

GEO INSIGHTS

Can the Global Supply Chain Survive Global Political Disorder?

BY DAVID J. E. CHMIEL

The managing director of Global Torchlight, a geopolitical risk advisory firm, discusses the various reasons for the supply chain disruption and what we may expect in the future.

Among the eclectic items I have collected over the years – my curated clutter – there sits an innocuous chunk of rather poor-quality concrete that crumbles a bit more with each passing year. It is a piece of the Berlin Wall. I hacked it off myself from the section immediately in front of the Brandenburg Gate using a borrowed hammer when I and about 20 classmates found ourselves on a high school trip to Europe as the Wall opened and the Cold War came to an end over 30 years ago.

It's hard to overstate how positive things seemed at that time. The Cold War's end generated tremendous optimism in our geopolitics. Meanwhile, as the Iron Curtain fell, governments also eliminated barriers to trade and investment through free trade agreements and closer multinational cooperation. Of course, there were still major upheavals including the 9/11 terrorist attacks and the financial shocks of the Great Recession. However, things always seemed to return to a steady state of cautious optimism about the longer-term direction of international politics and economics. More recent events, however, make it hard to stay optimistic. In the latter part of the last decade, we were already contending with trade wars, populism and a shifting geopolitical balance of power. However, COVID-19 and the horrific war in Ukraine are presenting us with a stark new reality that very few contemplated a few years ago. Disorder is the new normal in international affairs.

Of course, the consequences to business pale in comparison to the human suffering endured by the people of Ukraine or those directly affected by COVID-19. However, these events are amplifying pre-existing and fundamental challenges to the international policy, regulatory and security environments that many businesses previously took for granted. The global trading system that has existed for decades is increasingly affected by geopolitical competition as well as changes in domestic political priorities in many of the world's largest economies. This article considers four particular trends that are likely to affect the

interplay between politics and trade in the near- to medium-term as we adapt to this new, less-certain normal.

The Weaponization of Trade and Capital

Since the end of the Cold War – if not before – the prevailing narrative held that deepening economic ties helped to dull international strategic competition. That conjecture has come under considerable scrutiny more recently as the foreign policy and national

security interests of major economic powers increasingly conflicted. At the forefront of that debate were concerns about China's growing political and military assertiveness that often left it at odds with the United States and some of its allies. Governments started imposing barriers to trade and investment on national security grounds including foreign investment review laws, domestic procurement mandates and tariffs.

To a considerable extent, the focus of these efforts was initially on sectors deemed particularly critical to national security such as defense, dual-use technologies or energy supplies. However, COVID-19 increased the scope of this debate significantly. Global shortages of personal protective equipment, medical devices and active pharmaceutical ingredients led to calls for national self-sufficiency or, at the very least, reduced reliance on suppliers located on the other side of the globe. It is not coincidental that annual polling by Gallup found Americans holding increasingly favorable views on free trade – even in spite of then-President Trump's protectionist rhetoric – only for that support to decline significantly as the pandemic took hold. It is equally telling that President Biden retained many of the Trump administration's tariff and trade policies on taking office, particularly in respect of the U.S.-China trade relationship. Trade policy must now be viewed through the lens of national security.

Moreover, Russia's brutal war in Ukraine has resulted in trade and investment ties becoming critical tools by which governments have sought to pressure Vladimir Putin to end hostilities. While public opinion in many NATO member states remains largely opposed to direct military confrontation with Russia, there has been consistent, strong support for a rapid and material decoupling of Russia's economy. These measures are not without their limits, however. Some governments have been reluctant to pursue policies that risk significant blowback on their own economies – for example, embargoes on Russian fossil fuel imports – although they face increasing public pressure to accept such adverse economic consequences amidst growing evidence of Russian atrocities in Ukraine.



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Rather than acting as a brake on strategic competition, trade and investment ties give governments a whole new arsenal with which to leverage foreign and national security policy interests. The risk is that “national security” simply becomes a cover for blatant protectionism and it is already being redefined to include personal data, food and agriculture and infrastructure. In assessing the opportunities and risks presented by operating in a global trading environment, businesses can no longer simply ignore the possibility that today’s trade flow becomes tomorrow’s national security tool.

