ESPO keeps going – week 2

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The new normal is regional

Last week Peter de Langen wrote a column for ESPO with the main message that the corona crisis could accelerate some trends that were already visible before the crisis. He expected that the annual event of the Hong Kong port and maritime community in June – the IAME conference – could hardly be organized in a traditional way. On the day his column was published, it was announced that the conference would indeed be virtual. This is an illustration of how quickly a "new normal" happens and is indeed considered logical by all participants.

Much has been written by commentators about the end of globalization because of the corona crisis. Some point to the container as one of the negative excesses of globalization, alongside tax evasion or tax-stimulated bunker fuel and kerosene and so on. Following the crisis, the creation of a regional manufacturing organization based on proximity, simplicity and transparency will be the answer to global supply-chains, these commentators proposed. Will a regional supply-chain organization become the new normal? There are some strong arguments for it, based on insights developed some time ago.

Professor George Stalk and Andrew Waddell wrote one of the most compelling research papers in 2007 that recommended a regional production organization. Their report for the Boston Consulting Group was called "Surviving the China Rip Tide" and was a clear warning of the hidden costs of long supply-chains which include China. China as the global manufacturing location was strongly developing during those years. They calculated that the cost of maritime transport was only about 1 percent of the retail price. Direct and indirect costs associated with long supply-chains – financing, inventory costs, insurance, etc. – could add up to 4-8 percent of shelf costs. However, the biggest costs of long supply-chains were hidden costs. These costs come from gross margins that are lost when the products are not there for consumers – because of much larger demand than expected they are sold out immediately and are not easy to replenish because of the long supply chain – or oversupply costs: goods shipped that consumers don't want. Both are happening now due to supply-chain bottlenecks related to the corona virus. Stalk and Waddell calculated that these hidden costs can add up to 60 percent of the shelf price. Their research was a strong message for a regional and integrated organization of production chains: near-sourcing or re-shoring.

Why has this clear analysis not led to a more regionally oriented supply-chain design? The simple answer is: it did. World trade as a share of global GDP peaked in 2011 and has since declined. Global value chains have also stagnated since the 2009 crisis, according to the World Bank. And the OECD noted that the share of cross-border inputs from foreign supply-chains coming from the same region – Europe, Asia and North America – has increased since 2011/12. The process of de-globalization – or "Slowbalization" according to Dutch futurologist Adjiedj Bakas – is visible in changing trade patterns that will accelerate due to the US-China trade war and the corona crisis.

The Netherlands is a laboratory for globalization because of the large share of re-exports in total exports. Import growth in the Netherlands in the period 2010-2019 with Eastern European countries surpassed Chinese import growth: 52 versus 39 percent, according to data by CBS (Statistics Netherlands). But growth with "other Asian countries" such as Thailand and Vietnam increased by 64 percent. This is an indication that globalization will continue, but in a different way. Asia is also showing regionalization, with production capacity growing outside China. However, it is very difficult to copy certain parts of the current Chinese production infrastructure elsewhere by re-shoring or rear-sourcing. It will take many years to develop global high-tech production hotspots like Shenzhen outside China. Therefor it is extremely challenging to develop regional value chains for many products.

Overall, I expect the effect on shipping will be relatively faster growth for shortsea shipping to meet regional demand and stagnant growth for global deep-sea services. The Dutch are already anticipating this new normal by the decision to invest in the expansion of the Kornwerderzand locks to enable growing future shortsea traffic.