DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

“HOW TO IMPROVE GLOBAL SUPPLY CHAINS”

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Episode Summary:

Darrell West, vice president and director of Governance Studies at Brookings, discusses his new report, “Six ways to improve global supply chains.” In the conversation, West and host David Dollar discuss the recommendations for addressing recent snarls in supply chains resulting from the COVID-19 pandemic, the Ukraine war, and the trade conflict between the U.S. and China.

DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast Dollar and Sense. Today, my guest is Darrell West, director of the Governance Studies Program at Brookings, and we're going to talk about supply chains. There have been a lot of snarls in global supply chains as a result of the pandemic, the Ukraine war, and trade conflict between the U.S. and China. And Darrell has a new study with six recommendations for improving supply chains. So welcome to the show, Darrell.

WEST: Thank you, David. It's great to be with you.

DOLLAR: So one thing I really like about your report is that there's no magic bullet for fixing the supply chain snarls. There are six practical recommendations that interact. So let's start with the first recommendation, which is the idea of boosting domestic production through onshoring and nearshoring. Is this actually happening? Is this realistic?

WEST: It's happening to some extent. I mean, what a lot of companies undertook before the pandemic was what we call just in time manufacturing, where basically they would have very short supply chains order the products they needed when they needed them, count on them to be available for the manufacturing process, and then basically not invest a lot of money in storage. And of course, what we found during the pandemic was there were so many glitches and supply chain issues that it really created a number of problems.

So, I think over the last couple of years, a number of companies have tried to shorten their supply chains, not necessarily bringing production back to the United States— because we have high labor costs here and high energy costs. But trying to basically bring the components back in a way that would make it more accessible and reduce some of the delays that we've seen.

But it's very hard to do that without really raising costs for both the business as well as the consumer. So, I think it's been pretty limited in terms of the ability of companies actually to do this. I mean, the whole point of outsourcing supplies and moving things to countries around the world was to take advantage of the low cost there. And so that dynamic still is in play. And so therefore, it is hard for companies to bring production back to the United States.

DOLLAR: I think there are going to be some specific areas where we see this kind of actual reshoring to the U.S. Congress is debating a law that would basically provide $52 billion in subsidies for semiconductor production. I think that can work in a few strategic areas. But as you say, Darrell, it would be costly to bring everything back and that's not likely to happen.

WEST: I think the real issue is going to be in the critical mission industries. So you mentioned computer chips. So, clearly that is so important to a wide variety of both domestic products as well as national security issues. Pharmaceuticals is another area like, you know, many prescription drugs are made either in India or China. And the pandemic revealed that we need perhaps a greater production capability here. But I think you're right that in a lot of sectors, it's probably going to be too costly to actually do this on a widespread basis.

DOLLAR: Your second issue is logistical and transportation problems. And we've all seen the photos of a hundred ships lying off the coast of southern California waiting to unload. So, logistical transportation problems have been a big part of these these different supply chain snarls. So what's your analysis here? What's your recommendation?

WEST: I mean, this has been a huge issue kind of across a wide variety of sectors, just because so many businesses and so many industries rely on shipping to bring either the components to the United States for manufacturing here or to bring the manufactured product back to the United States.

And the costs have just grown enormously. I mean, some of the containers that used to cost $4,000 per container have risen to between 15 and $22,000. So obviously a huge increase there. There are only a handful of ports of entry for a lot of manufactured items, and those have experienced tremendous logjams and traffic jams.

And so what we have suggested there is there just needs to be better tracking of these container vessels just so people can keep track of where they are and try and manage the flow much more effectively. This actually may be one area where technology can be a big help. You can digitally track everything these days, and container ships certainly, I think would benefit from greater use of technology for tracking purposes in order to try and manage some of these logistical considerations.

DOLLAR: Yeah. So, I think this is really an important issue and your different issues interact. You know, if a certain amount of production comes back to the U.S. or, you know, nearshoring to Canada and Mexico, we still need the logistics to move stuff around. And a lot of these logistical problems work within the United States. So it’s not like bringing everything back automatically solves the logistical problems. We’ve really got to tackle these things as you recommend.

WEST: Yeah, we have a shortage of truck drivers, for example. So, to the extent the goods are having to move even within the United States, like not having sufficient trucks, not having sufficient drivers does add to the logistical problems in this area.