The Power of Public Opinion

One particularly striking aspect of the global public policy response to the war in Ukraine was the speed with which Russia’s economy was decoupled from those of the U.S., EU, Japan and others. In the run-up to the Russian invasion in February of 2022, the consensus of opinion was that sanctions were likely to evolve gradually over a number of months. In fact, many governments indicated that more stringent measures, such as the expulsion of Russian banks from the SWIFT payments system, would not be included in any initial sanctions package given the need to assess the economic consequences for countries imposing sanctions.

In reality, Russia became the world’s most-sanctioned country within days of the invasion and it is important to recognise the critical role played by public opinion in the acceleration of the policy response. The scale and ferocity of the Russian invasion combined with the resilience of the Ukrainian armed forces and the courage shown by the Ukrainian people and their president, Volodymyr Zelenskyy, all contributed to the galvanization of public opinion in the West. Social media quickly filled with public anger at the reticence of governments to act swiftly and decisively. In fact, polling data shows that people in many NATO member states are prepared to accept negative economic consequences of severe sanctions on Russia. Moreover, public opinion will likely demand that Russia continues to pay an economic price for its actions even if a truce is negotiated.

Equally importantly, this public outrage quickly generated pressure on multinationals to cease operations in Russia altogether – even where sanctions did not necessarily prohibit them from doing so. Major energy companies, retailers and global professional services firms have all announced the cessation of operations in Russia. Some businesses that opted to continue doing business in Russia now face increasing public, political and media scrutiny in their own countries – including protests outside their premises and threats of boycotts.

In a world in which there is persistent public mistrust in business and government, this groundswell of frustration is not wholly surprising. As will be discussed further below, domestic political discourse is changing in many of the world’s largest economies and that, in turn, is renewing debates on the nature of corporate citizenship. In the wake of the Russian invasion, the UK’s Institute of Directors called on all UK directors of Russian

companies to resign their positions, arguing that they “...should feel a stronger moral duty to uphold the fundamental values of freedom and democracy” over and above their legal duties as company directors. As governments increasingly weaponize trade and investment, it is highly probable that public opinion will demand that businesses “do their part” in the event of further major international security crises.

The Politics and Psychology of Inflation

The most considerable challenge confronting the global economy at present comes from inflation. While it was initially thought to be a transitory concern linked to pent-up consumer demand following the pandemic, it now has the potential to become more permanent and disruptive. The war in Ukraine risks further increases in food and energy prices which will, in turn, have consequences for economic security and well-being. Meanwhile, the disruption to flows of other commodities, coupled with the potential for further COVID-related lockdowns in key manufacturing centers, particularly China, risks driving prices for manufactured goods higher. Political leaders around the world are now becoming more concerned about a global economy in which inflation is, once again, a determinative factor.

It is important to remember that inflation is not just an economic phenomenon, but a psychological and political one as well. History demonstrates that endemic inflation can be a hugely destabilizing political force. It threatens peoples’ sense of economic security by eroding savings and putting pressure on household incomes. Its political consequences could be further compounded by the fact that, in many places, it is reaching rates not seen in decades. Entire generations of populations have simply not lived with the spectre of inflation and that, in turn, may create considerable pressure on governments to intervene more decisively to counteract its effects.

An issue of particular concern is the state of world food prices. According to data compiled by the Food and Agriculture Organization of the United Nations, real food prices were already at or near their highest point in 60 years even prior to the war in Ukraine. Now, with agricultural exports from Ukraine at risk, concerns are growing about a material impact on global food supplies. A debate is emerging among agronomists over the extent to which this may lead to actual food shortages with some arguing that any deficiencies in exports from Ukraine could be met by increased production in other grain-producing countries such as the U.S. and Canada. However, this will still have an impact on food prices owing to higher costs of shipping and other variable factors – the global food supply chain cannot simply be restructured overnight. That, in turn, adds further potential pressure to global inflation rates. Moreover, we cannot discount the possibility of food price increases translating into broader civil unrest particularly in countries that lack democratic accountability or where other problems such as endemic corruption already weaken political stability.

