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Deglobalization?

Comments on paper by Pol Antràs

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Antràs paper makes many valuable contributions

- Historical context for the slowdown in trade / GDP growth in last 10 years: a natural sequel to a period of unsustainable "hypergloblization" from 1986-2008
- Convincingly shows that factors that gave rise to "hyperglobalization" have now run out of steam: (technological change, reduced trade costs, entry of many new countries into global trading system)
- Provides a nice theoretical model that can explain the rapid acceleration of value chain globalization, based on scale economies, fixed (and sunk) investment costs, and sequential production models

Conclusion:

- Little evidence of systemic de-globalization so far
- Political and institutional factors are the main risks to trade in the future
- Value chain stickiness may prevent large-scale shifts in their geographical footprint

My comments will focus on two areas

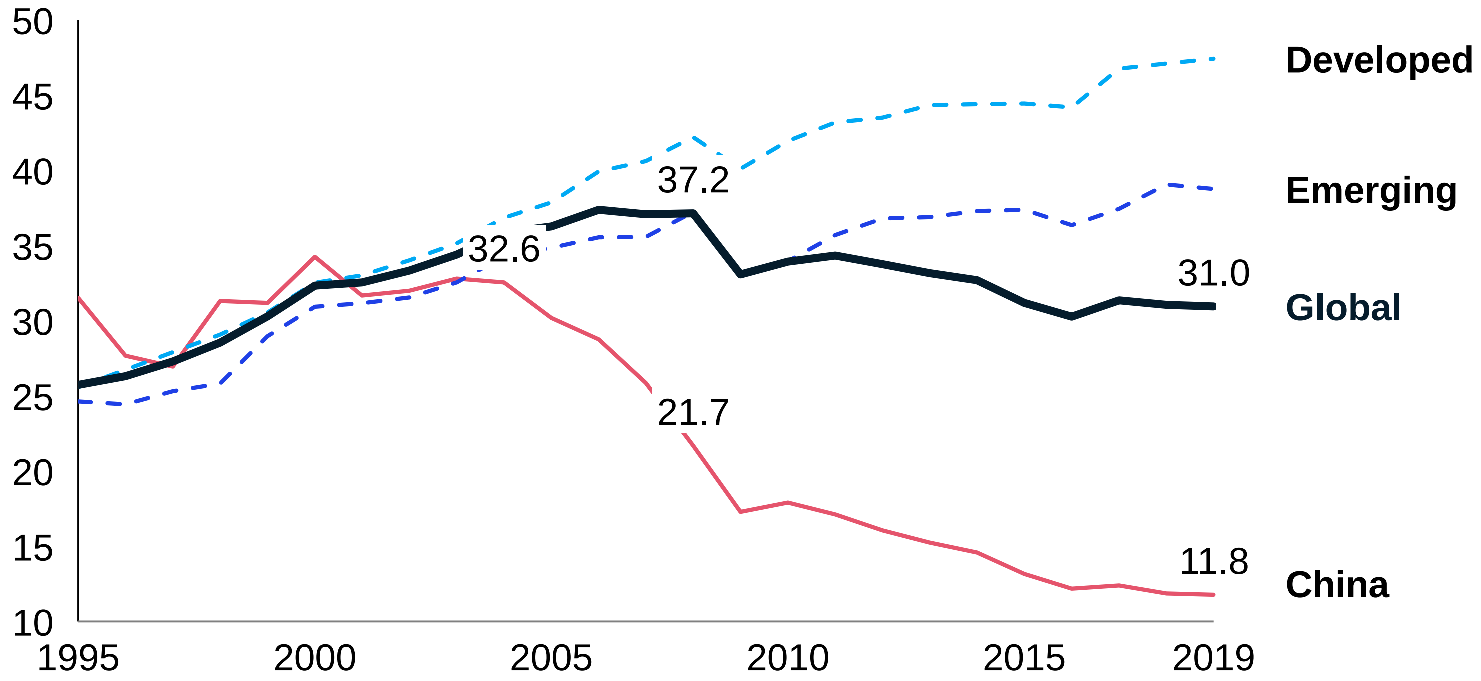
01 **Micro-empirical look at past slowdown in global trade**

02 Firm-level view on how global value chain risk could lead to a rebalancing of trade

The decline in global trade intensity over the past 10 years is attributed mainly to China

