The future of global value chains: key issues

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The future of global value chains: Key issues

by
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The COVID-19 pandemic has heightened concerns about the future of globalization and the viability of MNEs organizing activities in global value chains (GVCs). The pandemic's short-term effects are now well recognized and involve a combination of supply- and demand-side effects due to changed consumption patterns and disruptions to GVCs following restrictions to cross-border movements of many products and people.[1]

However, globalization was already under threat before the pandemic, and many commentators have referred to "slowbalization" or "deglobalization". Four new realities are particularly relevant: the growth of populism and economic nationalism; greater awareness of climate change and sustainable development; the deployment of new digital technologies; and changing power relationships between MNEs and host governments.[2] These new realities pre-date the pandemic, are ongoing and are likely to outlast it. The pandemic has exacerbated the effects of these new realities. The key issues are thus whether and how firms should reconfigure their GVCs, and what policy responses should governments adopt.

The new landscape has called into question MNEs' cost-efficiency business model underlying the offshoring and/or outsourcing key GVC activities. Should firms reconfigure their GVCs and put more emphasis on robustness and resilience[3] and hence re-shore and/or back-source (internalize) GVC activities?

The arguments for reshoring are that supply chains are shortened and less vulnerable to restrictions on cross-border movements of products and people. But such a strategy foregoes the cost advantages from offshoring and the risk-reduction benefits from the international diversification of supplies, whilst re-shored activities may still require essential raw materials and inputs that can only be sourced from overseas[4]. The arguments for greater internalization are that supplies are more assured, coordination is improved, and opportunistic re-contracting is reduced. But back-sourcing foregoes the benefits of externalization, including firms economizing on their scarce financial and managerial resources, greater flexibility in response to volatile output demand and access to cheaper and/or better-quality inputs from outside suppliers, and the potential to leverage power asymmetries over GVC partners.[5]

In short, it is not obvious that reshoring and/or back-sourcing are necessarily appropriate strategic responses for MNEs, and their advisability may well vary across sectors. GVC configurations are often product-specific and, therefore, over-generalization is risky. For instance, re-shoring and back-sourcing may be feasible strategic responses for some basic products, but less so for sophisticated products with more extensive networks of specialist suppliers.

What policy measures should governments adopt? In the short-term, many governments have responded to the pandemic by reassessing their reliance on international trade and investment, tightening their vetting of inward FDI on grounds of national security and fostering indigenous production capacity. Such introspective beggar-thy-neighbor policies are mistaken, as it is as vital to maintain export markets for outputs, as it is to secure supplies of necessary inputs. This is best achieved if all governments work together to preserve an open international system.[6]

In the longer-term, all governments will need to learn appropriate lessons from COVID-19, notably that firms cannot build GVC resilience alone, given the global and contagious (in both the public health and economic senses) nature of the pandemic. Governments should engage in concerted public health initiatives to deter and mitigate future pandemics. At the same time, governments clearly have a major role both in promoting the global sustainable development agenda and encouraging the necessary changes to firm (and individual) behavior through a judicious combination of regulation, taxes/subsidies, information provision, and the supply of suitable infrastructure. Comparable policy tools may also be used to encourage firms to deploy new digital technologies insofar as they are expected to bring widespread social benefits. But these policies—both individually and collectively—will have dramatic and far-reaching distributional impacts.

Some firms will grow ever more powerful, and this will exacerbate tensions that are already apparent between MNEs and national governments. Furthermore, some firms (and individuals) will inevitably lose out, even if there are aggregate societal benefits. These distributional asymmetries are the root cause of the contemporary growth of populism and economic nationalism. Perhaps the most crucial policy imperative for governments will be to manage effectively these distributional tensions and allow the losers to participate in the wider societal benefits.

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[1] Roger Strange, "The 2020 Covid-19 pandemic and global value chains," *Journal of Industrial and Business Economics*, vol. 47 (2020), pp. 457-458.

[2] Pervez Ghauri et al., "Research on international business: the new realities," *International Business Review*, vol. 30 (2021), pp. 1-2.

[3] Resilience has different meaning for firms, GVCs and countries. See Gary Gereffi, Written Testimony to the United States on Legislative Hearing on "Implementing Supply Chain Resiliency" (July 12, 2020), p. 4.

[4] See, e.g, the 2020 EU Action plan on critical raw materials and the June 2021 White House report on building resilient supply chains, revitalizing American manufacturing, and fostering broad-based growth.
[5] Roger Strange, "Do we need a theory of externalization?" in Ödül Bozkurt and Mike Geppert, eds., *A Research Agenda for International Business and Management* (Cheltenham: Elgar, 2021), pp. 23-42.
[6] See, Farok Contractor, "The world economy will need even more globalization in the post-pandemic 2021 decade," *JIBS* (online publication, Feb. 1, 2021), p. 6.

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