

# Contagion, reshoring, and trade wars: global value chains after the pandemic

(for the University of Sheffield)

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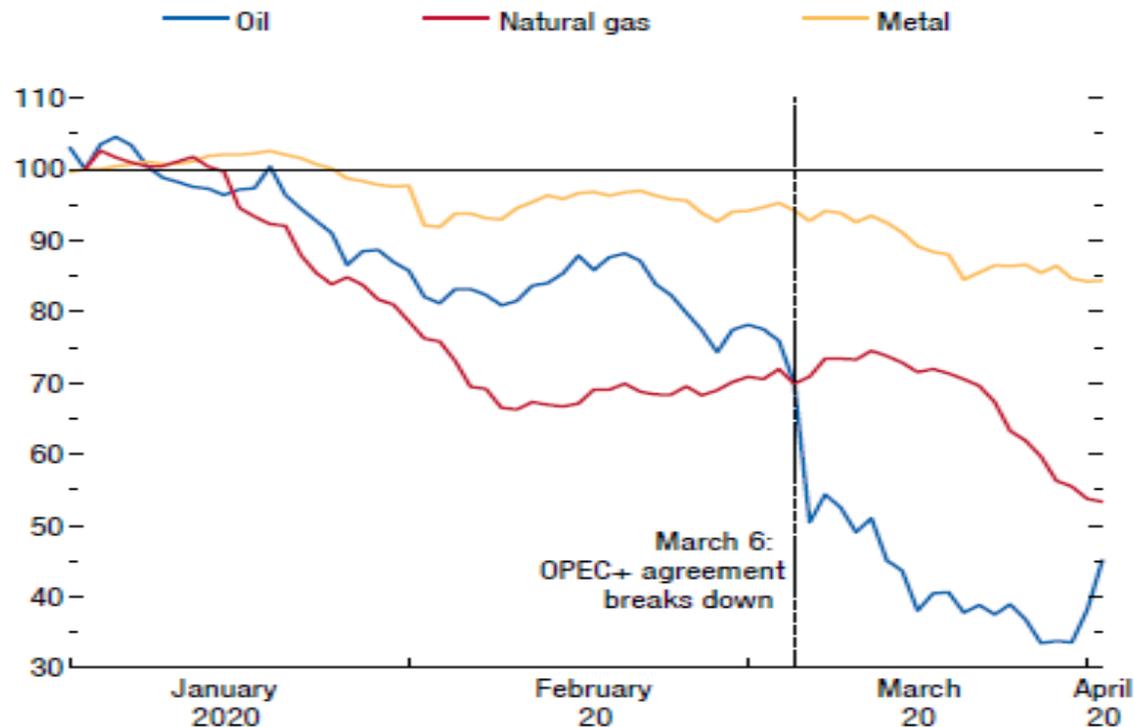
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# Introduction: everything changed. Faster.

- ▶ In a matter of weeks, the pandemic of Covid-19 has changed the course of world history. This event has already provoked a number of economic works.
- ▶ Although “This crisis is like no other” (IMF,) it hits on the weak points that were already there. For instance: deflation.

