Germs, Roads and Trade: Theory and Evidence on the Value of Diversification in Global Sourcing

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Abstract
This paper studies how diversification in global sourcing improves firm resilience to supply chain disruptions. I build a model in which firms select into importing, taking into account domestic and international trade costs. The model predicts that firms which are more geographically diversified in sourcing are more resilient to supply chain disruptions. Reductions in trade costs induce firms to further diversify their sourcing strategies. I then exploit the 2003 SARS epidemic as a natural experiment to examine the resilience of Chinese manufacturing importers. Firm imports fell by 8.0% on average when the trade route was hit by SARS, but fell by as much as 56% for firms without any diversification. Estimation based on sufficient statistics indicates that the disruption led to smaller increases in marginal cost for firms with more trade routes for imports and reduced total Chinese manufacturing outputs by about 0.7% at the peak of the epidemic. Furthermore, connectivity to roads increased firms' resilience to the SARS epidemic by facilitating diversification in global sourcing.