

COVID-19 and Brexit will pressure Global Value Chains

New research published by NIESR

FOR IMMEDIATE RELEASE

The May issue of the *National Institute Economic Review*, published on 29th April, will focus on new research exploring the rise of Global Value Chains (GVCs), where production has undergone a process of increasing fragmentation across international locations. Leading experts in the field provide in-depth analysis of various aspects of this major issue in world trade. The articles cover a wide range of topics, from protectionism, to the impact from COVID-19 and Brexit, the declining EU share in global manufacturing, as well as other key trends affecting UK and European industries.

The four articles are:

- On the relevance of Global Value Chains and the intra-European division of labour G2, by **Manuel Fritsch and Jürgen Matthes (IW Cologne)**;
- The EU's shrinking share in global manufacturing: a value chain decomposition analysis, by **Robert Marschinski and David Martínez-Turégano (Joint Research Centre, European Commission, Seville)**;
- Brexit and impact routes through Global Value Chains, by **Jyrki Ali-Yrkkö and Tero Kuusi (ETLA, The Research Institute of the Finnish economy)**;
- Value chains and domestic competitiveness, by **Michael Gasiorek, Alasdair Smith and Nicolo Tamberi (University of Sussex, UKTPO)**

Ana Rincon-Aznar, NIESR Principal Economist, who edited the collection, said: *"Over the last few decades we have witnessed an expansion of global value chains across the world where countries and firms have gained from efficiency and specialisation brought about by the fragmentation of stages of production. In the post-Covid-19 and Brexit world we may face increases in protectionism and other costs that can compromise or even lead to a reversing of this trend. Domestic producers that use a significant amount of foreign intermediate goods in their products will lose competitiveness, and consumers may suffer from higher prices or lower quality products, as substitution towards domestic materials or inputs is not always feasible."*

Jagjit S. Chadha, Managing Editor of the Review and Director of NIESR, said: *"The international division of labour and capital in global value chains of production has allowed considerable improvements in income and welfare in many developing nations over the past thirty years. But the abrupt cessation of these development during the Covid-19 crisis and the tendencies for more protection in the years since the financial crisis, may well leave us looking at the first decade of the twenty-first century as the high watermark of such developments."*

In the first of the collection of articles, **Fritsch and Matthes** guide us through the concept of Global Value Chains, the rationale behind them, their origin and subsequent evolution. They assess the amount of intermediate trade taking place between countries within the European Union, and the employment embedded in these trade flows. The demand for intermediate products from other European countries has a growing importance for the labour markets in the EU, and these intra-European intermediate consumption

networks account for nearly 20 million jobs, i.e., 8.6 per cent of total employment in the EU. They highlight the challenges that crises such as the Covid-19 pandemic pose to the sustainability of the international division of labour, especially in industries such as the automotive industry.

Still in the EU context, **Marschinski and Martínez-Turégano** are concerned with understanding the fall in the EU share in global manufacturing from 2000 to 2014, looking more closely at the reasons for this decline. The authors present a novel distinction; their aim is to identify whether the trend is the manifestation of a true loss of EU competitiveness or reflection of a reallocation of global demand towards certain sectors and countries. They find that the diminishing role of the EU in manufacturing value chains is largely a consequence of the geographical and sectoral reallocation of global demand to other countries like China (almost 75 per cent). The remaining quarter of the fall is found to derive from a lower EU participation in manufacturing value chains, which is probably a sign of a fall in EU competitiveness. The authors highlight that a severe fall in the EU's global share not only affects the low-tech industries (e.g. textiles) but also other industries, namely electronics. A more optimistic outlook is presented for some high-tech manufacturing EU industries, with pharmaceuticals emerging as the most resilient EU industry. The overall impact of Covid-19 on the manufacturing sector looks increasingly uncertain, given the significant fall in demand and the disruption to the supply side of chains, affecting all manufacturing economies in the world.

Ali-Yrkkö and Kuusi quantify the importance of the UK as a trading partner of the EU along the GVCs and consider the potential implications from Brexit. They develop a theoretical model that involves the estimation of value added that is generated through different routes of trade between the UK and EU. They find that for the 2000–14 period approximately one third of the total value added was generated through indirect trade, and two thirds through direct trade. Furthermore, almost a fifth of EU countries' value-added trade passes through the UK and onto other countries. The importance of the UK as a trading partner of the EU has experienced a slight decline over the past fifteen years. In light of Brexit, the authors provide a useful insight into the potentially large detrimental effects of the introduction of tariffs and other trade barriers implying multiple delays and tariffs if a hard Brexit materialises. They are expected to affect components or other products crossing the UK border several times and need to be considered comprehensively in future trade policy negotiations.

Gasiorek, Smith and Tamberi's paper shows that Brexit will indeed affect the UK's domestic competitiveness as a result of changes in trade costs, as well as external competitiveness. They simulate the UK's departure from the European Union, followed by a free trade agreement, and analyse the effects on UK domestic output, both at the aggregate and sectoral level. The authors emphasise that the increase in the cost of purchasing of intermediate inputs will exacerbate the decline in UK output, relative to that of the EU, given the high share of EU imported intermediates. Tariffs (or trade costs more generally) on intermediates will erode the value added of domestic firms by raising costs of production. Industries that appear particularly vulnerable include basic chemicals and motor vehicles.

ENDS

Notes for editors:

The research reflects the authors' views and does not necessarily reflect the views of the institutions that they may represent.

For full copies of these papers and queries for the authors please contact the NIESR Press Office:
press@niesr.ac.uk / 07930 544631 / l.pieri@niesr.ac.uk

The National Institute Economic Review is a quarterly journal of NIESR. From 2020 the NIER is published by Cambridge University Press ([CUP](#)). Founded in 1534, CUP is the world's oldest publishing house and the second-largest university press in the world.

The Review is published in February, May, August and November, and it is available from Cambridge University Press at journals@cambridge.org

Further details of NIESR's activities can be seen on <http://www.niesr.ac.uk> or by contacting enquiries@niesr.ac.uk. Switchboard Telephone Number: +44 (0) 207 222 7665