Scenari industriali - Centro Studi Confindustria

MANUFACTURING IN THE PANDEMIC AGE. THE RECOVERY AND ITS UNCERTAIN PATH

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Introduction and Executive summary

Introduction

The status quo ante is a goal not worth the name
(UNCTAD 2020a, p. I)

1. The pandemic has led to the launch, throughout the West, of massive public intervention initiatives in the economy, initially aimed at supporting incomes and then - with the introduction of specific programs to boost investments - at defining a medium-term development framework, based on a dual green and digital transition, in order to reduce strategic dependence on geo-economic powers that are less and less aligned with European and North American interests. For the EU, in particular, the change of course from the time of generalized liberalization and "expansive austerity", which had already been in a crisis of identity for some time, could not have been more drastic, and above all generalized: like a curtain falling suddenly to close a performance that no longer has an audience.

From this point of view, it could be said that the change of perspective in terms of economic policy - apart from the different intensity with which national programs will actually contribute to relaunching the economy in the various countries - represents the real point of discontinuity with which businesses will have to deal in the years to come; and that although in itself transitory - sooner or later it will have to dissipate - the pandemic has already brought about effects of disruption to the status quo that are destined to persist.

2. The reasons for public intervention are mainly based on a downturn in aggregate demand that is unprecedented in the post-war period, and which is the result of a halt in productive activity that has lasted long enough to have had persistent consequences. According to ILO assessments (2021), the working hours lost globally in 2020 were equivalent to 255 million full-time. The contraction was reflected in a fall in employment compared to 2019 of 114 million units, compared to an estimated increase in the absence of a pandemic of 30 million. Despite the recovery of production levels in most industrialized economies, this trend does not yet seem to have reversed.

The fact that a significant proportion of this downsizing affects underdeveloped economies makes the problem seem remote, but in reality, makes it potentially even more acute, because it occurs in a context where there are few, if any, public resources available to manage it; and where the virus itself is still circulating more widely, in the absence of mass vaccination programs. At a global level, the consequences may not be immediately evident (the economic weight of underdeveloped economies is almost negligible); but the ongoing recovery could suffer new setbacks due to new lockdowns - more or less partial - or to the arrival of new variants of the virus that might reappear in those areas of the world, and which cannot be completely ruled out in the developed world itself.

3. The abandonment of the rules of the game that accompanied economic and industrial development in the years of galloping globalization (open markets, prevailing multilateralism, international trade as the engine of world growth) implies a growing difficulty in interpreting the trends in progress and therefore also in the ability to anticipate the future: the divergence in the communication of the major international institutions - which should be the forum for understanding what is happening - bears clear witness to this.

On the one hand, UNCTAD states in no uncertain terms that: «in the absence of a radical change in policy and effective coordination at the global level ... pressures will arise to return to pre-crisis logic as soon as possible. (...) But adherence to those principles is precisely why there was no resilient recovery after 2010, i.e., why trade and foreign investment were already anemic before the pandemic arrived» (UNCTAD 2020a, p. II). At the same time, the World Bank's latest Global Economic Prospects nonchalantly goes to the opposite extreme in identifying trade cost reductions as the only policy option to counteract the consequences of the pandemic, («so that trade can once again become an engine of growth» (World Bank 2021a, p. xviii).

In between, a very diverse set of positions. The OECD warns of the implications of a global vaccination campaign that is continuing to leave most areas of the world behind, so that even in recovery, «confidence could be seriously undermined by further lockdowns and stop-and-go economic activities» (OECD 2021, p. 9). The Monetary Fund states that «thanks to an unprecedented policy response, the recession due to Covid-19 is likely to leave fewer scars than the global financial crisis of 2008» (IMF 2021, p. xvi), but at the same time underlines the strong impact of the pandemic on widening gaps between North and South of the world, and more generally on increasing inequalities within societies. The European Commission emphasizes the impetus that can be provided in the European sphere by the policy instruments that have been put in place up to now (NG EU) but points out that the recovery observed in Europe, the United States, and China is very different from the conditions prevailing in many areas that are lagging behind, which are still immersed «in a more difficult situation, with limited access to vaccines and reduced policy space weighing on growth prospects» (European Commission 2021a, p. 3)[1].

