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Why COVID-19 will not lead to major restructuring of Global Value Chains

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Introduction

The COVID-19 outbreak in 2020 put huge pressure on healthcare systems across the world, as they struggled with unprecedented demand for Personal Protective Equipment (PPE), medicines, testing kits and ventilators. Many countries reacted with outright bans on exports. These trade measures came against a backdrop of already rising protectionism and anti-globalization sentiments, as well as a fragilized World Trade Organization (WTO) (Curran, Eckhardt and Lee, 2021).

This backdrop is certainly concerning for MNEs and there is a risk that the international trading system will be further weakened by the pandemic. This means that the rules, which have framed the expansion of Global Value Chains (GVCs) around the world in recent decades, are increasingly uncertain. Indeed, there is evidence that since the advent of COVID-19, countries seem to be less concerned about WTO compatibility in their policy making than in the past (Curran et al. 2021). However, in spite of this, we argue that the current trade policy context does not make widespread 'de-globalization' inevitable, rather the pressures to de-globalize will vary significantly across industrial sectors and national contexts.

The concept that the world is moving towards 'de-globalization' is not new, however the debate has accelerated in the last year , with some arguing that, following the pandemic, GVCs will inevitably have to re-shore to reduce risk and increase resilience(Witt et al. 2021). Others hold that, on the contrary, renationalization of supply chains will not increase resilience, which rather requires GVCs to be global (Evenett and Baldwin, 2020), while some have taken the more measured view that greater regionalization is likely (Enderwick and Buckley, 2020). In this short opinion piece, we will argue that, although there is no question that major changes in the nature of globalization are likely to be fostered (or reinforced) by the current crisis, the final impact on the organization of GVCs will be mitigated by economics as well as politics and will vary across contexts and sectors.

International trade has long been controversial, with its impact on jobs in developed countries being particularly sensitive. However, in recent years, there has been a particular strong rise of anti-trade feelings and rhetoric in many western democracies, with even previously supportive trade economists increasingly concerned about the negative effect of trade on manufacturing jobs in the global North (Witt et al. 2021). The most impactful result of this trend was Trump's election in the US in 2016. His administration's widespread antagonism to trade and outright 'Trade War' with China had real, and probably enduring, impacts on trade (Witt et al. 2021), while its undermining of the WTO leaves the global trading system seriously weakened (Curran et al. 2021). Even prior to COVID-19, this context of increasing protectionism and resulting policy uncertainty was posing important new strategic challenges for MNEs (Witt et al. 2021).

With the arrival of the pandemic, shortages of vital medical supplies quickly became evident in many affected countries. Governments often responded with export bans or other type of trade restrictions. Recent analysis of these policy measures indicates that some are likely to be incompatible with WTO exceptions, including outright bans on trade in products whose relation to the fight against the pandemic was, at best, tangential (Curran et al. 2020). These widespread trade restrictions and the challenge to the rules of world trade which some pose, will have impacts both on trade and on policy uncertainty for MNEs, going forward.

Nevertheless, we argue here that despite these developments, it would be wrong to conclude that global integration and GVCs are doomed in a post-COVID world. Firstly, although many governments are developing ambitious plans to increase autonomy, the reality is that they have limited leverage, as it is private companies, not governments, who decide the structure of most GVCs. Secondly, the arguments for such intervention are far from overpowering. During the pandemic, in spite of new restrictions, global trade largely fulfilled its role of providing key goods where they were needed (Evenett and Baldwin, 2020).

Public policy responses to COVID-19

In terms of the evolving government responses to COVID-19, initial panic bans and restrictions on trade have given way to more long-term strategic reorientations. Policy debates reveal a growing concern across nations about the resilience of the GVCs on which their economies and societies depend (Witt et al, 2020). In Europe there is increasing discussion on the need to increase self-reliance in 'strategic value chains' and ensuring 'open strategic autonomy'. The European Commission is proposing a Strategic Investment Facility of €150bn to support the transition of the EU economy towards greater autonomy.

At the EU member state level, individual governments are developing similar plans. For example, as part of its Revival Plan (Plan de Relance) to reboot the economy, the French government plans to spend €600m on a specific program of 're-shoring'[1] of certain strategic industries. The priority sectors which the government highlighted are wide ranging: health supplies; critical intermediate products; electronics; agri-food and telecoms. Coming on top of the growing skepticism about globalization and trade restrictions during the pandemic, these policy shifts could have potentially important long-term implications for the operation of GVCs across the world economy.