DOLLAR: Your third issue I found really interesting: prioritizing public health. I mean, this is sort of an obvious measure during a pandemic to prioritize public health, but I wasn’t really thinking of it as a supply chain issue. So, I found that interesting that you had a pretty broad definition of the of the problems in issues going into the supply chain. So, what do you see as the link between public health and the supply chains?

WEST: I mean, the link that we see there is just the problems a lot of businesses had when their workers started to get sick, like the pandemic just was very disruptive, both on manufacturing and distribution, just because businesses could not count on their typical workforce to show up every day. And sometimes there were surprises of kind of needing people and not having them and basically not having any notice that someone had gotten sick and therefore was not going to show up.

So, in talking to various businesses I found that the pandemic was incredibly disruptive, especially from a public health standpoint, which is the reason we included it in the paper. It just disrupted manufacturing distribution coming up with the components that are needed in the process.

And then, of course, the pandemic completely kind of altered both supply and demand. So, for example, we found consumer demand came back faster than a lot of businesses have anticipated. And so therefore, some of the supply chain issue came about because they didn’t have the supplies necessary to meet the expanded consumer demand that we saw. Like we clearly saw that in the airline industry where demand for travel kind of surged back this summer, the airline companies didn't have the pilots, didn't have people in the right places, and then we delays and cancellations on a widespread scale.

So, it's kind of illustrates how health, which you would think would not be related to supply chain issues, actually can end up having consequences for the supply chain problems.

DOLLAR: Yeah, I might just say on a personal note, my family got back to finally doing a little bit of travel to see each other and we had one family member traveling whose luggage didn't arrive. That's pretty common, but then they couldn't find it. He spent the whole vacation without any of his luggage. And finally, a month later, it was delivered to his home back in the United States. So, pretty extraordinary glitches in the production chain.

Your fourth issue is—again, it struck me as not an obvious supply chain issue, but, you know, a big issue for the United States—is labor shortages. So I'd like to hear how you see that affecting supply chains. And, you know, maybe we could go a little bit into more detail about, you know, what can we do to address some of these labor issues in the United States?

WEST: I mean, we found that there are a number of businesses that said they were having difficulty filling their positions, like one of the major human resource trade associations did a survey of businesses, and they found 90% of businesses said they were having difficulty filling basic positions within their company. And so that then would create problems kind of across the business sector and aggravates some of these other supply chain issues. We've seen some businesses have difficulties because even when their people recovered from COVID, they would start to experience cases of long COVID and then be out of the workforce on a longer term basis or having to work a reduced workload during their recovery period.

So, it just kind of shows that the economy during an era of globalization became so tightly integrated that it actually didn't take much to just put things off kilter. And the pandemic just exposed so many problems. The health issue, the worker shortage issue, kind of changes in consumer demand the businesses were not able to fulfill. And all of these things ended up interacting in very complicated ways.

And on the solutions side, you know what all that suggests is there's such a multilayered dimension to supply chain issues. It's not like there's a single silver bullet that, voila, we can do this and the supply chain problems are going to go away. It's like all these things are interrelated. Like if you cannot get the components that you need at the time that you need them, if you have worker shortages, if there are public health disruptions—like all of this is just incredibly disruptive to the marketplace and the ability of businesses to produce the goods that they need.

DOLLAR: I mean, one of the really striking things about the pandemic and the recession that initially was caused and then the recovery is that labor force participation has remained significantly below where it was pre-COVID. So, it does seem like quite a few people have dropped out of the labor force, and I believe particularly women have dropped out of the labor force.

WEST: Yeah, absolutely. And certainly I know many women who have reported on childcare problems that they have experienced. And of course, the pandemic was very disruptive in terms of daycare facilities, public schools, and other educational institutions. And so people have not come back into the workforce to the degree that I think many people expected just because of, you know, people had these logistical challenges in their in their own lives that then made it difficult for them to come back to jobs.

DOLLAR: Yeah. And if, you know, people are happy with that and that's fine. I always like to remind everyone the main point of economics is human happiness, not necessarily to maximize production or GDP. But I suspect there are probably a lot of people, women in particular, who are frustrated that they can't get the childcare support that they need or other support that they need. And they would actually prefer to be working full time or maybe part time if they could get that kind of support. So I think of it very much in terms of giving people choices that enable them to make their lives better.