4. The interpretation of the evolutions underway, starting with those concerning the global manufacturing sector that is the subject of this Report, is complicated not only by the lack of a clear and shared theoretical frame of reference but also by the difficulty of calculating the actual intensity of growth in a phase in which the dynamics of the indicators that measure the trend in production activity is overwhelmed by the effect of the economic rebound following the fall of 2020. The simple recovery of pre-pandemic levels of traditional economic indicators (production, turnover, employment), although important - especially for a country like Italy, which emerged structurally downsized from previous economic and financial crises - leaves intact the problems that emerged over the last decade (well before the outbreak of the pandemic).

The globalization shock that arrived at the end of the 1990s, the 2008-2009 financial crisis, and the 2020 pandemic together constitute three successive levels of stratification of problems of fundamentally structural order. They relate to the redistribution of transformation activities and the management of growing tensions on the commercial and technological levels between the West and the emerging world (in particular the Asian area, with China at the center); to the internal imbalances within individual countries between that part of society (and businesses) able to ride - or at least support - the changes of these decades and the remaining part that has mostly suffered these changes; the ecological imbalances produced by a global growth that has been driven by the availability of low-cost products made (and demanded) without considering the long-term effects associated with them, in terms of environmental pollution and overexploitation of natural resources.

5. The solution to these problems, from the point of view of the West, and in particular of Europe, necessarily depends on the ability of economic systems to use in a structural way the enormous economic resources put in place to counter the effects of the pandemic, to an extent that is perhaps unprecedent-

[1] The translation of all these passages is by the Report coordinator.

ed; and that could transform the greatest global shock of the post-war period into the detonator of a new phase of development, even in Italy. In this context, an important point is also the role that the transition from an economic policy that is only concerned with guaranteeing the conditions of a competitive context to one that is more active in directing development trajectories could in itself play in reducing the degree of uncertainty that still strongly conditions the decisions of businesses, favoring a recovery of private investment alongside the public investment that the resources allocated allow to be restarted.

But imagining a future based on a vision different from that of the past is not immediate. The dissipation of what - for better or worse - has been no less than a world order for almost forty years leaves everyone orphaned of a strong reference point from the point of view of the contextual conditions within which a policy can be pursued (and more generally of a coherent conceptual framework). The void is felt above all in Europe, which until the very end believed in the idea that it was possible to face the future without choosing a course to follow, in other words without taking political responsibility for a strategy aimed at giving history a different trajectory from its inertial drift and is now lagging behind in everything.

6. In Italy too, economic activity (especially manufacturing) was clearly slowing down before the arrival of the pandemic shock, so that the collapse of the indices measuring the trend in output following the start of the various lockdowns in the various countries overlooked - and concealed - an already declining trend. In the same way, the current rebound in output (which is higher than that recorded in the other main Eurozone economies) is making it difficult to calculate the actual consistency of the current recovery and, above all, its possible translation into a new expansionary path.

There are plenty of evaluations that attribute a now stable character to the improvement in the expectations of households and businesses indicated by some surveys: in other words, that consider the recovery in activity levels as a "definitive" return to normality[2]. On the consumption side, the savings accumulated in the first phase of the lockdown by those not directly affected by the fall in incomes would contribute to this outcome; on the investment side, the "return" of the public component (also in the perspective of the use of the PNRR funds) and, on the private side, the extension of incentives aimed at favoring the digital and environmental transition - both of which are in any case factors stabilizing expectations and reducing uncertainty.

