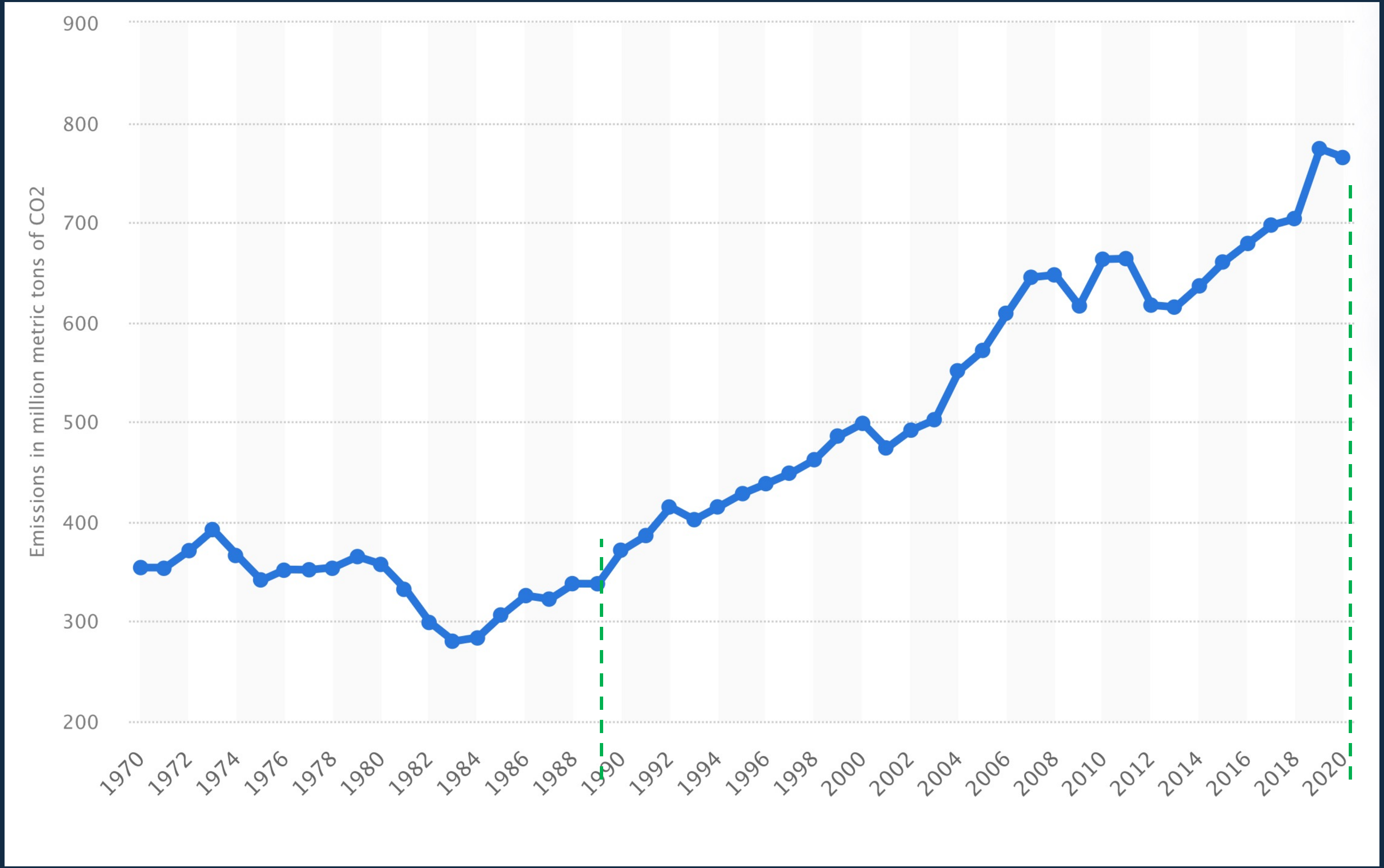
...with nearly 80% to just 15 countries and 90% to just 30 countries

As for costs, global CO_2 emissions have grown, despite being moved between countries with globalization





Trade via international shipping led to CO_2 emissions more than doubling in 2020 from 1990…