**Figure 1.1. Commodity Prices**  
(January 2, 2020 = 100)



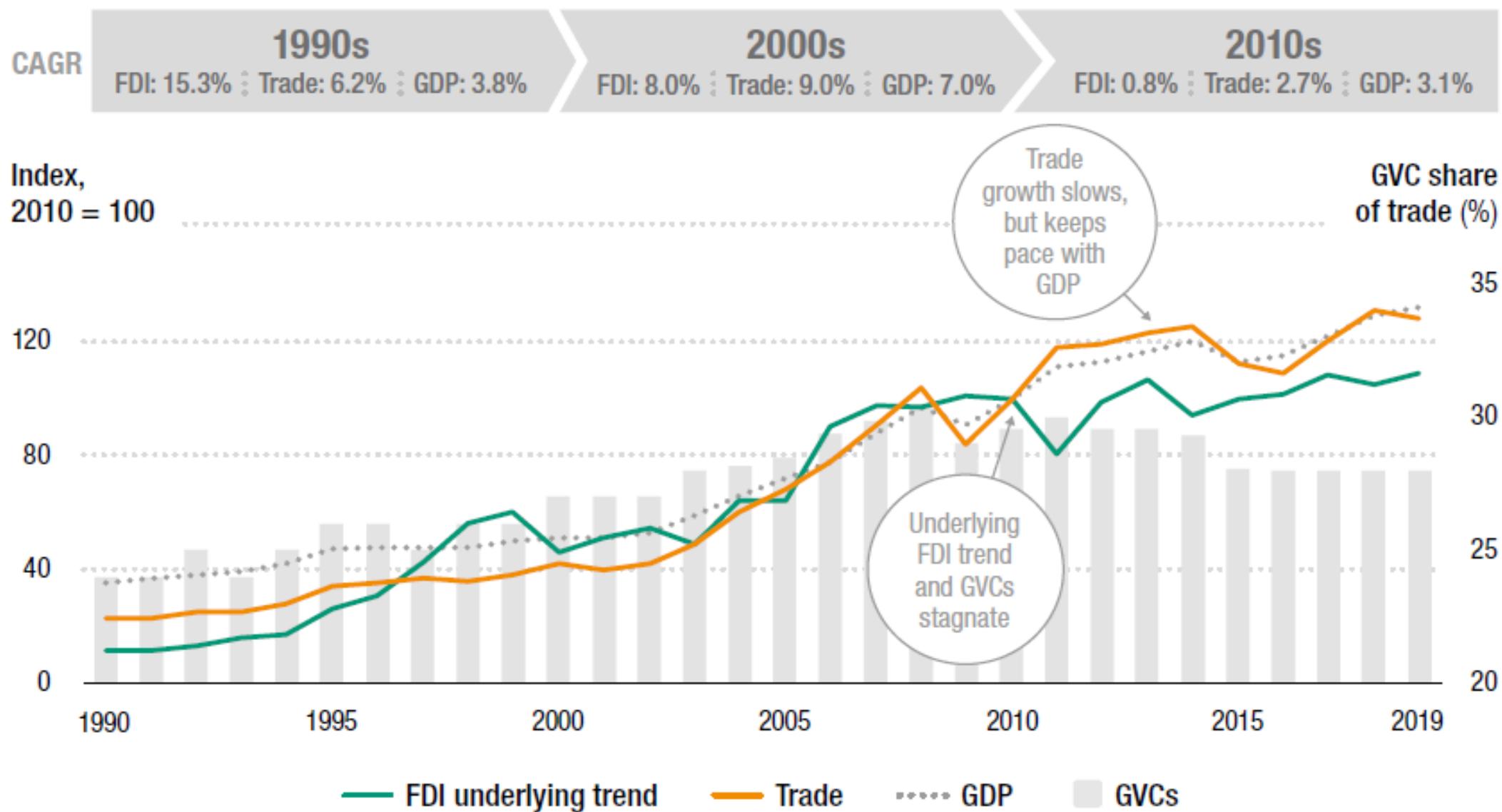
# De-globalization?

- ▶ Already with the 2008 financial crisis, globalization suffered a setback (but not a reversal).
- ▶ GVCs like financialization entailed a strong increase in systemic risk.
- ▶ Even before Trump, trade policies turned against globalization, also with the excuse of systemic risk.
- ▶ The systemic dimension was perceived but no alternatives were found.