The assessment of the intensity and persistence of the recovery of production activity in Italy as indicated by the main economic indicators is, however, an exercise that requires great caution in a pandemic context that is still far from being resolved, and above all it must be avoided at the risk of producing instability in the forecasts themselves, hinging them from time to time on current trends that the uncertainty of the pandemic framework can overturn from one moment to the next. There is more than one unknown factor weighing on the evolution of the economic scenario. The first is the fact that the freeze imposed to date by the restrictions on mobility has led to a subsequent recovery in expenditure that is as conspicuous as it is probably limited in time (the reduction in the 'excess' of savings will tend to take place in the immediate future, rapidly exhausting its expansionary effect)[3].

To this, we can add that the domestic component of demand must, in any case, suffer the effects of the impoverishment of a far from a negligible share

[2] See in particular Banca d'Italia (2021a and 2021b), based on the findings of its quarterly survey on inflation and growth expectations.

[3] See REF (2021).

of the population (only partly countered by support measures)[4]: ISTAT estimates indicate a 22% increase in the number of people living in absolute poverty between 2019 and 2020 alone, equal to more than one million individuals (from 4.593 million to 5.602 million), with an incidence on the population that rises from 6.4 to 7.7%; but the growing social unease now extends also to less disadvantaged segments of the population. Regarding the international component, although recovering, it is important to underline the possible risks that the persistent circulation of the virus in many countries, even those that are close and important from the market point of view (such as the United Kingdom, Russia, or Germany itself) could entail in terms of the introduction of new forms of distancing and isolation, and therefore stop-and-go effects on the economy (as well as possible interruptions along the supply chains).

On the investment front, the same consideration applies: uncertainty will continue to characterize for a long time a global context in which the pandemic appears to be under control, and not even that much, only in the developed West. From this point of view, much will depend on the extent to which the process of implementing the NRP is systematic and, as far as possible, regular overtime. But above all, as far as private investment is concerned, in order for the boost coming from the supply side (incentives) to translate into an increase in potential - which has fallen sharply in the years following the crisis - an improvement in demand expectations would be needed, as compared not to the pandemic years, but to the previous ones: i.e. a structural increase in demand above the pre-pandemic level.

7. This objective is not beyond the country's reach, also in consideration of the many interventions that the PNRR itself devotes to supporting education and research, social inclusion and cohesion, and health. In addition, it can be observed that the extent of the resources allocated gives Italy a strong advantage in international comparison: this should lead - net of the problems connected with debt repayment, the timing of which still seems indefinite - to a higher growth rate than other European countries, all other things being equal. However, it is necessary that the interventions, the extent of which is not monumental (more or less 40 billion per year, a significant portion of which must be repaid), succeed in significantly activating private demand which, in turn, is intercepted by a national supply, triggering a process of endogenous growth.

It is on this level that Italy and its manufacturing industry will be able to escape from the logic of a growth model hinged, over the years, exclusively on the expectation that the recovery of the 'locomotive' on duty (the United States, Germany, China) would return to activate foreign demand. Each time, this has led to a widening of the gap in development opportunities between internationalized companies and those more dependent on local demand. More generally, this once again draws attention to the need to bridge the gap that divides structured and competitive companies from those that are less so, in an increasingly selective context, in which the many problems that need to be managed and resolved simultaneously (the digital transition, the environmental, economic and social sustainability of their activities, the reorganization of supply chain relations) make it more difficult for them to remain on the market.

It is a context in which the objective of recovering the situation prior to the pandemic, as if to turn back the clock, is, first and foremost, impracticable. The 'world of yesterday' is now gone.

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4 See ISTAT (2021).

Executive summary

Chapter 1 - Global manufacturing in the Pandemic Age

The development of global manufacturing in the years leading up to the pandemic was characterized by important structural discontinuities, the origin of which - as argued by the Centro Studi Confindustria for some time now - is mainly endogenous and reflects changes of a different kind in the various economic systems. The different areas of the industrial world, therefore, entered the health crisis on different assumptions, which conditioned their subsequent course.

The United States - in spite of a protectionist orientation - has not recorded any reduction in the conspicuous trade deficit accumulated during the years of galloping globalization; and - in spite of the many proclamations - even the reshoring of production transferred elsewhere still appears minimal. In the USA (given the role of the dollar), balancing external accounts has never been a real economic policy problem (i.e. it has never acted as an external constraint on growth).