WEST: Yeah. No, that definitely makes complete sense and is very consistent with the things we talked about in our paper.

DOLLAR: The fifth issue you bring up is anti-competitive practices. And I think this is something that often flies under the radar screen in the United States. You know, there's been a lot of consolidation in many, many different industries. A lot of argument among experts about, you know, whether the concentration is so acute that it really starts creating anti-competitive situations or some economists think all you need are two or three firms in an industry to generate competition. So it's definitely an area of controversy, but one where I would say the dominant thinking has been in support of more consolidation, more mergers, et cetera. But apparently that also contributed to some of the supply chain problems. Is that right?

WEST: I mean, the thing that I worry about is you're right that there has been a lot of consolidation in a variety of different sectors. And we are in a situation where in particular areas there may be two, three, or four firms that are the dominant providers. And the risk there is just abuse of market practices that then create problems either in terms of production, manufacturing, or distribution.

So, for example, in the freight area, that concentration in that industry has led companies to jack up prices in an unfair manner. And so there's been a concern about that. Of course, there was the well-publicized case recently of baby formula issues where there were apparently four large providers in the United States there. One of them basically got shut down for health and safety violations, and then that created shortages there that complicated the lives of families all across the country. In the energy area, a number of members of Congress have openly accused oil producers of taking advantage of the situation and increasing prices there.

So, in the paper, we wanted to highlight some of these issues just in terms of market competition and the potential for anti-competitive practices that could aggravate some of the supply chain issues that we've seen in a variety of areas.

DOLLAR: I would just add that the baby formula situation, which you described, you know, that's a good example of a very concentrated industry in the U.S. Plus, I believe we've got restrictions on imports. And for many products, you know, free trade is the best competitive medicine, essentially. You know, antimonopoly policy is to allow imports. And obviously for something like baby formula, we want to be careful, but we've got some, you know, first class partners out there in Europe and a few other locations, you know, that have reliable health and safety inspections. And if you don't have imports from those countries, then it's just a little bit harder to really have a competitive market.

WEST: Yeah, that's a great point. And in fact, when the administration was trying to deal with the baby formula issue, that was actually one of the remedies that they put into practice, because as you point out, there were limits on the importation of baby formula from a number of other countries. So, one of the first things the administration did was to relax some of those limitations with countries where they trusted the baby formula and then used that to try and address the limited supply issue.

DOLLAR: Your sixth recommendation strikes me as the most difficult one, which is to mitigate some of the geopolitical tension and risks that we're experiencing. And obviously there are quite a few different ones. You know, at the moment the Ukraine war is is front and center and our conflict with Russia over that. But I think most analysts consider the relationship with China to be the big challenge for the long term because, you know, China with that vast population, they don't have to be that successful to catch up with the United States in overall economic size, perhaps surpass the United States in overall economic size. And of course, we have lots of lots of issues and differences around China. So, let's spend a little time going in to this one. How does this affect the supply chains? And then what are some of the things, realistic things, that you would recommend it do to mitigate the geopolitical tension?

WEST: Well, the world definitely seems a lot more complicated now than even five or ten years ago. And it just shows how supply chain issues are not merely just an economic issue where economic factors can create these types of complications, but politics, especially on a global scale, interferes with distribution, manufacturing, production, and the ability to get key components.

So, for example, in the computer chip area, we know that I believe it's more than 8% of the computer chips and especially at the high end come from either Taiwan or South Korea. And both of those places, the politics are much more complicated because we know China wants Taiwan and expects at some point for that to become part of mainland China. Some of the South Korea computer factories are 30 minutes from North Korea. And so you can just see that in part as a result of the Ukraine war, but in part because of the increasing complexities of the relationships with a number of different countries that the relationship between the U.S. and Russia, the China relationship, even India, where the United States has a friendly relationship—India has not kind of participated in the sanctions against Russia.

And so since so many products are made in Asian countries, the extent to which the world has gotten more complicated in terms of American relations with India, China, South Korea, Japan, and so on, as well as there are complications bilaterally between various of those countries themselves, independently of the United States, kind of the old model of American business is just kind of sending the production abroad to these countries and then expecting to be able to get the goods back whenever they needed it—well, it's a lot more complicated now.

