Introduction

Global supply chains are more than simply a function of raw supply and demand. The ability to source raw materials and components, process them and get products to market is impacted by political risk including political instability, regulation, protectionism and conflict. Historically, political risk has been a preoccupation of those doing business in developing countries. But following the election of Donald Trump, the Brexit vote and the rapid rise of populism in Europe, we might also ask the question of what growing public scepticism towards globalisation in the West means for the diplomatic and trade relationships that shape supply chains. More specifically, what big political developments should supply chain professionals be paying closer attention to if they want to stay ahead?

Donald Trump has openly criticised existing free trade deals for undermining living standards for blue collar workers and castigated companies for offshoring jobs. Partly to control immigration and partly to remove itself from the direct regulatory influence of other nations, the UK has voted to leave the EU, even at the expected cost of raising barriers to trade with its closest neighbours. Across the Western democratic world even mainstream politicians are disavowing trade deals they have spent years promoting.

It’s too early to tell how these developments will play out and whether policy – especially the Trump administration’s – will match the rhetoric; and Trump’s tweets. However, we are on safe ground when we generalise that Western politics is more focussed than ever on those who have been ‘left behind’ by globalisation and technological change. This suggests something of a retreat from the multilateral, liberal consensus shaped by the US and EU and bought into by the majority of the world. But if the West wants to focus more on protecting the incomes of workers at home, and less on international deal making, who will fill the gap on the global stage? Initiatives such as the Chinese-led Asian Infrastructure Investment Bank and its One Belt, One Road initiative give a strong suggestion that other global players are looking to shape the future.

These trends could impact the operation of supply chains by altering the terms on which markets can be accessed, rebalancing the risks inherent in doing business and changing patterns of consumption. Will it take longer to get goods from A to B because they are tied up in red tape? Will supply chain disruption be collateral damage in diplomatic disputes? We look at the matter from several angles to sketch out what these changes could mean in practice:

1. Supply chains in the cross hairs

Companies must deliver value to their shareholders. But they are increasingly under political pressure to ensure that they act as responsible citizens too. That loads new expectations on them, whether policing their supply chains, fighting modern slavery or paying their taxes. Will these expectations increase or lessen?

2. Where next for multilateralism?

Will the international organisations that are the cornerstones of the current global order be weakened? Does that mean the rise of China as a global influencer on issues such as climate change, environment and intellectual property?

3. The changing face of trade

In the face of pressure to increase wages and living standards for workers, will Western nations increase barriers to trade with countries they see as competing unfairly? Will that make the cost of doing business higher and tangle supply chains in more bureaucracy?

4. BRICS in the age of Trump

What ever happened to the BRICs?

5. Automation

Is political risk a red herring? Will technology be the ultimate driver of change by radically reducing human intervention and employment?
Globalisation has allowed companies to drive down costs and innovate through international sourcing. This has, for the most part, been a good thing, boosting economic growth for all parties and lowering costs for consumers. Yet, the long and complex supply chains that have developed alongside globalisation has brought with it risks which are not just operational, but political in nature.

Regulatory arbitrage

The first risk is that circuitous supply chains opens companies up to the criticism that they are using global sourcing as a form of arbitrage – circumventing strict labour standards and higher costs at home by buying-in from outside. While this has historically been a view held mainly by the left and labour movement, this thinking is becoming more prevalent both on the mainstream and populist right. Even the leader of the business-friendly UK Conservative party, Prime Minister Theresa May, launched her leadership campaign with a speech criticising ‘business as usual’ and calling on businesses to take their responsibilities to society more seriously. As politicians try to connect with working class voters who feel that their jobs and communities have been hollowed-out by globalisation, they will speak more in terms of ‘fair competition’ rather than ‘free trade’.

Unethical/criminal practices

The second is that complex global supply chains can allow unethical or criminal practices to infiltrate legitimate business. These can surface in a dramatic and sometimes catastrophic way. This reinforces the point that firms are not only outsourcing aspects of production, but also abdicating responsibilities. This has been vividly illustrated in recent years:

- US retailers were unable to verify whether the shrimp they sold was processed by forced labour in South-East Asia.
- Beef products across Europe sold by grocery chains across Europe were found to contains horsemeat which had entered the supply chain via a complex web of traders, processors and manufacturers before arriving on dinner plates.
- Scrutiny of the use of conflict minerals in electronic goods and conflict diamonds in jewellery following high-profile campaigns which shocked consumers who had not previously given any thought to the source of bought products.
- Poor safety conditions for workers, most recently highlighted by the Rana Plaza disaster in Bangladesh, which saw over 1,000 people die in the collapse of an unsafe building. Many of those who were killed were making garments for well-known clothing brands.