For businesses, the challenge lies not just in managing the economic impact of inflation itself but also the potential risks associated with public policy measures implemented in response. In the U.S. and elsewhere, politicians are already questioning whether businesses should pass on all inflationary cost increases to consumers or whether they should absorb the costs through lower profits. Some argue that relief could be found by eliminating tariffs or taxes on certain products to bring some price relief into supply chains. However, as was previously noted, trade and tariff policies can no longer be viewed through the sole prism of economics. Governments may decide that national security concerns justify keeping such measures in place even with the negative economic consequences they may bring about.

Shifting Paradigms in Domestic Politics

The new world order that emerged 30 years ago ushered in not just strategic stability and greater globalization, but also a preference for private sector solutions over public sector ones. As President Bill Clinton famously said in his 1996 State of the Union Address, “We know big government does not have all the answers. We know there’s not a program for every problem... The era of big government is over.” He was not calling for a complete return to laissez-faire governance, but a lighter touch by government certainly became the order of the day in global economic policy.

Governments, of course, intervened in the wake of the global financial crisis of 2007-2008 to support over-leveraged financial institutions and other troubled businesses. However, the onset of COVID-19 led to worldwide government intervention in national economies on scales often not previously seen outside of wartime. The era of big government became a political reality once again. While COVID-related economic supports have now largely been withdrawn in many countries, they have left a legacy of expectations that governments will continue to play a role in economic recovery efforts – often couched in the language of “building back better.” The risk of sustained inflation also creates the potential for further calls on government to play a more active role in economic policy.

As with sanctions on Russia, there is evidence that public opinion is driving such a paradigm shift. In the spring of 2021, the Pew Research Center asked people in all of the G7 member states whether their national economic systems needed reform in the wake of the pandemic. With the exception of Canada, over half of respondents in all of those countries said that their national economies needed either “major reform” or a “complete overhaul.” Nearly 70 percent of American and French respondents felt this way while there was 85 percent agreement in Italy. Of course, that does not necessarily mean there is support for protectionism and antipathy towards the global trading system. However, it does lead to the supposition that the citizenry of many of the world’s largest economies want to see government do more and potentially adopt policies that are not necessarily business-friendly. This is, in part, contributing to

debates around issues as varied as taxation policy, offshoring of manufacturing and the nature of corporate citizenship.

Another related challenge to global supply chains lies in the growing propensity of some governments for nationalization or expropriation of strategic assets or economic sectors. This is a perennial risk for businesses operating internationally, but it is now extending beyond sectors traditionally susceptible to government interference, such as oil and gas. In recent years, there has been heightened political rhetoric around nationalization of resources critical to the new greener economy such as Peru’s copper industry or Mexican lithium production. An associated challenge may come from inflationary pressures on interest rates on sovereign debt. The World Bank now estimates that up to a dozen developing economies may be unable to service their debts by the end of 2022 and any events of default would have economic impacts beyond those holding sovereign debt instruments themselves.

Conclusions

Although global political and economic systems are confronting significant headwinds, we are not yet seeing calls for a return to complete autarky and economic self-sufficiency. In fact, a strong case could be made that protectionist policies are contributing to deeper economic challenges such as inflation. The interruption of supplies of commodities as a result of war, sanctions or pandemic lockdowns are demonstrating the need for elastic supply chains that allow for substitution of suppliers in fairly short order. Moreover, the war in Ukraine may be a catalyst for greater cooperation in multinational organizations such as NATO and the European Union after years of sustained political criticism. In fact, recent events may be prompting more realistic collaboration between the EU and a post-Brexit UK.

However, what is also apparent is that political cooperation cannot be taken for granted. It is a misnomer to think that a militarily weakened Russia is necessarily any less dangerous or disruptive to the international system or that the course of events in Ukraine will necessarily cause China to change its approach to dealing with security issues it considers of vital national importance. The world ushered in by the fall of the Berlin Wall 30 years ago looks to be relegated to the history books. The overriding question must now be how the global economic system that we once took as the unassailable norm adapts to a world in which uncertainty and disorder are the “new normal” in geopolitics. 🇺🇸

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