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Op-ed

NEW GLOBAL TRADE AND INVESTMENT THINKING
By Daryl Swanepoel

Both the Covid-19 pandemic and the Russia-Ukraine war have been a wake-up call with regard to global supply chain thinking and have highlighted a need for new international trade and investment architecture. Firstly, it shone a light on Just-in-Time (JIT) manufacturing and, secondly, it brought into question the efficacy of global value chains (GVCs) and the outsourcing of manufacturing to external jurisdictions.

Modern manufacturing across the globe widely uses Just-in-Time (JIT) manufacturing processes, which is the production model in which products are created to meet demand, not created in surplus or in advance of need. Enterprises adopt the JIT approach to reduce costs, increase efficiency and speed up product delivery. To achieve these goals, however, they must eliminate waste typically associated with manufacturing, such as overproduction, unnecessary wait times and excessive inventory – it is then that they can implement an effective JIT strategy.

The vulnerabilities and deficiencies of the lean, just-in-time global supply chain model have been exposed by the Covid-19 pandemic. The geopolitics, labour shortages and pandemic-related shutdowns led to supply chain bottlenecks, increased costs and disruptions. The imbalances with supply versus demand made the JIT strategies somewhat obsolete and resulted in increased costs and rising inflation.

The tumultuous events associated with Covid-19 challenged the merits of paring JIT, as industries were left vulnerable when the pandemic hampered factory operations and sowed chaos in global shipping. Economies around the world were bedevilled by shortages of a vast range of products.

The Russia-Ukraine war had a similar impact on JIT manufacturing. Fourty-two per cent of Ukraine's exports were, for example, semi-finished manufactured products, which when stopped or delayed as a result of the war, had a negative knock-on effect on production processes down the line in other jurisdictions.

In response, organisations are now trying different strategies like onshoring or reshoring vendors and vertically integrated supply chains. Several leading organisations are planning to build operations closer to the markets they serve, arguing that locating suppliers closer to assembly and manufacturing locations could assuage product shortages.

Similarly, Global Value Chains (GVCs) were disrupted by the Covid-19 pandemic and are still being disrupted by the Russia-Ukraine war.

A GVC is where the different stages of the production of a product are located across a number of jurisdictions. Enterprises structure their processes through outsourcing and offshoring the production stages across different jurisdictions in order to optimise productivity and production costs. It is about maximising benefits derived from, for example, different government incentives, tariffs and subsidies, availability of skills and labour costs, and manufacturing cost structures, which differ from country to country.

To cite the OECD example: "A smartphone assembled in China might include graphic design elements from the United States, computer code from France, silicone chips from Singapore, and precious metals from Bolivia. Throughout this process, all countries involved retain some value and benefit from the export of the final product".

It goes without saying though that in order for the GVCs to function effectively, all jurisdictions across the chain need to be stable, predictable and open for business. Covid-19 disrupted this. "The persistent uncertainty related to the shift of the epicentre of the pandemic from region to region, and the parallel instability affecting production costs", made it impossible for enterprises to restart their business on a global scale. This led to many having to decrease or stall their production activities. Yet, simultaneously, there was an increase in demand for a range of critical products that could not be met.

The Russia-Ukraine war is having a similar negative impact on GVCs. According to Dun and Bradstreet data, at least 374,000 businesses worldwide rely on Russian suppliers, and at least 241,000 businesses across the world rely on Ukrainian suppliers. The war has interrupted the logistics supply chain and by extension made any GVC dependent on these two countries unworkable.

The trade sanctions imposed on Russia and those that circumvent the sanctions, the disruption of shipping and air routes, are impeding the flow of goods and creating product shortages. Threats of catastrophic food shortages around the world as a result of the war – Ukraine is a global supplier of wheat – raise the real possibility of famine in vulnerable societies across the globe.

At the same time, the movement of electronics, raw materials, and parts supplies out of China and other countries has seriously hampered GVCs. They now need to find innovative ways to recalibrate alternative ways to ensure a complete GVC.

What does this mean for global trade and investment?

Apropos trade, it means that individual countries (and/or regions) will have to re-evaluate their dependence on imports. They will have to plan their economies in such a way that they can be more self-reliant, lest they are held hostage by future pandemics and natural catastrophes. This does not necessarily dictate that countries need again to become inward-looking, albeit that in many instances local manufacturing will be more beneficial, for example, where it could aid job creation in high-unemployment economies. But then it needs to be balanced with competitiveness.

What it may entail is that supply chains need to be adapted to ensure sufficient stock reserves in individual markets and not only in the country of production. It may also entail new thinking in terms of the domain of manufacturing. Where markets – individual countries or regions – warrant it, the site of manufacturing should shift to those individual countries and/or regions.

African trade ministers have been calling for such for a long time. And with the launch and implementation of the African Continental Free Trade Area (AfCFTA) – the world's largest free trade area which brings together 55 African countries, organised in eight regional economic communities – this has become an imperative for African economic planners. It creates a single market comprised of 1,3 billion people with a combined GDP of around 3,4 trillion USD.

The objective of the AfCFTA is to, among others, remove trade barriers and advance Intra-Africa trade. It aims to promote "trade in value-added production across all service sectors of the African Economy" and to foster industrialisation, job creation, investment and competitiveness.

In terms of Chinese investment into Africa, the changing focus from export trade to manufacturing investment needs to be accelerated, which, in any event, fits well with the objectives of the Global Development Initiative.

Daryl Swanepoel is the Chief Executive Officer of the South African-based Inclusive Society Institute. This article is an extract from the Institute's paper titled "Navigating China-Africa Cooperation within a globally constrained geopolitical environment", which was prepared to support its contribution at the recent 12th meeting of the China-Africa Think Thanks Forum held in Jinhua, China.