

## COVID-19 and Global Value Chains: Trigger for a Sound Economic Order?

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**Research Report — Published Version**

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Coronavirus and its Societal Impact - Highlights from WZB Research

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## COVID-19 and Global Value Chains: Trigger for a Sound Economic Order?

**By Florian Butollo**

The impact of COVID-19 was felt in Germany even before any person was infected: several global companies reported a shutdown of their operations in China as early as February. Not only producers of garment, household equipment, and sneakers were affected, but also pharmaceutical companies and suppliers of medical protection equipment. The COVID-19 crisis therefore once again demonstrated the vulnerability of global value chains (GVCs) optimized for just-in-time production and cost saving. Indeed, they constitute an unsustainable way of organizing the production of our basic necessities of life, not only because they are sensitive to disruptions, but also because they only exist due to an externalization of social and environmental costs. A sound economic order should rely on decentralized and regional production units for the sake of improving its ecological footprint and its resilience to external shocks.

The COVID-19 crisis is now resulting in a reshuffling of GVCs, with [some commentators](#) arguing that “globalization as we know it is over.” Seen from this perspective, the virus is a trigger for the “reshoring” of production, i.e. a reorientation of manufacturing to locations in close vicinity to their target markets. Indeed, the severity of the prospected economic crisis and government actions that challenge the orthodoxies of (neo-)liberal economic policy suggest that the realm of possibilities for a substantial refurbishment of the global economy has widened. But how likely are multinational companies to reorient the geographies of production of their own accord?

Scepticism is advisable here. Predictions of reshoring have for many years been a feature of debates on the matter. Increased regionalization of GVCs had already been expected after the global economic crisis of 2008/09 and after the Fukushima disaster in 2011. More recently, industry 4.0 was hailed as a driver of reshoring because automation would make labor costs less relevant and digitalization would intensify the interactions between producers and target markets, making geographical vicinity more attractive.

But little has happened to meet such expectations. There are instances of reshoring that demonstrate the advantages of producing goods for local customers. But the big picture has barely changed. Especially China continues to serve as the ‘workshop of the world’ for a broad range of consumer goods, including those that are of critical importance in the current medical crisis. The relative growth of intra-regional trade that can be observed statistically does not indicate a retreat from global sourcing; rather, it reflects the surge in consumer demand in China which is largely supplied by domestic firms. Neither will digitalization significantly alter the picture. The effects of digitalization on the geographies of production are more complicated than industry 4.0 pundits would have it: Automation may make labor cost differences less relevant, but digitalization also [improves the abilities](#) to coordinate highly-flexible and globally-fragmented supply chains, as the skyrocketing success of e-commerce companies like Amazon has shown. In short: enterprises found economic incentives to sustain the present structure of GVCs, even though they are vulnerable to external shocks and even though they are deemed unsustainable in terms of their environmental footprint.

While the COVID-19 crisis does present a case for a restructuring and reorienting of GVCs, such measures need to be part of a comprehensive reform of the world economy; and this can only be prompted politically. Such perspectives are currently being discussed by a group of heterodox economists, who state in [their manifesto](#): “When the pandemic is over, we need to rebalance away from the tradeable and competitive economy towards the mainly sheltered foundational economy producing daily essential goods and services which underpin liveability and sustainability”. The crisis forces us to reflect upon what matters in economic relationships and how the foundational economy for the common good can be strengthened. Decentralized and regionally-integrated manufacturing can play a vital role for such transformations. The question of what political measures should be taken internationally to pursue these goals while avoiding the traps of hostile protectionism should take center stage in the strategic reasoning of policy makers, scientists, and economic actors during the months to come.

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