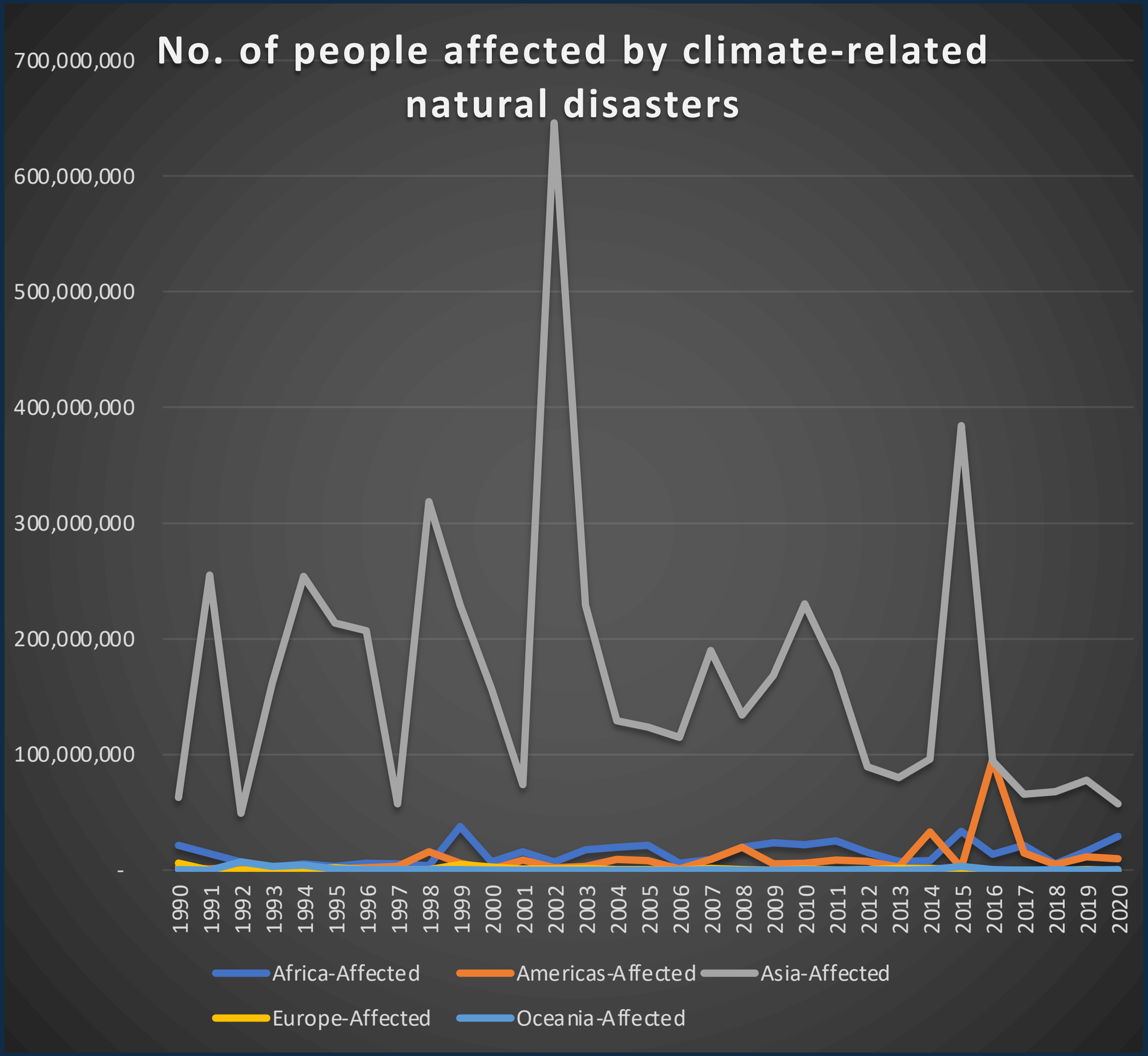


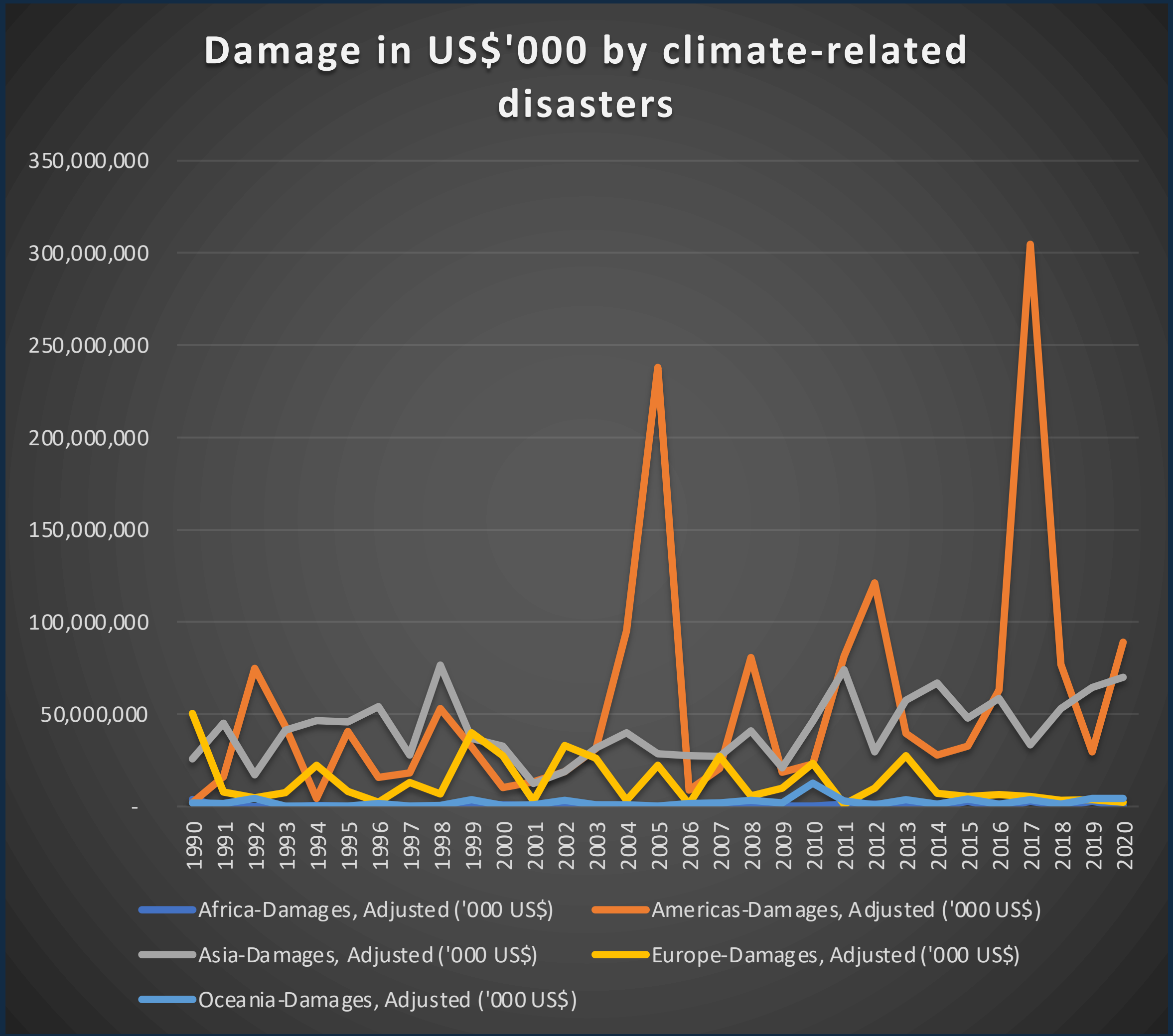
…with bulk carriers being responsible for 57% of the emissions in 2020.

Overall, shipping is responsible for 2.5% of global CO_2 emissions.

Source: https://www.statista.com/statistics/1291468/international-shipping-emissions-worldwide/

Unlike benefits, costs by way of climate-related natural disasters affected people in many countries over 1990-2020…

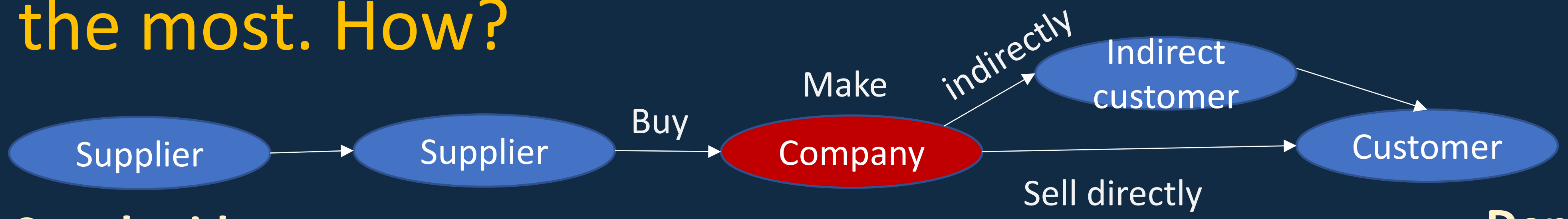




We also became more aware of “modern slavery” in the world.