Ratio of goods exports to goods gross output

Percent



China share of global exports, Percent

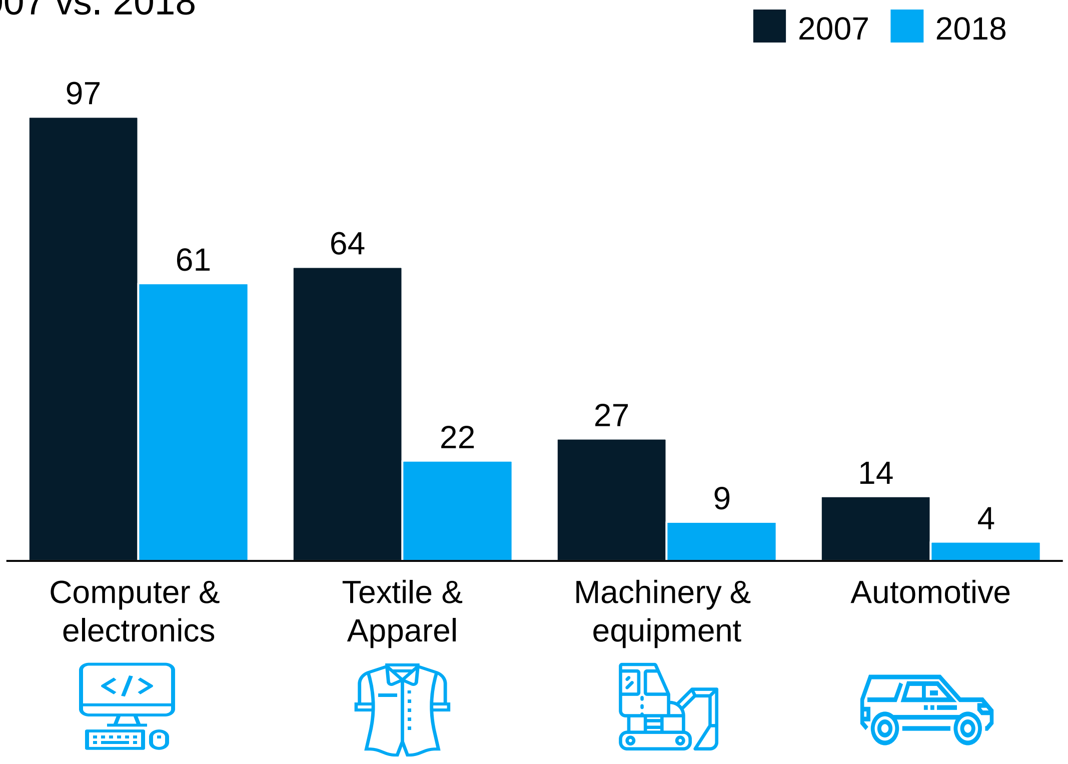
Note: Analysis include data for 75 countries, accounting for 96% of the global trade

Source: WTO, UN Comtrade, IHS, McKinsey Global Institute analysis

China's decline in trade intensity reflects two factors

China is consuming more of what it produces and exporting less...