However, governments have narrow room of maneuver. Trade restrictions have clear impacts on flows, but those during the pandemic were largely temporary. More long-term policy options are limited, unless there is a widescale reassessment of the role of the state in the economy. As Witt et al. (2021) recently noted, the response of different national institutional contexts will vary, however we hold that most GVCs will continue to be led by private lead firms, whose choices will be framed by a much wider range of factors than government concerns about potential future shortages. Furthermore, although the state can, of course, provide support for certain policy objectives, the EU has strict rules on state aid within the bloc, while the recent Airbus-Boeing dispute in WTO reminds us that multilateral rules also constrain public support to key industries. There are exceptions in sectors/countries dominated by state-owned enterprises, or in industries where the government is

[1] The term used is 'relocalisation' which is the opposite of 'delocalisation' the French term for offshoring.

often the key market, such as defense and, importantly, health. Although even there, public procurement may be subject to requirements for openness, either through Bilateral or Multilateral commitments.

In addition, widespread government intervention in GVCs would carry real risks. Although a global pandemic was a known threat, there was no way of forecasting exactly what products would be essential in the current context. Future crises will be no different, so government efforts to identify the 'strategic supply chains' they need to support are fraught with difficulty. Redundancy may be a key element of resilience (Grandori, 2020), but it has a cost, at a time when government budgets are already facing multiple spending priorities and reduced receipts. Although the shortages at the beginning of the pandemic were painfully obvious in most countries, the global supply chain ramped up production remarkably quickly. China alone exported more than 20 times more masks and protective clothing in the second quarter of 2020 than in the same period the previous year. Furthermore, efforts to reorient domestic capacity to provide vital goods proved expensive and were not always successful. Several high-profile projects by UK manufacturers to produce ventilators were shelved, while the one project that did manage to produce them – VentilatorChallenge UK – was hardly a poster child for industrial autonomy. They reported that they sourced the 42 million parts required from over 22 countries, with the furthest travelling 5.226 miles.[2]

For all of these reasons, concerns about securing supply chain resilience in the light of the weaknesses which COVID exposed will likely result in focused action in a limited number of priority sectors and, given the restrictions on government support, this is unlikely to result in major GVC reorientations. Sectors which were already seeking to shorten supply chains for a variety of business reasons – e.g. rising costs in emerging markets, new sustainability requirements and the availability of the type of new technologies encapsulated in Industry 4.0. (De Backer and Flaig, 2017) – will likely accelerate this trend, but the global impact is likely to be a modest, if steady, retrenchment, which will be more pronounced in certain sectors.

GVCs post COVID-19 – Resilient but less concentrated?

This is not to say that business as usual will prevail in a post-COVID-19 world. It is clear that the pandemic is a historic event that will have long lasting consequences. Against the background of rising skepticism on globalization in general and trade in particular, together with the major disruption which the pandemic has caused, it would be surprising if trade and investment rebounded to pre-COVID levels and indeed we don't expect that to be so. This is especially true for investment, where the increasing risk and unpredictability of policy environments worldwide will certainly give MNEs cause for deeper reflection before committing to large projects. However, we believe that, although there may be some shifts in geography, many GVCs will continue to operate across the global economy, especially in sectors where cost differentials are extensive and technological alternatives limited. Some companies within such sectors may shift to more regional, or mixed, structures and some, in very specific sectors where policy imperatives are strong and/or duplication of production structures is feasible, may restructure on a national basis. High tech and medical products seem the most likely targets for such policy intervention. There are clearly risks that MNEs in these sectors will be subject to increasing political pressure to restructure their GVCs.

However, there are many good reasons why MNEs chose to participate in GVCs in the first place. Although their calculations will undoubtedly be shifted by the pandemic, it does not completely change the fundamentals. We may indeed see a broadening of sourcing strategies and lower levels of

[2] https://www.ventilatorchallengeuk.com/

concentration, as questions of resilience, overdependence and flexibility become more important in decision making within GVCs. As Pi (2020) has recently argued, this should be conceived of more as a loosening of coupling, than a major decoupling. In an optimistic scenario, as COVID forces lead firms to better integrate non-financial costs into their strategic choices, they may also start to better incorporate environmental and social externalities, while the lifestyle changes brought about by the pandemic could give rise to long term shifts towards more sustainable consumer behavior. There may yet be some positive outcomes from this global tragedy.

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