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The European Union is the most open trading area in the world. Changes in the flows of imports and exports have a more profound impact on the EU's GDP than that of the U.S. or China. Over the last two decades, however, the impact of external events on growth has become more difficult to gauge because of the elusive nature of global supply chains, whose relevance is prevailing on simple trade flows and volumes. Supply chains need more stable international relationships than trade, which does not always require huge capital immobilization and can thus be more easily diverted to different countries. While the pandemic crisis after February 2020 exposed some structural fragilities of global supply chains, the war in Ukraine, after February 2022, is dramatically redesigning international strategic relationships and economic alliances. In this brief, we will try to present some of the dynamics that are taking place – mainly in the US – in engineering supply chains. Re-shoring is being replaced by friend-shoring, implying the dependence of economic relationships on strategic alignment. In this regard, the evolution of the US supply chains, and its conceptualization, will have a relevant impact on the future of the European economy. However, Europe will have a more vital interest once peace is brought back to Ukraine: persuading the major global players to acknowledge the common goods – not only peace, of course - that require global cooperation. Climate change and economic cooperation are at the top of the list and cannot be achieved in a divided world.

From re-shoring to friend-shoring

Until one year ago, re-shoring, that is, domestically relocating manufacturing activities that had been outsourced globally, was the catchphrase illustrating the favorite strategy of most democratic leaders. In the past decades, the socioeconomic stability of Western democracies had been wounded by the protest of large swathes of the electorate who felt left out by globalization and the related increase in trade flows. Donald Trump's "America First" slogan was the prototypical flag waved by nationalists and conservatives throughout the world, but US Democrats and European left-wingers have also been eager to grab the standard and make it their own, only veiling their protectionist preferences by lowering the tones of the anti-global propaganda.

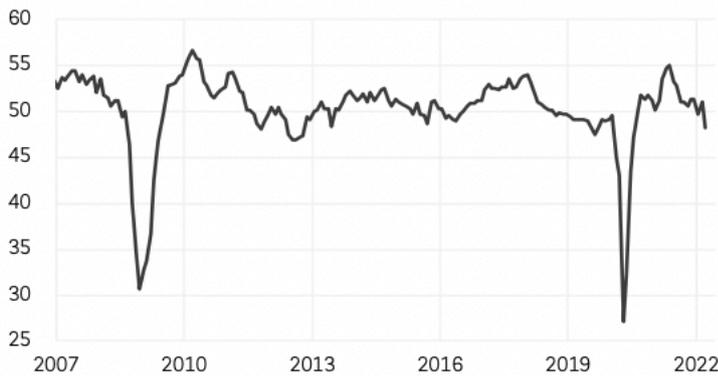
After the financial crisis of 2008, trade flows stopped growing and Foreign and Trade policies have been aligned with the domestic agendas. In his first speech as president Trump promised to "remove the rust from the rust belt and usher in a new industrial revolution." His presidency mainly had protectionist intentions, but a more pervasive strategy, unilateralism, dictated his foreign policy views and reverberated in economic asymmetric isolationism.

Global Supply chains stress index



Source: Federal Reserve of New York

Global manufacturing PMI, new export orders



Source: Markit, BNP Paribas

The Biden Administration followed some of Trump’s practices, aligning foreign strategies with its domestic political goals. Since its inauguration, the new Administration has also been keen to highlight the links between security concerns and the structure of global supply chains. In Biden’s executive order¹ of February 24, 2021, the president framed the problem as follows:

The United States needs resilient, diverse, and secure supply chains to ensure our economic prosperity and national security. Pandemics and other biological threats, cyber-attacks, climate shocks and extreme weather events, terrorist attacks, geopolitical and economic competition, and other conditions can reduce critical manufacturing capacity and the availability and integrity of critical goods, products, and services. Resilient American supply chains will revitalize and rebuild domestic manufacturing

¹ <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-americas-supply-chains/>

capacity, maintain America's competitive edge in research and development, and create well-paying jobs.

