Nation states in an economically globalized world

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One aspect which causes major problems in the world economy is the fact that we have nation states still acting as independent units with different cultures, religions, political systems and values, while being a part of a very complex and fragile global economy. In the beginning of international trade global dependences were very weak, all the goods traded internationally were mostly a kind of luxury items, nice to have but rarely essential for life in the importing country. Trade over larger distances was still dangerous and could not be relied upon for essential goods. In 1776 Adam Smith published his work "An Inquiry into the Nature and Causes of the Wealth of Nations" and in 1817 David Ricardo published his work "On the Principles of Political Economy and Taxation". Both roughly concluded that it is best for all nations to produce those goods they can produce best and import those they can buy cheaper from other countries. Following this conclusion of course increased the dependance of countries on international trade, but the risks were still limited. In the mid-20th century multinational companies created smaller versions of themselves in other countries and made heavy local investments abroad to produce their final products within or close to the market of the country where they wanted to sell them. The reasons were transport costs and stronger control over the sales of their products in the foreign market. The subsidiaries in the foreign countries still were highly vertical integrated since transaction costs between different companies were still high. This means that all components and processes for creating a final product at home as well as in a foreign subsidiary were produced within the same company and the same country. Dependance between the home company and its subsidiaries was mainly financial.

In the 21st century so-called transnational companies[1] or globally integrated enterprises[2] evolved. These companies base locations and functions wherever cost, skills, and business environment are best. This often creates companies which produce components for their final products at many different locations. These companies critically depend on well operating supply chains between their different locations. In extreme cases a local disturbance at just one of their locations may impede all products of the company. At about the same time, the cost of transactions between companies substantially decreased and electronic markets allowed easily to connect with other companies to outsource production

[1] Peter F. Drucker, The Global Economy and the Nation-State
[2] Samuel J. Palmisano, The Globally Integrated Enterprise

of specific components of final products. In total, there was a substantial shift from vertically integrated companies to globally spread networks of independent companies. However, while legally independent, those companies economically depend strongly on each other. Exactly as with transactional or globally integrated enterprises, production of such companies may be substantially disturbed or completely stopped, if the supply chains connecting these companies are disturbed for more than a short time. This sensitivity to disturbances was substantially increased in the 1960s when the Japanese introduced lean manufacturing which reduces manufacturing cost by perfectly organizing supply chains and thereby reducing storage of goods and the related costs. Hence, today we have already a strongly integrated and interdependent global economy, but nation states still with strongly different cultures, religions, political systems, and values.

The recent pandemic clearly showed the disastrous effect of supply chain disturbances and nurtured plans for the development of future resilient supply chains which try to include suppliers in different regions for the same goods and agile supply chains which allow fast adaptation through change of their products as a reaction to local or regional disasters. However, the situation will never be really safe, since certain raw materials for high-tech products and medicines exist only in specific countries.

In general, we can say that local disturbances of supply chains can cause a switch from an "economy of plenty", where supply of goods fully covers demand, to a "shortage economy" where demand of goods substantially exceeds the corresponding supply. This latter fact of course leads to substantial increases in prices and henceforth to large inflation. However, since the shortage not only includes final products, but also raw materials and components needed for further production, industrial production is also severely impacted. This latter case may lead to serious layoffs in companies and reductions in investment indexes. If central banks then fight the increase in inflation with rate hikes, this may increase the recession instead of damping it. This double-blow to the economy may create a serious social crisis.

Normally, if inflation is caused by printing money of the local government, investors move from paper money to real assets, including shares in companies, thereby supporting the industry. However, in a shortage economy, the opposite may happen since industries may not be able to operate due to missing raw materials and components.

In total, many factors may lead to severe disturbances of the global supply chain networks, examples are local or regional natural disasters, epidemics, wars between countries, or trade sanctions against countries. Disturbances of the global supply chain networks with a duration larger than a few weeks easily lead to a switch from an economy of plenty to a shortage economy. This does not only lead to sharp increases in prices and corresponding inflation, but due to the disruptions in industrial production caused by missing raw materials and technical components, also to layoffs and possibly a major recession, as well as serious social crises.