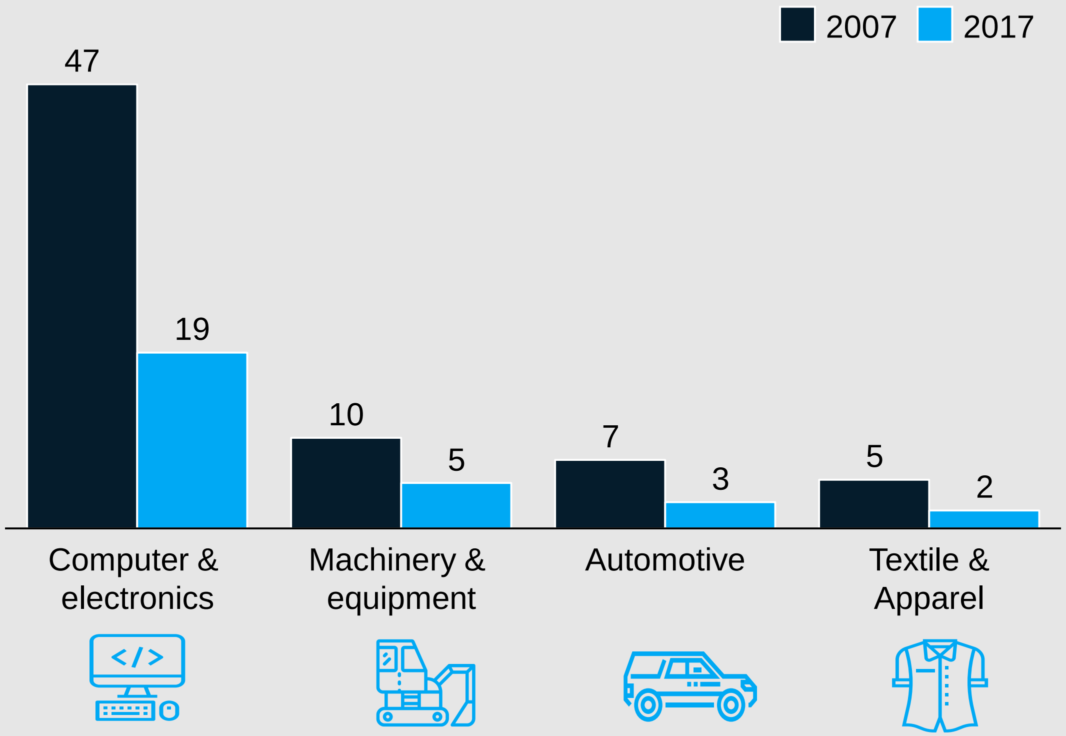
China's exports as a share of gross output,
2007 vs. 2018