Corporate reputation

Thirdly, and related to the previous point: in a world of instant communication and social media, corporate reputations are hard won but easily damaged. The level of scrutiny of the business practices of large companies has never been higher. Increasingly, customers and policymakers want to know where products come from and how they are made; and holding accountable the companies they deal with for practices along the entire supply chain. Companies that fall short can suffer considerable damage to their corporate reputation.

The legalistic response of many corporates to these human tragedies – that they cannot be held responsible for the actions for every aspect of their supply chains, or that auditing and verifying the integrity of their supply chains is unduly costly and burdensome – is to some extent understandable. And some of the regulatory responses to these problems – such as Dodd Frank 1502 - are cumbersome without necessarily solving the underlying problem.

Where next?

While Donald Trump says he wants to eliminate regulations which he thinks are overly burdensome, at the same time he argues that US jobs are being undercut - often by competition from markets with extremely low pay, poor labour conditions and safety standards. Political pressure to onshore jobs, coupled with measures such as border taxes to try to level the playing field may change that balance.

Equally firms must earn and protect their social license to operate, which means taking a greater interest in what goes on in the depths of their supply chains. Ignoring the issue is not an option.
Where next for multilateralism?

Multilateralism has received many definitions from political scientists and economist, however the central tenant remains consistent: it is the policy of operating in concert with multiple actors and has defined and underpinned the democratic world since the end of the Cold War.

Recent geopolitical developments have however indicated a clear turn away from multilateralism. The electoral sentiment behind the UK’s referendum to leave the EU and the election of US President Donald Trump on an ‘America First’ message are distinctly anti-multilateral in nature. It is still early days in Trump’s tenure, however early signals indicate the administration will take a multilateral scepticism even at a granularly technical level.

A recent letter from House Finance Committee Vice-Chair Pat McHenry to Federal Reserve Chair Janet Yellen spelled trouble ahead. Although not originating from the White House, McHenry’s letter instructing the Fed to cease all international regulatory cooperative work through international forums such as the Organization of Economically Developed Countries (OECD) and the Basel Committee on Banking Supervision on the grounds that this work undermines the promotion and prioritisation of American interests is a clear sign of what is to come. Meanwhile, despite US Vice President Pence’s assurances at the Munich Security Conference in February 2017 that the US remains committed to NATO’s Article 5 collective defence guarantee, eastern European allies remain concerned by the administration’s strong line on 2% defence spending.

Undermining from within

Scepticism of these international multilateral organisations is likely and expected from geopolitical powers that inherently do not benefit within the system. Russia serves as the prime example of a country contained by NATO, sanctioned by the EU, targeted in the WTO, isolated in the UN and chucked out of the G8. Unsurprisingly, Russia holds little faith in the current international settlement and adopts a domestic ‘Russia First’ position.

What is new is the growing opposition to multilateralism amongst western liberal democracies, even beyond the Anglosphere. Philippines’ President Duterte has railed against its US defence umbrella even in the face of Chinese aggression in the South China Sea and France’s domestic nativist party Front National and its Presidential candidate, Marine Le Pen, are both polling strongly [at the time of writing] in upcoming elections and espouse a wholesale rejection of and withdrawal from the EU and NATO.

Le Pen’s disdain for both institutions is shared, albeit more guardedly, by right-wing populists across Europe, including notably Germany’s AfD and Hungary’s Fidesz Party. On the left of the spectrum, multilateral scepticism takes the form of opposition to international financial institutions such as the IMF and World Bank, as advocated by Greece’s Syriza Party, Spain’s Podemos Party and the majority of the European Parliament’s Green Alliance of left-wing parties. These European populists of both the right and left wing advocate for greater national power – either democratic or not – in the face of faceless, unaccountable international organisations.

Despite the EU’s structural resolution against populist inclinations, continued electoral success from anti-EU elements increasingly undermines the bloc’s stability. While the EU may survive, indeed even strengthen, without the UK; France’s departure from the bloc would spell the death knoll of the EU. With the death of the political EU comes the dissolution of the Single Market and the EU Customs Union and the reintroduction of tariffs and trade restrictions within the largest economy on earth – resulting in significant disruption to global supply chains heavily reliant on a truly integrated European economy.