Using different rhetoric, Biden might be able to usher in Trump's desired re-shoring revolution, although under a different name. A few months after Trump's demise, a new narrative took hold introducing a different kind of international strategy: reining in globalization allegedly for the sake of globalization. One year after Biden's executive order, the invasion of Ukraine by the Russian Army on February 24, 2022, and the ensuing economic sanctions, have provided new reasons for rethinking the setting of globalized trade. The level of simplification of the debate is surprising: the new economic world should be divided between friends and non-friends.

"Going forward, it will be increasingly difficult to separate economic issues from broader considerations of national interest, including national security." With these words, on April 13, US Treasury Secretary Janet Yellen introduced in the current political vocabulary the idea of "friend-shoring", a characterization that had remained theoretical so far, or at most an idea with which mostly imaginative think-tankers had been toying.

Mrs. Yellen's speech is of such significance that parts of it need to be reported in full.

While many countries have taken a unified stand against Russia's actions and many companies have quickly and voluntarily severed business relationships with Russia, some countries and companies have not. So let me now say a few words to those countries who are currently sitting on the fence, perhaps seeing an opportunity to gain by preserving their relationship with Russia and backfilling the void left by others. Such motivations are short-sighted. The future of our international order, both for peaceful security and economic prosperity, is at stake. And this is an order that benefits us all. And let's be clear, the unified coalition of sanctioning countries will not be indifferent to actions that undermine the sanctions we've put in place.

Secretary Yellen could not be clearer in showing how the military, strategic, and economic links will be more intertwined in the future than ever.

The Russian invasion of Ukraine has dramatically demonstrated the need for us to stand together to defend our international order and protect the peace and prosperity that it's conferred on advanced and developing countries alike. As we do so, it's worth considering the breadth of unmet global challenges that would benefit from greater cooperation of the kind we have mustered in confronting Russia.

For the relationship between the United States and the European Union, the difference between re-shoring and friend-shoring is far from semantic only. **Re-shoring** implies that American (European) companies would be incentivized to bring back to America (Europe) their offshored activities. During Trump's "euro-hostile" presidency, European leaders had mused over the necessity to build autonomous European supply chains. Criticism of the practices and the power of the US-led tech sectors had also connoted the EU governments' endeavor to design European strategic autonomy in advanced sectors. Since US unilateralism is now on hold, at least according to Biden's rhetoric, Europe's *Sonderweg* might swiftly be moved back to the backburner.

Friend-shoring, instead, is a commitment to trade with countries that "have a strong adherence to a set of norms and values about how to operate in the global economy and about how to run the global economic

system.” Secretary Yellen was very clear in motivating the sanctions against Moscow, observing that Russia flaunted “the rules, norms, and values that underpin the international economy.” In this case, at least in terms of principles, American and European companies should receive incentives to deal and trade with each other. “European supply chains” would be less interesting, as would be “strategic technological autonomy” from the rest of the world.

Needless to say, the language that characterizes the two different “shorings” may seem reminiscent of juvenile Facebook “culture” whereby Russia is “banned” and China is threatened to be “unfriended” if it sides with Russia. In effect, identifying which of the two “shoring” strategies prevails will be of profound importance for Europe’s economic future.

A recent post on the International Economic Law and Policy Blog reminds us that “the language of friendship was cited in preambles or primary provisions of many post-WW2 bilateral treaties of amity to set the right tone for the governance of trade and navigation.” Moreover, in his memoirs former US Secretary of State Cordell Hull remarked that “fair and friendly relations” were the opposite of “the injurious results and dangerous possibilities of economic warfare.” Friendship, however, is an ambiguous definition if one only thinks of the extensive abuse that the Soviet Union did of the term in its relationship with the “brotherly” countries of Eastern Europe before 1989.

If the definition of “friend-shoring” is not entirely new, its substantial meaning is certainly old: as US president, Ronald Reagan may have been a free trader, but he used tariffs against Japan and supported an industrial policy that conditioned diplomatic relationships in US economic interest. Even in the past, when global rhetoric was less conditional, industrial alliances were mostly adapted not to harm US strategic hegemony.

