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Economic Newsletter

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Deglobalisation: Is Local Always Lekker?

Once again global leaders met together in Davos in late May for the annual meeting of the World Economic Forum. Of the many topics headlined for the event, including climate change and the war in Ukraine, the theme of "deglobalisation" has been met with much anticipation, particularly from market participants and global investors.

For several years now the idea of deglobalisation has been gaining traction as many countries and businesses are looking for opportunities to "onshore" or "nearshore" their production lines as opposed to relying primarily on supplies coming in from foreign countries. These ideas, whilst not new, were largely exacerbated by the ensuing Covid pandemic, as many global supply chains were disrupted, and in some cases severed, as a result of the protracted global lockdowns which were enforced.

There have been several factors which have given credence to the notion of deglobalising the world, many of which have been economic, but some would argue more of which have been political in nature. The China-United States trade war which began in January 2018 when the US President Donald Trump began imposing tariffs and other trade barriers against China in response to what the US deemed to be "unfair trade practices" and "intellectual property theft" brought the theme of deglobalisation into the spotlight. While this conflict was certainly not the first of its kind, it had the effect of significantly raising concerns of a decoupling world.

Moving forward to today, the continuing tensions between the US and China along with the geopolitical fallout resulting from Russia's invasion of the Ukraine, as well as ongoing supply bottlenecks catalysed by Covid-19, countries are now facing the decision as to whether they should continue to rely on foreign trade to the same degree or if they should look towards local production.

Two Sides to Every Coin

A large driver of reducing the reliance on global supply chains is the idea that companies prefer to have production closer to their customers, thereby reducing the risk of the supply chain. Covid-19, whilst an extreme event, illustrated the dangers of relying too heavily on global supply chains for supplies, particularly those relating to essential medical supplies. A further argument against increased levels of globalisation is the emergence of world monopolies such as Amazon, which was a large benefactor from the global pandemic. Smaller, local alternatives are often crushed in the wake of these behemoths, which possess far more aggressive pricing power and have a much broader reach. As a result, many countries have seen local production levels decline as they were undermined by larger global competitors.

However, increased levels of globalisation has brought about incredible advancements and has increased the average standard of living for most of the global population. Dramatically reducing this current level of globalisation will introduce many inherent risks into the system, primarily owing to the fact that very few countries are able to produce every single commodity utilised by their citizens without relying on their global neighbours to some degree, whether it be for natural resources, technology, labour etc. Consequently, some measure of interrelation and trade will always be incumbent on global countries in order to maintain a tenable level of productivity.

If one were to assess the ramifications of the abovementioned trade war between the US and China, the outcome has ultimately proved economically negative for both countries, but particularly for that of America. Analysis published by the Wall Street Journal found that "the trade war did not achieve the primary objective of reviving American manufacturing, nor did it result in the reshoring of factory production. Though the trade war led to higher employment in certain industries, tariffs led to a net loss of U.S. manufacturing jobs. The trade war reduced the United States' trade deficit with China in 2019, but this trend reversed itself in 2020, with the trade deficit increasing back to its pre–trade war level, while the United States' overall trade deficit has increased."[1]

Many economists argue that a global decoupling would lead to very much the same outcome, but on a much larger scale.

Current Effects of Deglobalisation

Widespread food shortages, one of the largest humanitarian threats of deglobalisation, is currently playing out as a result of the war in Ukraine. In 2021, either the Russian Federation or Ukraine (or both) ranked amongst the top three global exporters of wheat, maize, rapeseed, sunflower seeds and sunflower oil, while the Russian Federation also stood as the world's top exporter of nitrogen fertilizers, the second leading supplier of potassium fertilizers and the third largest exporter of phosphorous fertilizers. Both countries are net exporters of agricultural products, and they both play leading roles in supplying global markets in foodstuffs, for which exportable supplies are often concentrated in a handful of countries, exposing these markets to increased vulnerability to shocks and volatility.

The war in Ukraine has significantly impacted both the production as well as the trade of these agricultural products, leading to mass food shortages in many countries which rely on Russia and Ukraine's supply. Egypt's finance minister Mohamed Maait warned that millions could die globally due to "food insecurity" and significantly higher food prices as a result of the ongoing conflict.

Where does South Africa Stand?

South Africa is characterised as a small open economy with increasing levels of trade and financial integration. Our major import and export trading partners include China, Germany, India, Japan, the United Kingdom and the United States. Whilst South Africa is characterised as a resource rich country with the ability to produce many goods and food items within its borders, increased globalisation has added to the country's productive capacity through increased choice and cheaper production inputs.

Although South Africa is more protected from deglobalisation than many other countries – we have our own independent (albeit unreliable) power supplier, most basic food products consumed are produced within our borders, and we have a very large supply of labour – a reduction in trade flows would also prove very detrimental to our economic output. Since the advent of democracy in 1994, which saw many foreign countries doing away with tariffs and trade restrictions imposed against South Africa, our country's international trade flows have steadily increased. South Africa's trade openness ratio, which measures the sum of imports and exports relative to GDP in nominal terms, increased from 37% in 1992 to approximately 60% in 2016. Access to global markets has facilitated the flow of technology, grown exports, and increased investment flows – all of which have been positive for South Africa's growth.

While local is indeed lekker, finding a sustainable balance between domestic and global reliance will have the most far-reaching positive outcome for the economies of the world. In his closing statement at the World Economic Forum, Loic Tassel, president of Procter & Gamble, the America multinational consumer goods corporation, suggested that "Globalization is not a good thing; it's a great thing. We come to the question, is it moving, is it pausing? I think it's temporarily pausing. Our responsibility as leaders is to continue to ensure globalization keeps progressing, not because it is in the interest of the companies — which would be right anyway — but because it is the core interest of consumers."

[1] *The Wall Street Journal*, China Trade War Didn't Boost U.S. Manufacturing Might, 2020