So, with China, we had the tariff war and so, large tariffs imposed on products made in China as a result of the Ukraine war. There are sanctions on Russia, and then that creates problems in terms of countries that do business with Russia, and then the ability of American firms to kind of keep the supply chains that they had in place. There are barriers to entry in a number of different countries in various sectors.

So, it's like it's hard to have stable and predictable supply chains when politics intrudes on these manufacturing and distribution issues. And so, many companies have just found the level of complexity that they've had to manage has increased pretty substantially. A lot of companies, of course, are now investing pretty substantially in risk assessment to try to get a handle on where these risks are likely to come up and in what form they are going to come up. So, that whole situation is very complicated. It has obvious relevance for supply chain issues, but it becomes hard to resolve because it's not really a technical issue, an economic issue, or even a logistical issue. It is a raw political issue.

DOLLAR: Obviously there's been at least some decoupling between China and the U.S. as a result of the situation that you just described very nicely. Can I ask you a very speculative question? Do you think that that decoupling that's occurred so far is it is that the beginning of a trend that could accelerate and really lead to a bipolar world? I mean, obviously it could. And then there are other voices saying, well, we have to find a way, you know, to coexist with China, wall off certain parts of our economy to protect ourselves, but otherwise have trade and investment. So, where do you see yourself on that spectrum, you know, particularly in terms of what do you think's actually likely to happen?

WEST: I mean, I think it's going to be hard to decouple from China in the short run because, you know, it takes years to build factories—like in the computer chip area. People have told me it takes seven or eight years to really build at least a high-end chip manufacturing facility. And so even though there is interest and likely to be big public investment on the part of the United States to bring that capacity back to United States, you know, it could be 2030 before we actually have those factories up and running. And you can kind of multiply that times a lot of different sectors, like, most Apple products are still made in China. The factories are there. Many of the components either originate there or from other countries around the world. It's really hard to recreate that in the United States, and it's also likely to be very expensive.

Now, if the national defense or national security situation continues to deteriorate, at least in key component areas, the United States may not have a choice other than to try and either bring those facilities back to the United States or at least bring them to friendly countries where we know we can count on them. But I think in the short run, it's it is going to be hard to decouple it just because, you know, it took years to create these production facilities and to develop these supply chains. They're not easily moved on a short term basis.

DOLLAR: I think that's a really important point, Darrell. And an added complication is that China is participating in this big regional trade agreement now, the Regional Comprehensive Economic Partnership. And it's mostly our allies, you know, Japan, South Korea, Australia, Singapore. Those are some of the big economies. Those are essentially allies of the U.S. But you've also got Indonesia, Vietnam, these these are, you know, countries that we see to some extent helping create some leverage against China. So, now they're all together in this trade agreement that's eliminating tariffs on parts and components in order to have value chains really firmly situated in the Asia-Pacific region. So, it's not just a matter of decoupling from China. You know, we've got basically allies and important Asian economies other than China that are all deeply integrated. And you mentioned Taiwan. Taiwan is not in that agreement, but it's actually deeply integrated with all of those other economies.

WEST: Yeah. I mean, you're exactly right that, you know, many Asian countries that the U.S. would view as friendly countries actually do a lot of trade with China. So, it's hard for them if we try and force them to choose between China and the U.S. to actually get them to make a choice or to get them to make a choice that's favorable to the United States because they're doing a lot of business there. They have jobs that are dependent there. Some of their key sectors are dependent on either Chinese components or Chinese production facilities. So, it just illustrates how challenging the geopolitical aspect is in terms of manufacturing and the difficulty of making improvements in this area, because you're not really going to be able to solve the supply chain issues unless you can develop greater stability and greater consistency in the various geopolitical arrangements.

DOLLAR: I'm David Dollar, and I've been talking to my colleague Darrell West, who's the director of Governance Studies at Brookings and the author of a new report on "Six Ways to Improve Global Supply Chains," which is available on the Brookings website. And I like the nice practicality of different recommendations that interact. There's no magic solution, but there are things we could do that would significantly improve the situation relative to the supply chain snarls we've had over the last few years. So, thank you very much, Darrell, for explaining all that to us.

WEST: Thank you very much, David.

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Until next time, I'm David Dollar and this has been Dollar and Sense.