In Europe, on the other hand, there is an obvious problem of slowing growth, due to the permanent search for an improvement in competitiveness (to recover additional shares of demand outside national borders) and therefore a strategy of substantial internal deflation. But - since about half of the total exports of European countries are intra-area exports - policies to contain domestic demand have at the same time turned out to be policies to contain an important share of foreign demand of individual countries.

The picture is different, however, for the emerging economies, where the elements of change are acting at least on two levels. The first follows the slowdown in demand from the West in the years following the financial crisis, which forced a reorientation of policies from growth based on a strictly export-led logic towards explicit strategies of Domestic Demand Led Growth (DDLG), a phenomenon that has taken on particular intensity in the East Asian area and especially in China. The second relates to the decoupling strategy pursued by the US government, aimed at reducing the degree of dependence on Chinese manufacturing. But, above all, it is the growth of domestic demand in China that has determined the actual intensity of the 'decoupling', the size of which has allowed the other East Asian economies to re-direct part of their exports towards it, increasing its weight as the source of the area's final demand. The result is the establishment of the area as an autonomous global manufacturing hub, which completes an integration already evident in the years leading up to globalization and brings to the fore a regionalism that - even in the years of multilateralism at its height - has never ceased to exist.

These dynamics are compounded by the effects of deliberate industrial policy choices, which in the pre-pandemic years helped to loosen trade and production links between the North and South of the world. From this point of view, China's strategy of 'decoupling' from the West on the supply side, with the aim of acquiring increasing technological independence, is particularly noteworthy.

In this context, it should be emphasized that twenty-five years after the establishment of the WTO (the "strategic" lever of the globalization process), the only area of the world lagging behind that was actually affected by a process of manufacturing development (excluding the countries of Eastern Europe) was East Asia. In the wake of China's tumultuous growth, in just a few years it has recovered what has been described as the Great Divergence of Asian countries compared to Western economies in the 19th century, re-proposing a new manufacturing polycentrism on the global scene.

It should also be emphasized that the development of supply chains in the "emerging" world, and in particular in the Asian area, has never implied - except in some areas - a dismantling of manufacturing production in industrial countries, where the actual size of offshoring has never come to invest a preponderant share of production. The point is that the absolute size of the activities outsourced by the more developed economies was enough to fuel the start of an industrialization process in economies lagging behind due to the modest starting size of their industries (China included).

However, there are numerous signs of increased regionalization of trade from 2015 onwards, in some regions and sectors, which could be further accelerated by the pandemic. In this respect, the construction of a matrix of trade interdependencies between the world's main economic areas allows us to show that intra-area trade is increasing for all areas except Europe (where the level is still exceptionally high); the most significant increase is in Asia, where the level of integration is comparable to that of the US.

The sudden shortage of inputs imposed by the world trade freeze resulting from the series of various lockdowns has, in any case, marked the end of a historical phase in which the satisfaction of domestic demand in advanced countries had been diverted from the production field to the commercial one (and therefore from the firm to the market), bringing to the surface the intrinsic vulnerability of a model of vertical fragmentation of added value on long and geographically dispersed supply chains on a global scale.

Chapter 2 - Recent trends of manufacturing activities, international trade and foreign investments

After a fall in the early part of 2020, the global processing industry quickly rebounded in the remainder of last year. After the rebound, however, the growth trajectory came to a substantial halt. The first explanation for the global stagnation is the delayed implementation of the vaccination campaign outside the West, coupled with the spread of the so-called Covid-19 Delta variant, which led governments in many developing countries, especially in Asia, to resort to population containment measures.