- 40.3 million (est.) modern slaves (5.4 people per 1000) in 2016,
    - 24.9 m in forced labor
- 16.0 m in the private economy -> supply chains
    - 9.2m female
    - 6.8m male
- 71% of the 40.3 m were female.

Yet globalization continued, led by those who benefitted the most. How?



Supply side

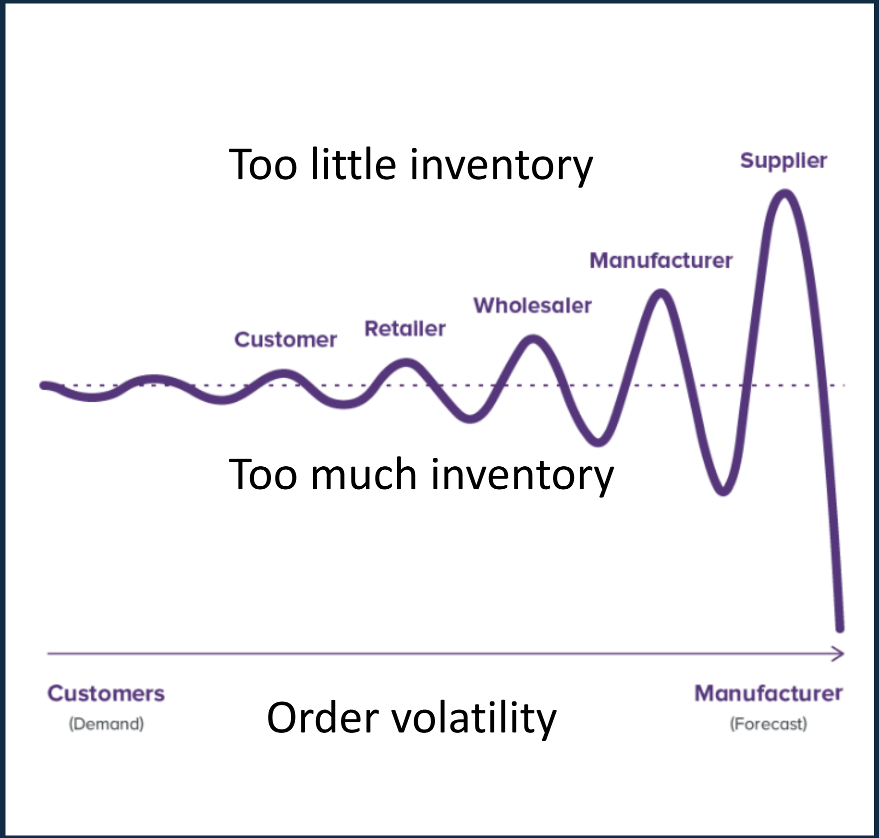
Demand side

- Companies face 'make or buy' decisions to be able to create goods or services for their customers
- If you buy, the supplier has the same decision
- Make decision: make it here (home country) or make it elsewhere (low-cost country)
- Buy decision: buy here or from a supplier in a low-cost or high-capability country

- Companies wish to expand sales
- Sell to companies in other countries
- Those companies may add value-added services in turn

Supply chains got longer…creating more disruptions and the bullwhip effect instability

- More fragility: the more links that can break, disrupting the flow of goods
- Bullwhip effect: amplification in *the variability of orders* as you get farther away from the handle held by the consumer (buyer) – and *continued instability* even when there is adequate capacity
  - Covid-19-related shortages – longer shipment times; unavailability of some goods; then oversupply
  - Walmart and Target stocks hit badly: too little inventory, then too much inventory → markdowns



So, globalization grew with $1.4 trillion of exports in 1990 to $18.3 trillion in 2019…The result was

1. Growing inequality across countries
2. Growing inequality within countries, particularly low-cost countries supplying richer economies
3. Countries getting poorer by exporting low-value add goods (minerals or agricultural produce) and importing high-value-added items, (e.g., electronics and weapon systems)
4. Growing damage and threat to the environment, leading to climate change
5. Growing problems of social sustainability
6. More economic and non-economic migration (and outsourcing of that problem to other countries like Rwanda)
7. …

Globalization has benefits and costs, but those who benefit from it and those who pay the price are not the same companies or the same countries.