China exports CAGR (2007-18)	**0.6%**	**2.5%**	**1.9%**	**2.4%**

...and China's domestic supply chains are also growing

Share of imported intermediate inputs to total inputs,
2007 vs. 2017

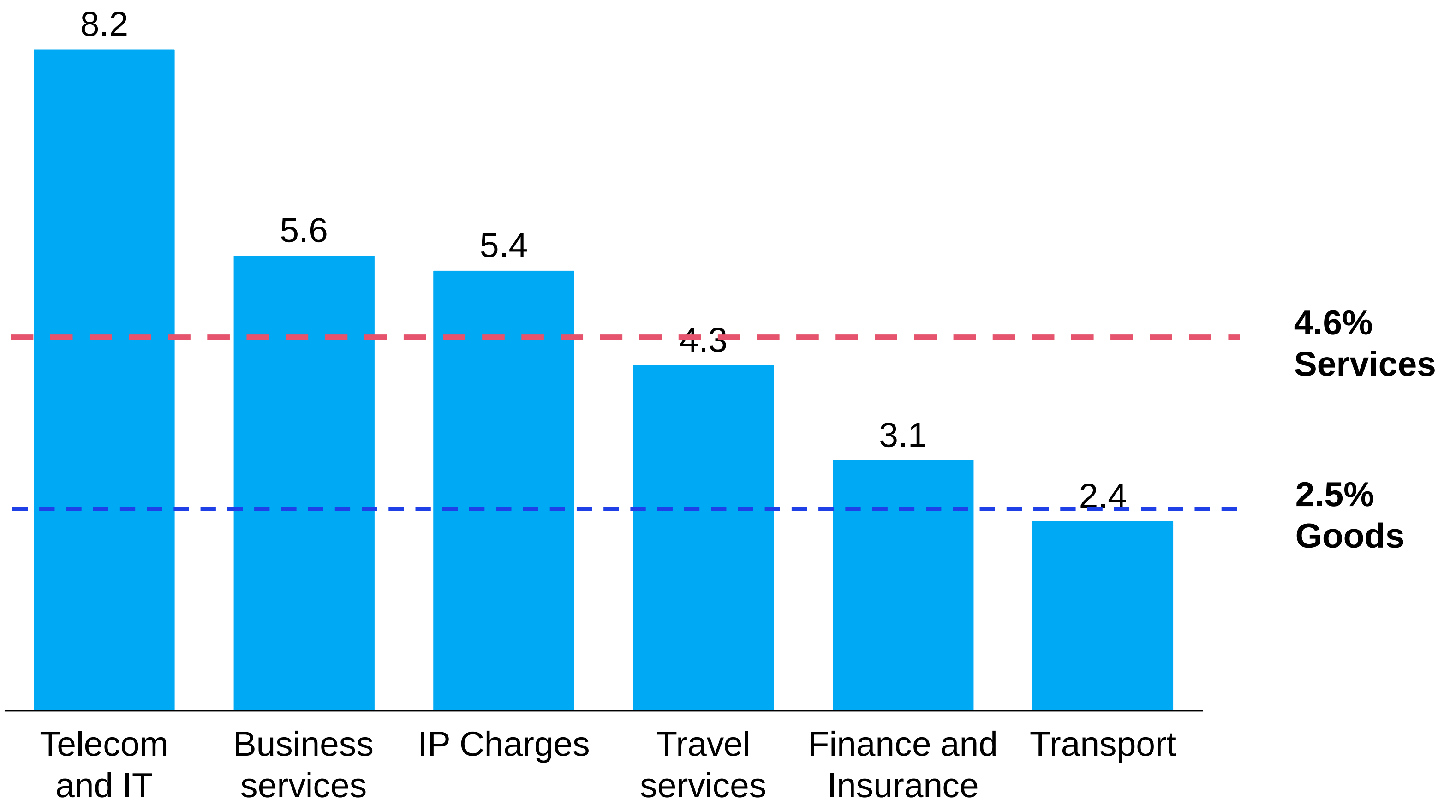


Source: UN Comtrade, IHS, WIOD, McKinsey Global Institute analysis

Services trade is growing faster than goods trade

Services trade is growing 80% faster than goods trade

Services sector GAGR, 2007-19
Percent



Source: WTO, McKinsey Global Institute analysis

Implications of the "China story" of trade slowdown

- Decline in trade / GDP is a sign of **success, not failure, of globalization** – it reflects China's economic development

- We might expect the **slower growth of trade / GDP will continue** as India and other low-income countries develop domestic consumers and supplier industries

- **Services trade is growing faster** than goods trade

- Conclusion: **no evidence of systemic de-globalization, just a different type of globalization**

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Supply chains are not chains: they are highly complex, multi-tiered and interconnected networks, with different network structures

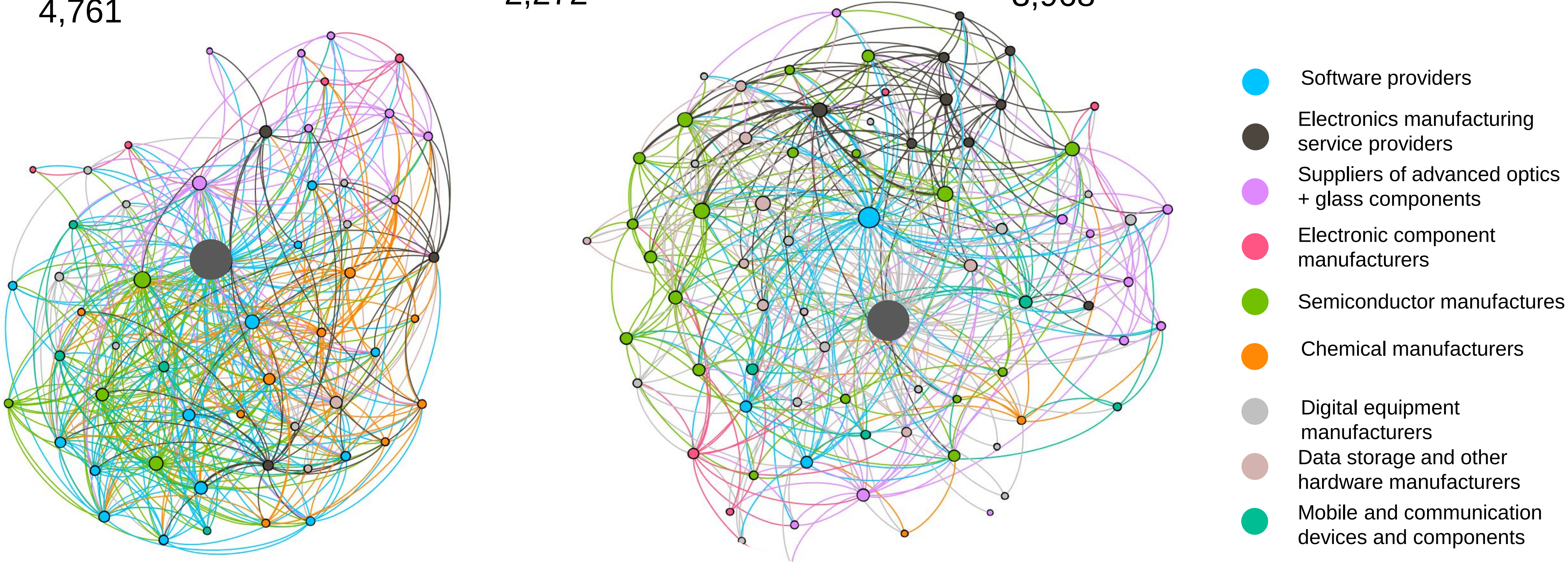
Dell’s ecosystem is more clustered (risking bottlenecks) while Lenovo’s is deeper (risking lack of visibility)