Shifting polarities

The global outlook for multilateralism is not however as dire as it may immediately seem. Close US/UK allies, Canada, Australia and New Zealand have continued to advocate for an internationalist outlook, with Canada’s globally-minded liberal Prime Minister, Justin Trudeau, doubling down for any media outlet listening by praising the benefits of trade and immigration. As Australia and New Zealand seek to kick-start FTAs with the EU, Trudeau’s Government has worked hard to finalise and implement its own multilateral Comprehensive Economic & Trade Agreement (CETA) with the EU.

For those advocating that multilateralism remains the preserve of the liberal democratic West, an unlikely bulwark of multilateralism has emerged in the form of an increasingly globally confident China. The Chinese
Government has invested heavily in the international political assumption that multilateralism breeds global success; seeking a leadership role in international climate negotiations, institutionalising an alternative-G7 in the formalised BRICS forum and its foreign investment activities in the Asian Infrastructure Investment Bank (AIIB), and a willingness to replace the US in the Trans-Pacific Partnership (TPP).

China’s emergence as a champion of multilateralism is as much a product of Chinese faith in multilateral endeavours as opportunism in the face of US withdrawal. And China is not alone. France and Germany seek to redefine European financial regulation in the face of UK withdrawal; Russia capitalises on NATO fragility by increasingly testing collective European security resolve in Ukraine and the Baltics; Canada attempts to rewrite international investment trade rules in lieu of US political support for TTIP.

Where next for multilateralism?

Where next?

Regardless of whether multilateralism outright disappears with absent sceptic leadership, or the respective focal points of multilateralism merely shift elsewhere, the shift in the status quo will herald significant uncertainty for principle stakeholders – including crucially international business. Regulatory rules governing international trade and supply chains can be expected to alter substantially or disappear altogether and require supply chains to adapt accordingly, including devising new systems and routes to market.
Changing nature of trade

International trade is undoubtedly undergoing significant sea-change. The election of Donald Trump as US President showed overt electoral support for his message of ‘America First’ and a re-evaluation of international trade norms to better suit domestic US economic interests. Trump promptly displayed the practical applications of this trade strategy by signing an Executive Order on 24 January 2017 withdrawing the US from the multilateral Trans-Pacific Partnership (TPP).

Trade opposition as a uniting position

Trump’s approach to trade has tapped into a growing electoral and political sentiment shared across the traditional left-right political divides that define Western democracies. TPP emerged throughout the US Presidential campaign as an unlikely campaign point that united Trump with his Democrat opponents. Even past the campaign, former Democratic Presidential nominee candidate Senator Bernie Sanders and staunch critic of Trump, praised the EO withdrawing the US from TPP.

While Trump has mobilised the American conservative case against free trade agreements, reserving particular ire for the North American Free Trade Agreement (NAFTA), left-wing Europeans have increasingly grown vocally opposed to the EU’s trade agenda, including notably the Transatlantic Trade & Investment Partnership (TTIP). This European opposition has rested on arguments that TTIP, and its sister agreement the Comprehensive Economic & Trade Agreement (CETA) between the EU and Canada, would lead to the dilution of European social welfare and regulatory standards.

The epitome of this debate came in the form widespread opposition to the use of Investor-State Dispute Settlements (ISDS) in TTIP and CETA. The EU has subsequently scrapped the use of ISDS and embarked on a reform programme with the Canadian government to lead international voluntary efforts to establish a Multilateral Investment Court. Whether these efforts lead to a substantive and meaningful outcome remains to be seen.

Democratising international trade

A clear theme throughout recent developments in Western trade policy is a growing democratisation of the policy area, with greater electoral and stakeholder interest in the details of international trade agreements. Initially opposed to the concept, the EU has subsequently pushed for greater involvement and inclusion in the development of its trade programme, encompassed in the launch of its ‘Trade for All’ strategy in October 2015. In the Q&A session of a January 2017 trade policy event, EU Trade Commissioner Cecilia Malmström urged greater stakeholder input into trade policy at earlier points and more local levels to ensure continued democratic legitimacy in agreements.

The knock-on consequence of this increasing interest and input into trade policy is a revaluation of trade policy ambitions. As NAFTA looks set to be scrapped, or at least reviewed; TPP all-but-dead; TTIP firmly in the freezer; and Brexit looking increasingly set to put the UK outside the EU’s Single Market; an increasing reticence for multilateral trade agreements appears to be taking hold.