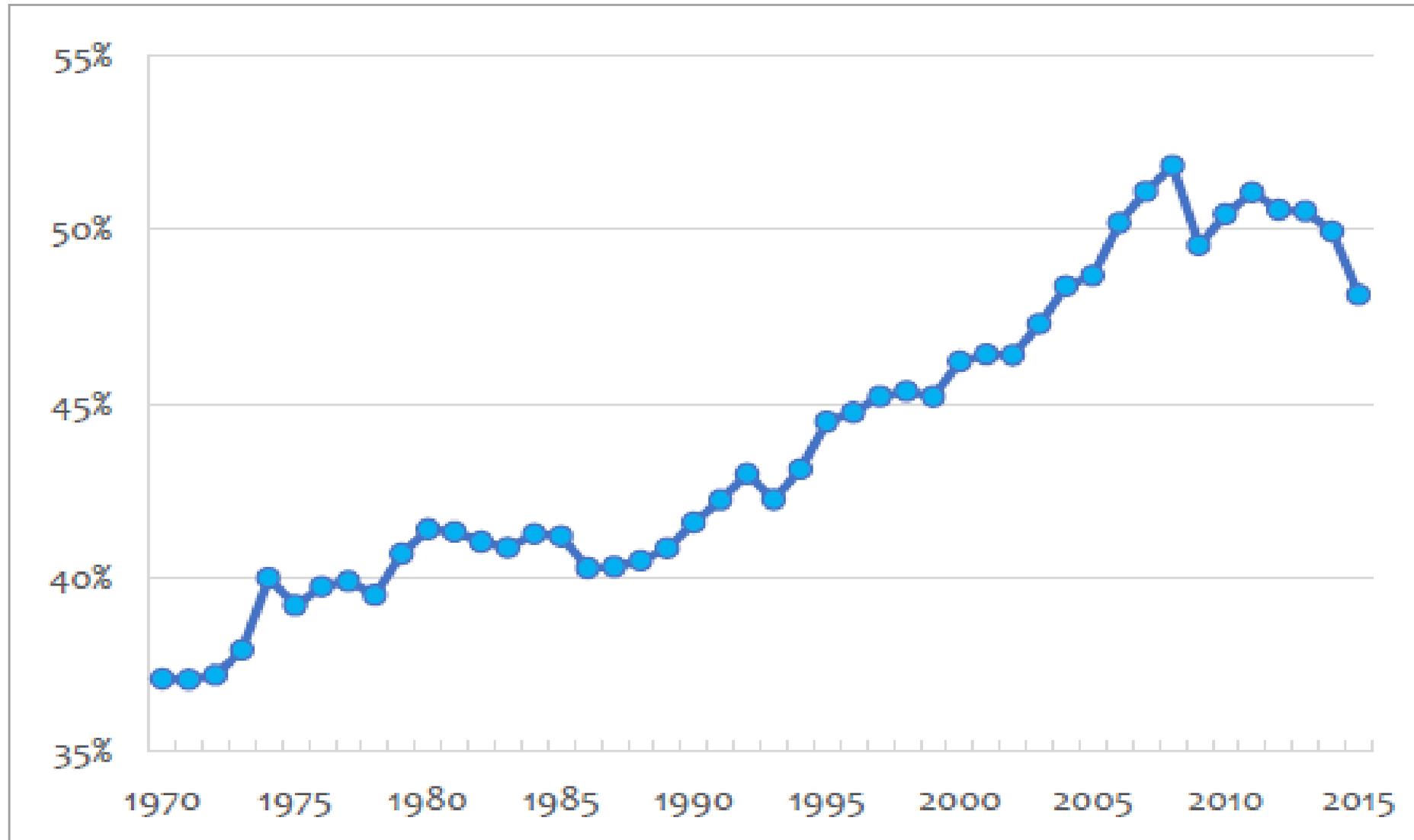
Figure IV.2.