As well as adversely affecting production activity, these problems have led to disruptions in the supply of raw materials and semi-finished products, and thus reduced availability and higher input prices for manufacturing downstream in the value chains. These difficulties were compounded by delays in resuming the movement of cargo ships through Asia's main junctions with those in Europe and North America: incidental factors (the closure of some Chinese ports in the summer months or the blockage of the Suez Canal in March) added to more stringent sanitary protocols for unloading goods and - among other things - to stock replenishment requirements, resulting in higher transport costs and further bottlenecks in supply chains. Significant increases in commodity prices appear to have stabilized - or even declined somewhat - in the most recent phase; to the extent that they are linked to rising oil prices, these increases may be temporary.

The fall in economic activity levels in 2020 has led to a reduction in global CO_2 emission levels for the first time in the last five years - including for manufacturing - in terms of both direct and indirect (fossil fuel energy use) contributions, which are estimated to fall between 2019 and 2020 by 2.4%, despite China's still negative contribution.

The outbreak of the pandemic, with the consequent freezing of production activity in all economic systems, had a strong and immediate impact on the international exchange of goods; the restart of production activity from the third quarter of 2020, which was in turn boosted by the arrival of vaccines, provided new impetus to world trade, which in the first quarter of 2021 reached its pre-crisis peak (third quarter of 2018), regaining the previous trend.

The dynamics of world trade also depend, however, on the uncertain evolution of trade relations between the main areas. From this point of view, three major agreements can play a central role: the Trade and Cooperation Agreement (TCA) between the EU and the UK (which came into force on-January 1st 2021), which changes the relations, not only trade, between Great Britain and the Union; the 'resurrected' Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) signed in 2018 by Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam on the ashes of the Trans-Pacific Partnership (which never entered into force due to the US abandonment), towards which the current US administration has shown a new interest; and - most importantly - the Regional Comprehensive Economic Partnership (RCEP), which represents the world's largest agreement. The agreement, which brings together China, South Korea, Japan, Australia, New Zealand, and the ten members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam), marks the start of the world's largest trading bloc and aims to increase the level of integration in an area that had inherited from the past a strong internal fragmentation on the political level, bringing to the same negotiating table for the first time countries with different degrees of development and historically often in strong contrast between them. Its member countries have a total population of more than 2.2 billion, account for almost 30% of GDP and 27% of world trade, and alone produce more than 50% of global manufacturing output. Against this backdrop, it is conceivable that China's economic and trade leadership in the region will be strengthened and that it will become the regional reference point for establishing, shaping, and disseminating its own trade rules and technological standards.

At the global level, however, protectionist measures that make international trade in goods more difficult are simultaneously increasing. According to Global Trade Alert, new measures were introduced in the first ten months of 2021 compared to the same period in 2020, while trade facilitating measures decreased.

In the first half of 2021, the flow of foreign capital (FDI) invested in the world increased, recovering pre-Covid levels, after plummeting in 2020 (-35% compared to 2019). However, the growth hides a certain heterogeneity, both in terms of geography (advanced countries have seen a stronger and more consistent increase than emerging and developing countries) and investment methods (more use of mergers and acquisitions than greenfield activities). The sectors that benefit most from foreign capital are health and green transition. For FDI, as for international trade in goods, a trend towards regionalization emerges, i.e. a higher intra-regional share of FDI, in Europe, North America, and East Asia.

Chapter 3 - Manufacturing in Italy

By 2021, Italian manufacturing had steadily recovered to pre-pandemic activity levels, becoming one of the main drivers of industrial growth in the euro area. In Germany and France, despite a less drastic decline in production volumes in the most critical months of 2020, full recovery from the shock still seems far off.

Italy's industrial performance is explained first and foremost by a dynamic of the domestic component of demand which, thanks to government measures firstly to support labor income and then to stimulate spending, has made a decisive contribution to the recovery of domestic production. While foreign turnover in August 2021 was up 2.8% in value compared to its February 2020 peak, domestic turnover was up 7.0% over the same period.

A key role is also played by the low degree of exposure of Italian manufacturing companies to the bottlenecks that are affecting global value chains at this juncture. On average in Q3 and Q4 2021, "only" 15.4% of them complained of supply constraints on production due to lack of materials or insufficient facilities, compared to an EU average of 44.3% and even 78.1% of respondents in Germany.