If trade – and the balance of payments – were once the main objective of economic diplomacy, in the last two decades a more critical role has been played by “supply chains”. The latter links economic interests with integrated businesses across different countries. Maintaining a relationship among countries is more complex than simply trade among countries. Sometimes, the disruption in certain single components in remote countries may cause an irremediable standstill of whole sectors throughout the rest of the world. An example is the recent shortage of semiconductors in Asia affecting the car industry in the US and Europe.

A 2021 White House Report² on “supply chain resilience” mentioned resiliency strategies for critical industries and components.

Innovations essential to military preparedness—like highly specialized lithium-ion batteries—require an ecosystem of innovation, skills, and production facilities that the United States currently lacks. The disappearance of domestic production of essential antibiotics impairs our ability to counter threats ranging from pandemics to bio-terrorism, as emphasized by the FDA’s analysis of supply chains for active pharmaceutical ingredients.

The list of products mentioned in the White House’s report is topped by semiconductors, large-capacity batteries, critical minerals, and pharmaceuticals. Most of those industries are currently based in China or India.

² <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf>

The conflict triggered by Russia in Ukraine has aggravated the predicaments that the supply chains already suffered during the most acute phase of the Covid-19 pandemic crisis. The main difference is that the war at the EU's borders has changed the character of economic diplomacy. If during the pandemic, cooperation was assumed to be politically neutral, now countries are called to adopt the sanctions proposed by the US and Europe if they want to remain "friends" of the West, that is, if they want to be part of friend-shoring and the new architecture of globalized trade.

Trade dependent on strategic alignment

Secretary Yellen made no mystery of what the Biden Administration expects from China.

The war in Ukraine and sanctions against Russia highlight the pivotal role of China. China has long claimed to hold sacrosanct key international principles—including those enshrined in the U.N. Charter with respect to sovereignty and territorial integrity. Whatever China's geopolitical aims and strategies, we see no benign interpretation of Russia's invasion, nor of its consequences for the international order. China cannot expect the global community to respect its appeals to the principles of sovereignty and territorial integrity in the future if it does not respect these principles now when it counts.

The underlying logic of "friend-shoring" is that friends shall not harm US national security interests. According to Yellen, China's commercial and investment practices are seen to "unfairly damage" U.S. economic security.

China has recently affirmed a special relationship with Russia. I fervently hope that China will make something positive of this relationship and help to end this war. Going forward, it will be increasingly difficult to separate economic issues from broader considerations of national interest, including national security. The world's attitude towards China and its willingness to embrace further economic integration may well be affected by China's reaction to our call for resolute action on Russia.

After the pandemic shock, the new geostrategic considerations elicited by Russia's invasion of Ukraine have made resilience in western economies even more of a political priority. Multinational supply chains, Yellen said, "while having become very efficient and excellent at reducing business costs, have not been resilient." According to Yellen, to develop resiliency, the United States must deepen its economic ties with "like-minded" countries and develop "open" plurilateral agreements to foster "high standards with respect to labor, the environment, privacy protections, [and] digital [services]."

The Biden Administration shares several of the objectives of its predecessor. Immediately after the publication of the White House report, the US Senate approved a \$250-billion bill³ to compete with a rising China. The combined initiatives signal that the US Administration still intends to rebuild economic self-sufficiency, jump-start innovation, and spread economic benefits more broadly among Americans by aligning foreign and trade policies with the domestic agenda. The US Innovation and Competition Act, for instance, was the first step in putting some of the domestic goals into action. Most notably, the bill included \$52 billion in subsidies aiming to reshore the production of high-end semiconductors, a business now dominated by Taiwan and Korea, and a more modest sum to roll out wireless broadband. As it was pointedly observed in a *Foreign Policy* article, the

³ <https://www.wsj.com/articles/senate-approves-250-billion-bill-to-boost-tech-research-11623192584>

bill “funnels billions into new research at the U.S. Department of Energy, NASA, and other agencies on technologies like 5G, artificial intelligence, and quantum computing, and expands funding for scientific and technical education.” Moreover, as Brookings’ scholars recently observed, the bill also authorizes \$10 billion to create new regional technology hubs,⁴ many likely to be in the industrial Midwestern states where Trump did so well in 2016.