Nothing new?

These recent developments however only build on longstanding concerns and lack of support for truly multilateral trade in the collapse of the Doha Round. Both the US and the UK are shunning these multilateral deals (the EU’s Single Market in the British case) in favour of establishing bilateral agreements.

On one hand, this means a raft of new trade deals may eventually come to fruition. But these agreements look increasingly likely to rebalance existing relationships (UK-EU trade post-Brexit; US-Mexican trade under NAFTA) and will be less ambitious than originally sought (a quick-and-dirty US-UK deal in place of a more substantive TTIP agreement).

Where next?

In the short term, it is increasingly clear that pre-existing trading terms cannot be relied upon and are politically, if not technically, up for renegotiation. This creates significant uncertainty and disruption for business and supply chains as politicians demand reassessments of trading terms – likely to arrive back at the same terms once the relative benefits are assessed and negotiated. In the longer term, politicians are increasingly less likely to listen to sceptical electorates in favour of business that capitalises on international supply chains and liberal flows of goods and services. International businesses therefore must frame the benefits of trade beyond purely economic terms to ensure political support for continued tariff-free market access and regulatory coherence and actively building coalitions with civil society to ensure business is not isolated in stumping for free trade.
Global supply chains are undergoing a transformation as the world’s economy changes. And growth in emerging markets in particular is affecting the nature and direction of global supply chains.

Since initially grouped together by British economist Jim O’Neill in 2001, the four BRIC countries of Brazil, Russia, India and China have even turned a theoretical economic acronym into a real partnership. The group hosted its first joint annual summit in Yekaterinburg, Russia in 2009, and in 2010 the group would invite South Africa to join as well – becoming the BRICS. China will host the other countries in September 2017, and they also intend to establish a BRICS credit rating agency.

The formal grouping of these emerging market giants poses challenges for supply chain management. As the BRICS economies materially change in the coming decades, so must supply chains. Labour-intensive industries may become uncompetitive and be forced to make way for high-value services; more investment might be needed in improving productivity and greater automation; and ultimately the sourcing of raw materials and production of goods may move elsewhere, as these economies transition into more highly-educated, consumption and service-based economies.

However, this excitement must also me tempered. In recent years the BRICS economies have showed signs of slowing – and even receding. The reasons vary between each, but broadly speaking it has been caused by political instability and the difficulty in overcoming the challenges that growing economies create. International attitudes to free trade are also in flux, which is in turn creating uncertainty in emerging economies.

The BRICS bloc itself is changing too. China and India continue to grow strongly, but the Russian, Brazilian and South Africa economies have fared less well. This has also exposed weaknesses in the BRICS model itself - that the five economies are fundamentally quite different as shown below.

While the BRICS countries may well return to strong growth in the coming years, it’s not clear whether the same can be said for the use of the acronym. What is clear is that the global economy is in a period of transition, and supply chains will need to adapt with it. Perhaps the underlying importance of the BRICS is less about the acronym, but the emergence of new economies that are eager to challenge established political orthodoxies. These political changes have the potential to be as significant as the economic ones.

Brazil faced political paralysis 2016, alongside a receding economy, and inflation nearly reaching 10% in May. Between October and December 2016, 12.3 million Brazilians were out of work – nearly 12% of the workforce – up by a third more compared to the last quarter of the previous year. The IMF’s growth forecast for the country is just 0.2% in 2017, the weakest of the BRICS economies and well below its global growth forecast of 3.4%.

Russia’s focus on geopolitics has resulted in the country facing sanctions, and its economy remains reliant on volatile commodities like, steel, aluminium, oil and gas. It was hit particularly hard by the drop in the value of oil in late 2014, leading to a prolonged recession. Russia is expected to pull out of its recession in 2017, recording a dip of 0.2% in 2016, partly down to a recovery in oil prices. Political uncertainty and sanctions are hurting investor confidence, however.

China has been the economic standout star of the BRICS over the last decade. While it continues apace, some economists believe it has reached the so-called “Lewis Turning Point” – the point at which surplus rural labour entering cities dries up, forcing wages to increase. Economic growth has begun to slow into a “new normal”, and there are concerns about high levels of Government debt and weak consumer spending in a savings-oriented economy. The country has protected its manufacturing sector against increased costs by pegging the Yuan to the US Dollar, but under a Trump presidency this could change.