## FDI, trade, GDP and GVC trends, 1990–2019

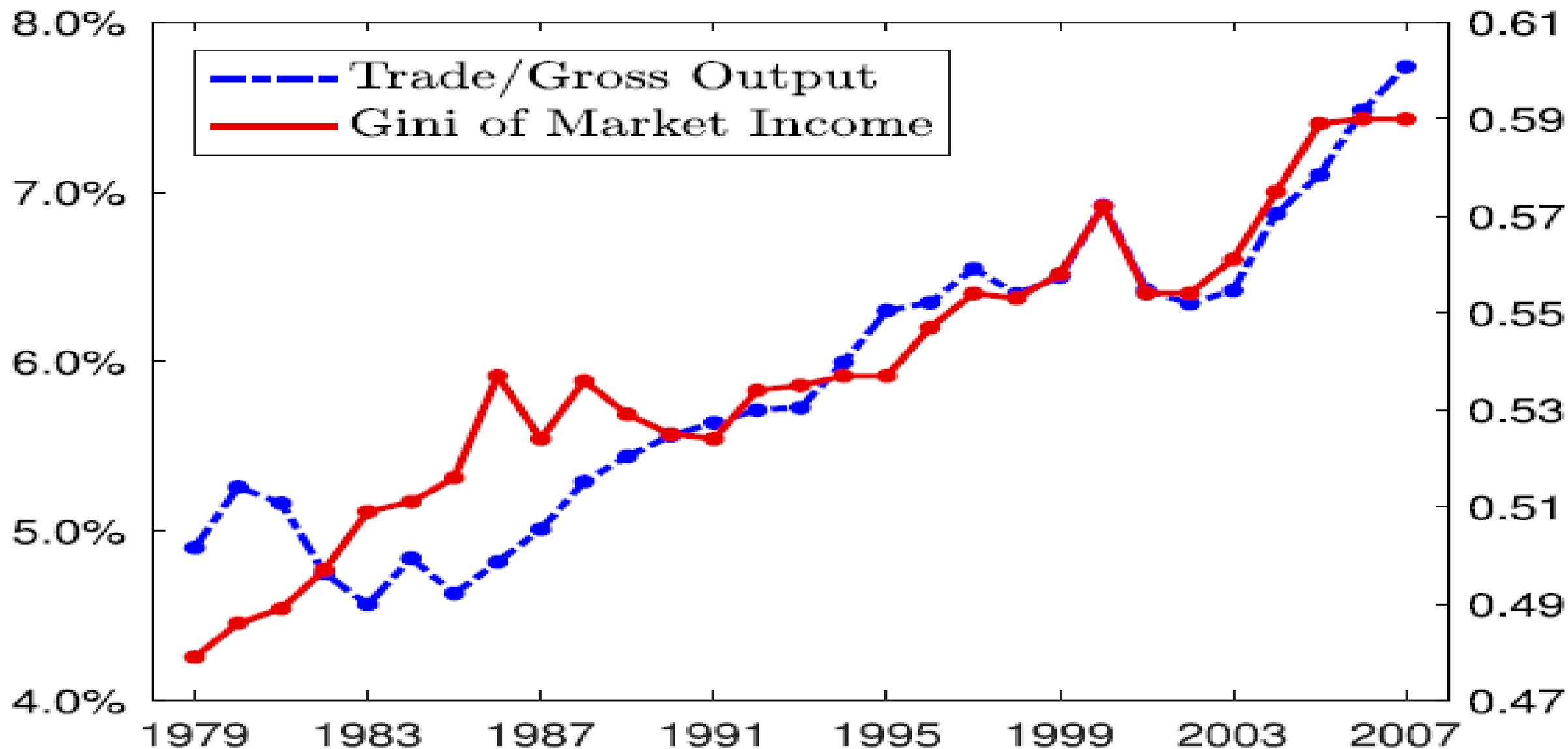
(FDI, trade and GDP indexed, 2010 = 100; GVCs, per cent)



**Chart 2. GVC Trade as Percentage of World Trade**



**Source:** Borin and Mancini (2019), as reported in World Development Report (2020)



**Fig. 1. Trade integration and income inequality: United States (1979–2007).**

# Measures against the pandemic

- ▶ impressive in terms of speed and dimension
- ▶ Huge debt increase (public and private) (US federal debt: +\$4,6 trillion, Fed assets: +\$3,5 trillion), 14\$ trillion overall;
- ▶ Public policies will be important to reshape the industrial landscape with an intensification of what was under way even before the crisis.
- ▶ A resurgence for SOEs?