Number of publicly known Tier 1-2 suppliers

Dell only
4,761

Shared
2,272

Lenovo only
3,968



Source: Bloomberg, McKinsey Global Institute analysis

External shocks are often impossible to predict, but happen with regularity

Expected frequency of a disruption by duration

Based on expert interviews, n=35

Shocks are diverse

Force majeure

- Geophysical
- Acute climate event
- Pandemic

Geopolitical

- Financial crisis
- Trade war
- Military conflict

Malicious actors

- Counterfeit
- Cyber attacks

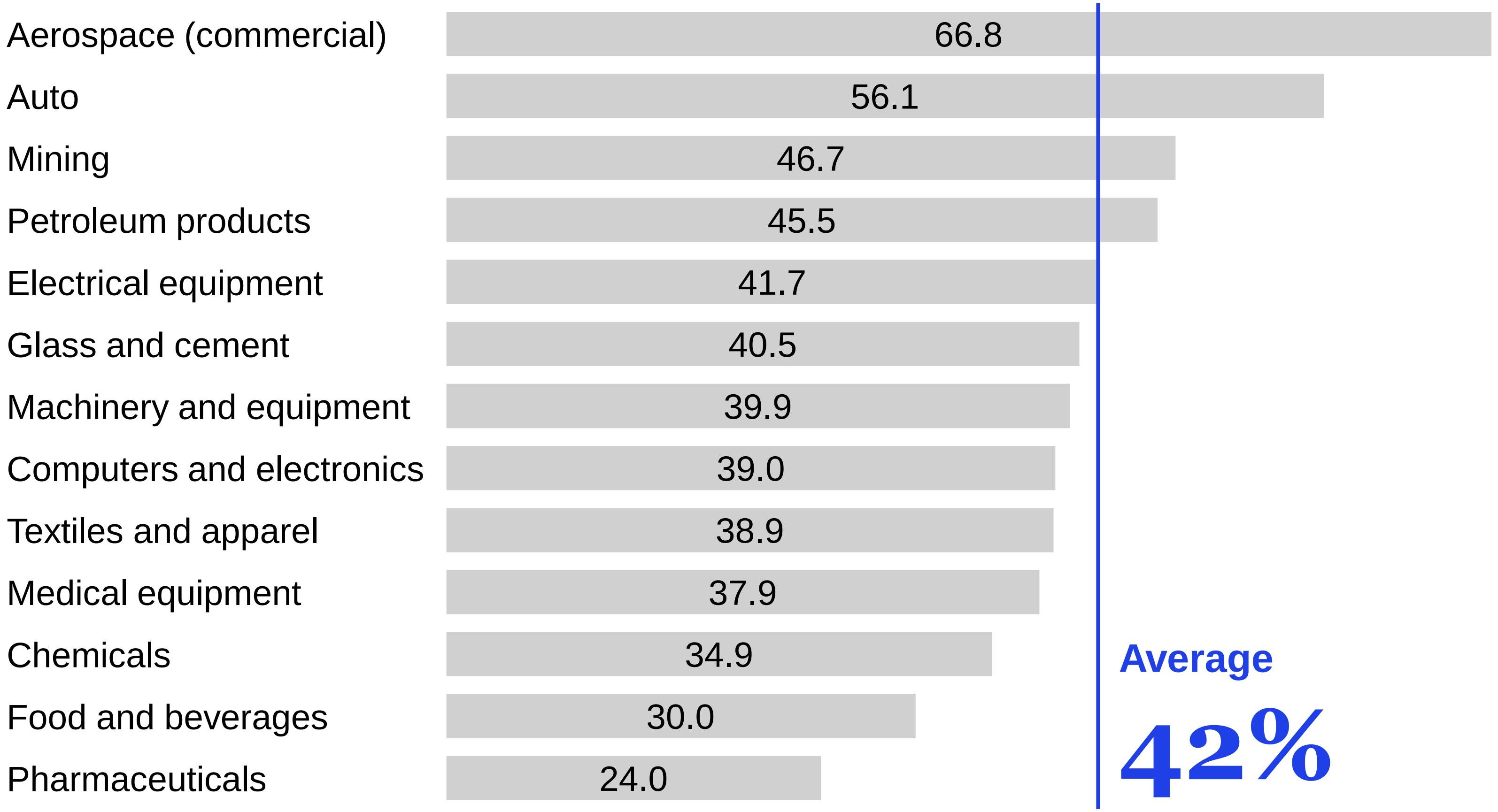
Idiosyncratic risks

- Supplier bankruptcy
- Industrial accident

Disruptions have a measurable impact on the bottom line across industries

Net present value of expected losses over a 10 year period

% annual EBITDA