South Africa has been beset by political tensions and low domestic demand, resulting in tepid economy growth in 2016 of 0.3%, with forecasted 0.8% growth in 2017 according to the IMF.

India continues to tackle structural problems in its economy and a shortage of infrastructure. The recent withdrawal of high-value banknotes, an attempt to crack down on tax evasion, has hit its rural economy hard. Prime Minister Modi’s February 2017 Budget lowered taxes for poorer Indians and small businesses, and provided $60bn for investment in infrastructure, in an attempt to revive demand in the economy.
Automation

Since the start of the Industrial Revolution, there has been a steady and continuous stream of labour-saving advances in technology. Global supply chains are an obvious area for the advance of robotics, and every day the frontiers of the industry expand with greater automation and more innovative technologies. Supply chains benefit from the embrace of technology: customers, distributors, manufacturers and suppliers are more connected than at any time previously, and businesses are able to get to market faster, be more responsive to consumer needs and increase their efficiency.

Where are the advances?

The focus on automation so far has largely been on repetitive, transactional processes, in warehouses as well as on the production line. This is the least controversial: automating warehouse systems replaces low-skilled monotonous jobs. The use of automation reduces labour costs and headcount, whilst improving efficiency and reducing mistakes.

More recent advances have also seen computerisation spread to domains previously defined as non-routine. For supply chains, this involves the introduction of process robotics, which automates the entire supply chain from end to end – rather than just individual tasks – allowing different sections to be managed in tandem. While handing over control of the entire process can seem counterintuitive to supply chain managers, this allows businesses to be responsive and agile, and assists with risk management in removing room for human error and allowing for greater traceability if problems do occur.

At what cost?

An increasing concern for policymakers and forward-looking politicians is the resulting displacement of workers under both types of automation. The reduction in lower-skilled manufacturing jobs as a result of warehouse automation has thus far been tolerated and even politically ignored. The more significant displacement caused by process robotics and end-to-end automation is largely a fringe public policy concern, but will need to be increasingly managed by policymakers and politicians. These policymaker concerns are however only the beginning.

Moving forward

Looking to the future, we will see increased automation in the way that goods are transported. Semi-autonomous vehicles are already on the roads, and in a number of years, fully autonomous vehicles are expected to radically change the transport landscape. In both the UK and the US, policymakers are driving this agenda, bringing new legislation to encourage the development of this technology. For the supply chain, which faces a problem of a looming shortfall of skilled drivers in the road haulage sector, this could be the solution. Research undertaken by AXA also found that automated freight will not only be more efficient and make roads safer, it will also reduce the prices of end products.

As well as automated trucks, the rise and popularity of drones, or unmanned aerial vehicles (UAVs), provides another method of transportation for companies. Both Amazon and Dominos are looking at the use of drones, with early tests revealing the possibilities they have for delivery. Whilst currently limited to small packages, development to include much larger items of varying shapes and sizes can be expected. Drones are also currently limited in where they can fly, with the Civilian Aviation Authority (CAA) placing restrictions on flight over congested areas and near other vessels, vehicles and structures. This limitation in their use of air space has implications for the kind of deliveries they can make.

Playing regulatory catch-up

Beyond this, the regulatory landscape is not currently keeping pace with the use and development of UAVs. Anyone can buy a UAV, with no registration or required training, and there is little understanding of safety. A high-profile drone accident could significantly alter the trajectory of the UAV market and limit future application. If the technology does progress, there will be insurance implications for commercial organisations looking to use UAVs for product deliveries.

With an increase in the use of technology comes increased exposure to cyber-crime. For example, the greater the inconnectedness across supply chains, the greater the risk that a cyber-attack on one machine cannot be contained. Additionally, automation in supply chains is fuelled by cloud-based IT systems, which inevitably provide security risks. Businesses must ensure they have the necessary protection in place, or they face severe reputational or brand damage.
In relation to autonomous vehicles, the Government highlighted potential cyber security risks as a concern in a report on driverless cars, pledging to work with car manufacturers. If hacking occurred on a widespread scale, the damage could be unprecedented. Similarly, successful hacking of drones could cause personal injuries or property damage, and in the worst-case scenario could be used in a terrorist attack.

Overall, it is clear that robotics are having and will continue to have a significant impact on supply chains across the next decade. However, businesses and regulators must ensure that they take the public with them on this journey, in order to manage changes to employment and to maintain trust in a new automated world. The adoption of robotics will hinge as much on public perception as the profits they create.
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