# Prerequisites and motivations for GVCs

## *Prerequisites*

1. significant cost advantages
2. friendly politics
3. enabling technologies

## *Motivations*

1. improving operational efficiency
2. intervening in foreign markets
3. diversifying suppliers

No common trends: different in different sectors

# Main post-pandemic influencing aspects

1. Health and security issues (where drugs are produced)
2. Technological issues (digital acceleration)
3. Specific industrial sectors and sustainability (*bullwhip effect*: amplification due to the supply chain)
4. Financial issues (funding, subsidiarization)
5. Consumers' issues (back to national brands)
6. Political issues (new health policies as an excuse)

# From diversification to contagion: a basic model

- ▶ The economy is made by plots of land that can be used to cultivate crops **a** or **b**;
- ▶ **b** yield (**B**) is higher (**A**=1, so **B**>1), but **b** is prone to a virus that destroys the harvest for **D** (out of **N**+**D**) years



- ▶ What is the maximum harvest? It depends from how the land is divided between **a** and **b**, we call **q** the proportion of the land allotted to **b**

$$y = n[qB + (1 - q)] + d(1 - q)$$

Tipping point condition

$$B > \frac{n + d}{n}$$

# Comments

- ▶ **informational difference:** **B** is relatively easy to assess, **d** is anyone's guess;
- ▶ **factors** that tend to reduce **B** also tends to reduce **d**, so that, a priori it is difficult to assess the net effect (it is probably different for different sectors and goods);
- ▶ A classical **prisoner's dilemma framework**: for firms it is always convenient to choose **b** because a higher yield produces higher private profits, while **d** hits everybody, so that it is not a specific problem for firms who profited from a higher **B**.

# An example of why $q=1$ is always chosen

“The Chao Phraya river floods in Thailand the same year were a second major natural disaster, with a deep economic impact on the hard disk drive (HDD) industry for which Thailand was concentrating 43% of the production. The leading firm in the HDD industry, Western Digital, had its factories inundated while its rival, Seagate, had factories in the same place in Thailand but located on elevated grounds (Haraguchi and Lall 2015). Some of Toshiba’s factories were also inundated, but the company could divert production to the Philippines. However, it took only six months for Western Digital to retake the lead in the market and 2012 was actually a record high for the production of hard disk drives. *While many observers were expecting more diversity in the location of production after the 2011 experience, it happens that Western Digital not only continued to produce in Thailand but also decided to close a factory in Malaysia in 2017 to concentrate even more its production in Thailand*” (Miroudot, 2020)

# What kind of industrial policies?

- ▶ Trade policies full of distortions, so that it is difficult to envisage a policy that is able to eliminate or even only reduce them;
- ▶ Governments act pragmatically, often without a general strategy and with results that are very different for different sectors.
- ▶ Already in 2012 Obama launched the “Blueprint for an America built to last” that was also a help to reshoring. EU and UK had similar plans.
- ▶ Why reshoring is different from creating new jobs? It is political marketing («a glorious past») but for now, reshoring made no difference (in the US the figure is less than 800,000 since 2010, out of a labour force in excess of 163 million)
- ▶ And now? Security and political reasons
- ▶ Can “q” be capped by law? It is very difficult with GVCs (car industry)

# Conclusions: trade wars are looming

- ▶ Pentagon has been trying to reduce US over-reliance on China for critical supplies at least since the half of 2010s, to no avail;
- ▶ The EU position is not against globalization or GVCs but against “too much” of it. World is gone “too far” in globalization;
- ▶ Paradoxically, trade wars will reduced manufacturing jobs also in the West because they entail a reduction in the overall trade;
- ▶ States will participate in trade wars and they will be forced to help national firms to reorganize: Western countries will be forced to be more like China to fight against China;
- ▶ Regional agreements (such as the RCEP) and political GVCs
- ▶ With the pandemic, cooperation is more vital than ever but...
- ▶ Re-shoring like globalization is going to become a **political mantra**

# THANK YOU!

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FIGURE 2.5 Global network of merchandise trade, selected years, 1986–2016