1. Based on estimated probability of severe disruption (constant across industries) and proportion of revenue at risk due to a shock (varies across industries). Amount is equivalent to one-year's revenue, i.e., is not recurring over the modelled ten-year period. Calculated by aggregating the cash value of expected shocks over a ten year period based on averages of production-only and production-and-distribution scenarios multiplied by the probability of the event occurring for a given year based on expert input on disruption frequency. The expected cash impact is discounted based on each industry's weighted average cost of capital

2. Based on weighted average revenue of top 25 companies by market cap

Source: McKinsey Global Institute analysis

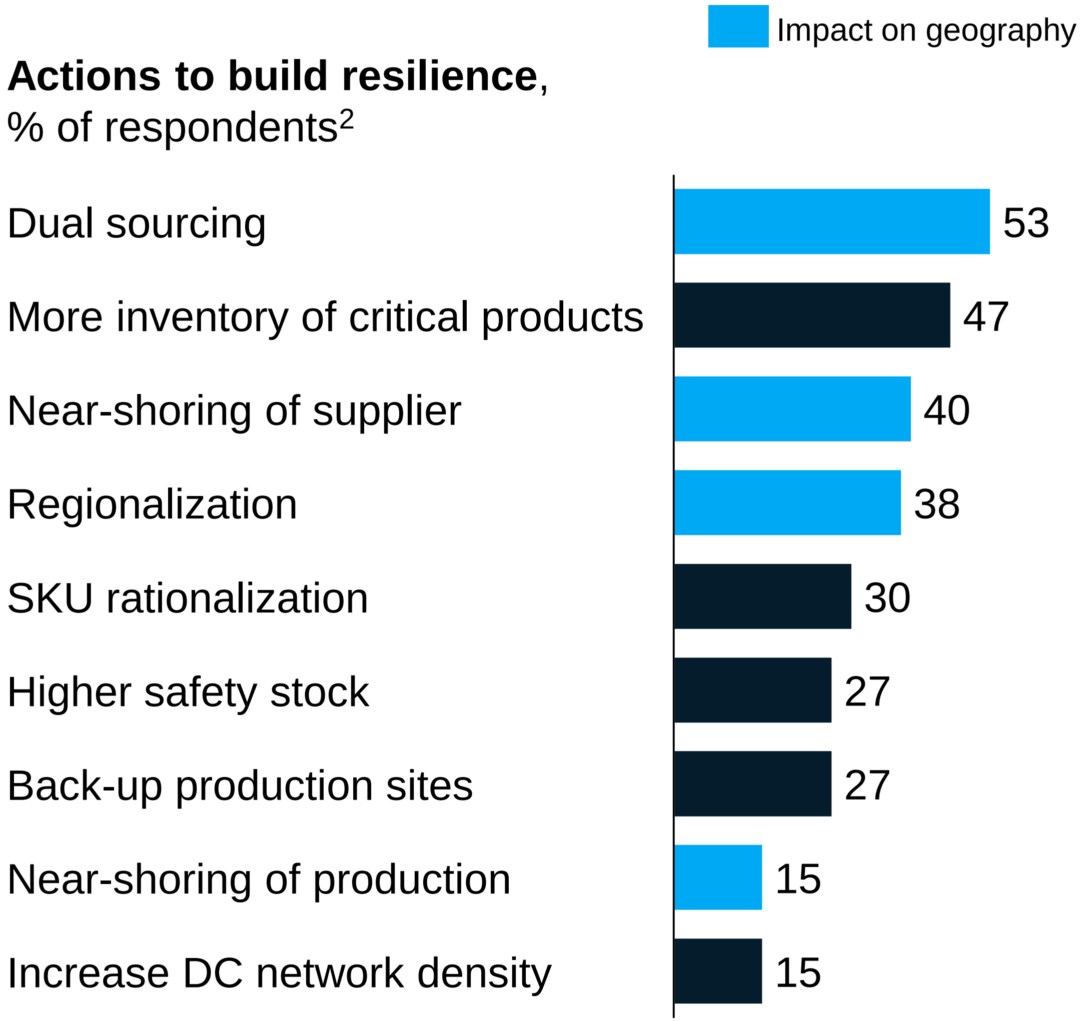
Building resilience is a high priority among supply chain executives – and many actions could shift the geography of trade