The assessment of shared values and strategic alignment is difficult per se. It also reaches very deeply into the democratic structure of modern democracies. Data sharing and exchange of information are not regulated on an international scale and might become a source of division between countries.

Recent supply chain disruptions have raised national awareness of the need for improved information exchange. Resiliency—the ability to recover from an unexpected shock—requires visibility, agility, and redundancy. The lack of digital infrastructure and transparency makes our supply chains brittle and unable to adapt when faced with a shock. For all these reasons the Biden Administration has just launched a digital infrastructure to connect the supply chain.

To take the first step toward addressing this challenge, the Biden-Harris Administration is announcing the launch of Freight Logistics Optimization Works (FLOW), an information-sharing initiative to pilot key freight information exchange between parts of the goods movement supply chain. FLOW includes eighteen initial participants that represent diverse perspectives across the supply chain, including private businesses, warehousing, and logistics companies, ports, and more. These key stakeholders will work together with the Administration to develop a proof-of-concept information exchange to ease supply chain congestion, speed up the movement of goods, and ultimately cut costs for American consumers. DOT (Department of Transportation) will lead this effort, playing the role of an honest broker and convener to bring supply chain stakeholders together to problem solve and overcome coordination challenges. This initial phase aims to produce a proof-of-concept freight information exchange by the end of the summer.

The intrinsic sensibility of data trading between countries reveals how complicated future trade relationships will become, how close to the functionality of democracy and how dependent they might be on the strategic hegemony of one country versus another.

⁴ <https://www.brookings.edu/blog/the-avenue/2021/06/10/senate-republicans-and-democrats-agree-time-to-close-regional-economic-divides/>

Europe's interests

The Biden Administration made no mystery of the strategic implications of friend-shoring. However, making the discourse even more about the “bipolarity in the world”⁵ will complicate any consideration of the sustainability of globalization⁶ altogether.

The clearest example is the fight against climate change. Dividing the planet into “friends versus non-friends” will make it extremely difficult to compromise on global common goods. Russia’s dependency on fossil energy was a huge problem even before 2022, but similar considerations could be made about the reluctance of China in accomplishing a swift environmental transition.

Europe has recognized the vital importance of a global effort in contrasting climate change, even when President Trump denied its existence. The 27-country Union should now take the initiative and recreate a forum of cooperation at the global level.

Secretary Yellen suggested that it is time to think of a new Bretton Woods or at least a redesign of the role of the global institutions ensuring that they reflect “both the current global economy and also members’ commitments to the IMF’s underlying principles and objectives.” The evocation of Bretton Woods is reminiscent of a time when the United States was a unipolar power. Secretary Yellen was careful in avoiding that impression when she mentioned that “by joining together (sanctioning Russia), we demonstrate that these sanctions are not motivated by any one country’s foreign policy objectives.” However, her remarks raised the impression that the United States seeks to regain control over the globalized economy by competing with China’s Belt and Road Initiative using its own “friendly” version. Clarifying this strategy is vital for Europe’s trade-dependent economy.

The tragic events in Ukraine make visions of the future foggier than ever. However, the European Union is called to defend the weighty goal of global cooperation that has inspired it since its conception after WWII. Sharing values with liberal democracies - primarily the US - has always been part of Europe’s unwritten constitution. Emerging challenges like post-war reconciliation, climate change, and pandemics require more government involvement than in the past and more global coordination than ever. They are also not amenable to a divided world. European politics must urgently deliver a “friendly” but more inclusive response to the acute but divisive strategy of the Biden Administration.

⁵ <https://www.atlanticcouncil.org/news/transcripts/transcript-us-treasury-secretary-janet-yellen-on-the-next-steps-for-russia-sanctions-and-friend-shoring-supply-chains/>

⁶ <https://foreignpolicy.com/2020/07/04/this-is-what-the-future-of-globalization-will-look-like/>