

Resilient supply chains as a pandemic lesson



An economy such as India can ill-afford the shocks of disruption or be held hostage by an over-reliance on imports

A key lesson learnt by the world during the COVID19 pandemic has been the importance of creating resilient supply chains that can withstand disruptions and ensure reliability for the global economy.

Disruptions in supply chains can be natural or manmade. In Japan's case, the Great Tōhoku Earthquake of 2011, followed by the Tsunami, led to a nuclear disaster (Fukushima Daiichi), causing a sharp drop in Japanese automobile exports to the United States.

EXAMPLES THAT HIT HOME

Manmade interruptions in supply chains are equally disruptive. Terrorist drone attacks on Aramco's oil refineries at Abqaiq and Khurais in Saudi Arabia in September 2019 resulted in a drop of 5.7 million barrels of oil per day, triggering a steep plunge in Saudi Arabia's stock market and a sharp spike in global oil prices.

China has long practised "supply chain politics". Japanese entrepreneurs learnt a hard lesson when the detention of a Chinese fishing trawler captain in 2010 near the disputed Senkaku Islands resulted in the Chinese government cutting off exports of rare earths to Japan.

When the novel coronavirus pandemic broke out, it had an immediate and telling effect on supply chains emanating from China. In India, several companies felt the disruption in the automotive, electronics and white goods sectors. India excels in the pharmaceuticals sector but the overreliance on Active Pharmaceutical Ingredients (APIs) from China still creates vulnerabilities in the value chain.

Tensions with China led the United States government to impose restrictions on export of microchips to China's biggest semiconductor manufacturer, Semiconductor Manufacturing International Corporation (SMIC), following assessment that there was an "unacceptable risk" that equipment supplied to it could be used for military purposes.

A NEW INITIATIVE

Greater weaponisation of trade and technology is here to stay. It is in this context that India, Japan and Australia initiated the Supply Chain Resilience Initiative (SCRI) in September this year, focusing on automobiles and parts, petroleum, steel, textiles, financial services and IT sectors. The SCRI may be bolstered by the future involvement of France, though this might depend on the European Union's position. The United Kingdom has also shown interest in the SCRI.

Geo-politics and geo-economics can never be truly separated. This is what Henry Kissinger called the “principle of linkage” in his analysis of U.S. relations with the Soviet Union. When the Nixon administration came to power in 1969, the Soviet Union wanted access to some key western technologies in computing. Yet, it was unwilling to accommodate U.S. concerns on strategic and military issues. Kissinger clearly pointed out that to “separate issues into distinct compartments would encourage the Soviet leaders to believe that they could use cooperation in one area as a safety valve while striving for unilateral advantages elsewhere...”

China has resorted to similar tactics, of maintaining advantageous trade and economic engagement, without relenting on strategic issues. China's calls for “normal relations” with India are unrealistic given the continuing face off in Ladakh.

MOVES BY AUSTRALIA, JAPAN

China has often used its economic leverage to weaken an opponent's resolve on contentious issues. Facing such a dilemma, Australia has demonstrated strong political will in countering arbitrary Chinese sanctions imposed on its key exports of grain, beef, wine, coal and much else. This is a price that a democracy such as Australia finds worth paying, for demanding an inquiry into the origins of the coronavirus and advocating a robust Indo Pacific vision.

Since the normalisation of diplomatic ties in the 1970s, Japan has invested hundreds of billions of dollars in the Chinese economy. For many Japanese companies, global performance and profits are linked to manufacturing facilities and supply chains in China. Yet, they have shown an early capacity for risk mitigation through the “China Plus One” business strategy, aimed at diversification of investments to the Association of Southeast Asian Nations (ASEAN), India and Bangladesh.

In Phase1 of Japan's \$2.2 billion Relocation Package announced this year, 89 Japanese companies availed subsidies to diversify out of China. Of these, 57 companies relocated to Japan, 30 to Southeast Asia and two to India.

A sizeable number of small and medium enterprises (SMEs) chose to relocate to Southeast Asian countries such as Vietnam, Thailand and Malaysia. That in itself is hardly surprising since Japanese entrepreneurs are far more familiar with the cultural and business environment in ASEAN countries as compared to South Asia.

However, companies in health care and medical devices, especially those manufacturing personal protective equipment (PPEs), would have benefited more by shifting to India which offers a much larger domestic market as well as lower manufacturing costs for global exports.

INDIA'S VULNERABILITIES

A large emerging economy such as India can ill-afford the shocks of disruption in supply chains. Nor can it allow itself to be held hostage due to an overreliance on imports. For instance, the pandemic caused a breakdown in global supply chains in the automotive sector since most global manufacturers in China abruptly went off line. For India, which imports 27% of its requirement of automotive parts from China, this quandary was a wakeup call, given the sudden shortage of braking components, electrical components, interiors and lighting fixtures.

What is noteworthy is that despite being the fourth largest market in Asia for medical devices, India has an import dependency of 80%. Among the biggest exporters to India in this field are China, the U.S., Germany, Singapore and Japan. This is clearly not sustainable. Given the renewed thrust in the healthcare sector, this is the right time to fill gaps through local manufacturing.

India's electronics industry was worth \$120 billion in 2018-2019 and is forecast to grow to \$400 billion by 2025. Today, India is seeking to enhance its presence substantially in the global supply chains by attracting investments in the semiconductor components and packaging industry. The government is actively promoting domestic manufacture of printed circuit boards (PCBs), components and semiconductors, as the Indian electronics sector gradually shifts away from completely knocked down (CKD) assembly to high value addition.

DEFENCE BECKONS

Defense is among the key pillars of the 'Atmanirbhar Bharat' policy. The government is providing a big boost to defence manufacturing under the 'Make in India' programme. It has identified a negative import list of 101 items. There is a tremendous opportunity for foreign companies to enter into tie ups with reputed Indian defense manufacturers to tap into the growing defense market in India.

The push for self reliance through 'Atmanirbhar Bharat' is not an autarkic policy. It does not imply foreclosure of the Indian economy to foreign trade and participation in the global economy. On the contrary, it is aimed at strengthening India's capacities to participate more vigorously without being prey to supply chain disruptions.

India has the capacity and the potential to become one of the world's largest destinations for investments, and one of the world's largest manufacturing hubs, in the aftermath of the pandemic.

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