Executive survey results,
May 2020

93% Supply chain leaders planning to increase resilience[1]

44% Would increase resilience at the expense of short term efficiency[2]

Actions to build resilience,
% of respondents[2]



1. Survey of leading executives, n=60

2 Survey of leading executives, n=605

Source: McKinsey Global Institute survey of executives

One implication of building resilience: global value chains could shift to different countries in the medium term

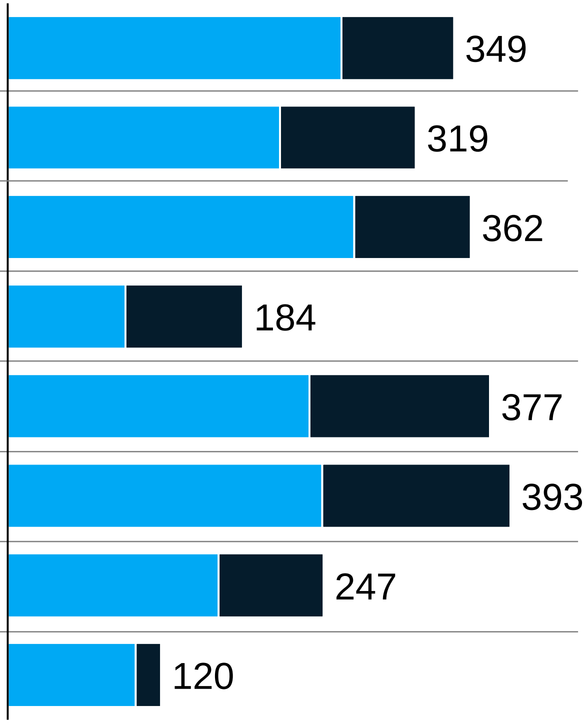
If global value chains regionalize,15% - 25% of trade flows could shift to other countries ($2.9T to $4.6T)

Rough estimate

Low shift feasibility — **High shift feasibility**

Mid estimate | High estimate

Select GVCs	Feasibility of shifts: Economic factors[1]	Feasibility of shifts: Non-economic factors[2]	Total trade ($b)	Annual exports that could shift geographies ($b)
Auto			1,730	349
Electrical equipment			928	319
Machinery and equipment			1,455	362
Semiconductors			995	184
Pharmaceuticals			626	377
Apparel			688	393
Computer and electronics			708	247
Medical devices			268	120
All value chains (including other)			$18.0T	$2.9T (16%) / $4.6T (26%)



1. Economic factors include variable cost difference, capital intensity, product complexity, and trade weighted distance
2. Non-economic factors refer to likelihood of increased market intervention to advance objectives such as national security, national competitiveness, and essentiality

Source: McKinsey Global Institute

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Thank you

Please see full MGI report at:

https://www.mckinsey.com/business-functions/operations/our-insights/risk-resilience-and-rebalancing-in-global-value-chains