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Covid-19 forces Europe to rethink globalisation

Globalisation as we knew it is over, Europe must regain sovereignty over key industries. Nearshoring could be one option

Read this article in German.

Since the outbreak in China, which led to the closing of a large number of factories in the country in late January, not a single industrial sector in the rest of the world has been spared. The automotive, electronics and textile industries, among others, have suffered and continue to suffer colossal losses unheard of in peacetime. In the textile industry alone, the losses are estimated at several hundred billion dollars. Experts predict a 50 per cent drop in mobile phone sales in the first quarter of 2020. And automotive production has ceased with the closing of several manufacturing sites in Europe.

While the global economic impact is difficult to quantify, the IMF already predicts that global growth in 2020 will be lower than that of 2019 without yet giving any figures. (The world economy grew by 2.9 per cent in 2019, and in January, the IMF was forecasting growth of 3.3 per cent for 2020.) More pessimistic, the OECD, in an interim report published in March 2020, estimates world growth will be between +1.5 per cent (worst case scenario) and +2.4 per cent.

The shutdown in China has impacted nearly every other country in the world as China alone accounts for a third of world growth. Due to a cost-saving economic approach very widespread in western economies, China has become the world's factory and produces today nearly 30 per cent of manufactured goods, 50 per cent of stainless steel and 80 per cent of printed circuit boards essential to smartphones and laptops. Europe's share in global value chains has shrunk in favour of China, which has won them a key role in the global supply chain. Germany, France, Italy, the UK are today extremely dependent on Chinese suppliers, whether it is for parts or raw materials, to the extent that in some strategic and vital sectors, they have completely lost their national sovereignty.

The disruption of global supply chains

The pharmaceutical industry is a widely discussed example. For several years now, Europe has offshored its pharmaceutical manufacturing. Today, 80 per cent of active ingredients are imported from China and India, including molecules for vital medication such as antibiotics, anti-cancer drugs and vaccines. Just thirty years ago, only 20 per cent of active ingredients were imported.

European countries have also relied on China's industrial capacities to produce the protective masks that they are desperately lacking today at the expense of national production. Italy, France and Spain are currently in urgent need of surgical masks and respirators, but also goggles, ventilators, hand sanitiser and many other products they long ago stopped manufacturing, instead purchasing them from China.

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Therefore, when Chinese factories suddenly closed in January, it was evident that there would be a domino effect and thus a disruption in supply. Chinese exports crashed. Experts evaluated a 20 per cent drop in January and February. Within a few weeks, several European manufacturers ran out of components and parts needed for final product assembly and were forced to halt production. A large number of them were obligated to declare ‘force majeure’.

The automotive sector has been particularly hard hit. A single car is made of around 20,000 parts that are, on average, manufactured in over 30 different countries, including China. To create a finished vehicle, a very complex sub-assembly process is required, a process which is fuelled by an equally complex parts supply chain. Additionally, the widespread practice of just-in-time (JIT) manufacturing means that stocks are limited. Car makers like Fiat, BMW and Jaguar Land Rover were therefore the first to suspend operations at their European facilities.

The pandemic forces Europe to rethink globalisation

Then, as the virus spread, global demand for medical products, such as hand sanitiser and protective masks, increased widely and rapidly. But the Chinese factories, where these products have been mass-produced for years, were closed. In several countries, the lack of medical equipment due to supply chain disruption has been fatal.

Today, factories are progressively reopening in China but the global supply chain is still at risk. Border closings and lockdowns in various European countries, combined with the slowdown in air freight, are making product transportation a challenge. Furthermore, the health crisis is now worsening in the United States, which is putting the supply chain under additional stress. The disruption is now moving westward with European goods being difficult to deliver to the American continent.

In just two months, the coronavirus pandemic has reshuffled the cards of globalisation. It has revealed the fragilities of our global production system, how dependent our economies have become on manufacturing chains scattered across the planet, how far a product must travel from, where it is made to where it is consumed and how – with any disruption to one part of the chain – fabrication grinds to a halt. The international division of labour, which ruled the world economy for decades, is no longer sustainable and has been exposed as a source of great insecurity.

Yet, the pandemic could be a positive turning point.

Europe needs nearshoring

It has brought nearshoring and the need to shorten supply chains to the forefront. Instead of making decisions based on cost optimisation, which has forced companies to offshore productions to low-wage countries, Europe should adopt a more balanced distribution of supply sources and develop means of production closer to consumers. This would limit supply risks and shortage in case of a crisis and, at the same time, save costs on logistics. It takes four weeks to ship products from China to Europe, so having productions closer would allow us to be more flexible and adapt to changing markets and events more efficiently.

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European manufacturers also need to evaluate their risk exposure and diversify their supply chains. They can no longer source components from one single supplier in one single location. With the US-China trade war, companies have already started restructuring their supply chains outside of China. This move might accelerate after the end of the crisis.

The pandemic is also a chance for Europe to win back its sovereignty over crucial industries such as medical and pharmaceutical manufacturing. In such an uncertain geopolitical environment, the need to secure essential supplies in order to reduce the European Union's dependence on the rest

of the world has never been more critical. French President Emmanuel Macron recently announced that he wanted France's full and complete independence in the production of masks 'by the end of the year'. This is the first step. But the EU must adopt a real supply chain strategy for medical products. That starts with the sourcing of raw materials and extends to manufacturing, assembling, packaging and distribution in production facilities on European soil.

The European workforce is comparatively expensive, but a combined process of automated and manual work should enable companies to bring manufacturing back to Europe. In the electronics industry, robotisation can contribute to nearshoring since production lines are already completely robotised in China. Some European robotics manufacturers are already working on it.

One thing is certain, the period ahead of us requires a transformation of the global supply chain model as globalization as we have known it is now over.



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