The overall dynamic of business demographics in manufacturing has therefore not changed significantly as a result of the pandemic crisis, although the balance between registrations and terminations continues to be negative: the cumulative loss between 2017 and 2021 is estimated at over 37,000.

The Italian production trend over the last two years has been very heterogeneous at the sector level. The electronics sector performed well, thanks to the strong push towards digitalization, as did all the sectors linked to the construction industry, driven by the boom in public and private investment in construction. The fashion and transport sectors are still in a bad shape, due to demand problems and supply bottlenecks. In contrast to a global average increase, the pharmaceutical sector is also negative.

Italy's trade in goods with foreign countries has rebounded quickly and robustly after the slump in Q2 2020, returning to well above pre-crisis levels. In June-August 2021, exports at constant prices exceeded end-2019 levels by 2.6% (+7.3% in value). The export trend for intermediate inputs and capital goods was particularly positive, while the recovery for consumer goods is still partial. Among capital goods, growth is mainly driven by electrical equipment, while the recovery for mechanical equipment is not yet complete.

The greater dynamism of Italian manufacturing compared to that of the other main European economies was reflected in an increase in its share of total EU exports, which grew both in intra-area trade and in trade with the rest of the world.

On the employment front, the rebound in industrial production from the summer of 2020 was reflected in a significant recovery in hours worked, which, however, were still below pre-pandemic levels at the end of the second quarter of 2021 (-4.2%). Over the same period, direct employment in the sector fell by around 42,000 workers in 2019 (-1.1%).

For the second half of 2021, manufacturing companies' expectations in terms of labor demand appear to be steadily and significantly improving, especially as regards companies in the North (especially the North-East) and the Centre. However, this trend is associated with an increase in the share of companies reporting increasing difficulties in finding the labor they need for the production cycle, in a context of a progressive increase in the degree of capacity utilization.

In 2020 there was a massive recourse to state-guaranteed bank loans by Italian companies (126 billion euro requests up to December, of which 97 billion euro granted through the Guarantee Fund for SMEs), which reversed the ten-year trend of reducing the weight of bank debt on total liabilities and correspondingly increased the burden. At the same time, the weight of the financial coverage provided by equity capital has been reduced.

The availability of bank financing has been complemented by extensive recourse to the bond market. Overall, including other financial liabilities to third parties, the new net debt incurred by Italian manufacturing companies in 2020 amounted to 4.1 turnover points, compared to just 0.3 in 2019.

An analysis carried out by Centro Studi Confindustria in collaboration with ISTAT shows that the Italian manufacturing system at the dawn of the pandemic showed a high propensity to invest in innovation: of the almost 69,000 companies with at least 10 employees surveyed in 2019, two-thirds said they had invested in innovation projects. However, this high propensity corresponds to a relatively low degree of complexity of innovation strategies (measured as the number of investment levers activated at the same time), due to the behaviour observed especially among smaller companies. In most cases, innovation in Italian manufacturing was achieved through investment in tangible goods (70.6%), but the proportion of innovative companies engaged in R&R activities (58.6%) and in the purchase of data analysis capabilities (45.5%) was also high. Much lower, instead, is the presence of personnel training activities for innovative projects (28.9%).

The preliminary results of an analysis carried out by Centro Studi Confindustria in collaboration with the RE4IT research group, concerning the backshoring processes underway in the manufacturing sector, reveal that the phenomenon of the return of previously outsourced supplies to Italy is not marginal. Among those who had foreign supply relationships in place in the last five years, 23% have already initiated total or partial backshoring processes. The most active sectors were food, textiles, and other manufacturing industries. In first place among the reasons cited to explain the phenomenon is the availability of suitable suppliers in Italy (which means that the past outsourcing has not led to the disappearance of national supply networks in the area in which the company operates) and the possibility of reducing delivery times (which implies that recourse to national supply is considered more efficient from an operational point of view).

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