So, where is globalization headed?

To think about it, take this quiz:

Q1. Should a company look for new markets?

a. No
b. Yes

Q2. What if the new markets present risk?

a. Don’t look for new markets
b. Diversify your risk by looking for more new markets

Q3. Should a company look for new cheaper sources for raw materials and components?

a. No
b. Yes

Q4. What if these new cheaper sources are risky or not dependable?

a. Don’t buy from them
b. Diversify your risk by looking for other sources

There are benefits, costs, and risks tied to globalization

1. Globalization has benefits:
    Those who benefit don’t have an incentive to change

2. Globalization has costs:
    Those who pay these don’t have a say

3. Globalization also has risks…these affect both, so can we do something here?

Let’s distinguish between de-globalization and de-risking globalization

Deglobalization

- Reduced global trade
- Trade within the country or only with nearby (friendly) countries

De-risking globalization

- Reduce dependencies on any one country – or currency

There are many ways to de-risk global supply chains

- Regionalize supply chains: sell anywhere in the world, but buy raw materials and produce within the same region
  - (E.g., Barilla buys durum wheat in Italy for Italian consumers; Diageo creates regional beers and other products based on regional purchasing)
  - Onshore or near-shore assembly (low value-added closer to home)
- Diversify sources: Reduce dependency on any one country by creating multiple dependencies
- Segment your supply chains, by product: Create separate supply chains for different products.

However, these efforts lead to even more globalization!

Paradoxically, “the end of globalization” will lead to even more globalization

- Those who benefit (disproportionately) will seek more globalization
- Those who pay the price (disproportionately) will have even less to say on the matter
- Those who benefit will seek to de-risk, which will also increase globalization.

Did Larry Fink really mean the end of globalization? No, he said, "the end of the globalization we have experienced"

- The new globalization will be more efficient, with increased attention to de-risking
- The flow of money is the last bastion of inefficiency in global supply chains
- This is what Larry Fink said in the same letter (March 2022):
  - A global digital payment system…can enhance the settlement of international transactions ….[and] bring down costs of cross-border payments…BlackRock is studying digital currencies, stablecoins, and the underlying technologies.

So, BlackRock is investing in efforts for making globalization more efficient, not predicting its end.

While businesses figure out how to benefit while de-risking globalization, governments should seek to reduce the costs we listed earlier:

1. Growing inequality across countries
2. Growing inequality within countries
3. Countries exporting low-value add goods and importing high-value-added items
4. Growing damage and threat to the environment
5. Social unsustainability
6. More migration
7. …

1. Work towards lowering the barriers to trade across countries to decrease frictional costs and reduce volatility

a) Free trade agreements

b) Digital solutions for international trade

c) Make cross-country payments more efficient
- Support government-backed digital currencies

d) Seek to reduce geopolitical tensions
- Reverse Brexit?
- Swap freedom of movement of people within EU for that of goods?
- Reduce other tensions?

2. Develop an industrial policy for development and robustness

a) Export more value-added items
   - Build within-country capability

b) Import less value-added items
   - Import fewer such items or add more value within the country

c) Reduce dependence on any one currency.

3. Require large companies to report on…

a) Level of risk and efforts towards de-risking the supply chain
b) Transparency of supply chains (environmental and social sustainability)
c) Level of attainment of the 17 UN Sustainable Development Goals in the supply chain (meant to be achieved by 2030).

4. Support small and medium enterprises for making the economy more robust to shocks and attain mild self-sufficiency in critical sectors (e.g., food, medical goods) to meet domestic needs for *at least a few months.*

Ensure a more level playing field with the tech giants

a) Develop ‘commons’ – shared infrastructure for all companies
   - For example, Open Network Digital Commerce meta-platform in India with access to individuals, small businesses, large businesses, e-commerce startups

b) Treat tech giants as utility companies

Summary: Where is globalization headed?

- Globalization has benefits, but also costs and risks
- There have been predictions for the "end of globalization"
- A supply chain perspective on globalization:
  - Why globalization is under threat
  - De-globalization vs. de-risking globalization
- Expect more globalization…to de-risk globalization.
- Governments will need to
  1. Lower barriers to trade with geopolitical and digital solutions
  2. Develop an industrial policy
  3. Require more reporting, especially on UNSDG goals attainment
  4. Support small companies, particularly in critical sectors to increase (mild)self-sufficiency.