Resilience in Vertical Supply Chains
Gene M. Grossman, Elhanan Helpman, and Alejandro Sabal
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ABSTRACT
Forward-looking investments determine the resilience of firms’ supply chains. Such investments confer externalities on other firms in the production network. We compare the equilibrium and optimal allocations in a general equilibrium model with an arbitrary number of vertical production tiers. Our model features endogenous investments in resilience, endogenous formation of supply links, and sequential bargaining over quantities and payments between firms in successive tiers. We derive policies that implement the first-best allocation, allowing for subsidies to input purchases, network formation, and investments in resilience. The first-best policies depend only on production function parameters of the pertinent tier. When subsidies to transactions are infeasible, the second-best subsidies for resilience and network formation depend on production function parameters throughout the network, and subsidies are larger upstream than downstream whenever the bargaining weights of buyers are non-increasing along the chain.

Gene M. Grossman
International Economics Section
Department of Economics
Princeton University
Princeton, NJ 08544
and NBER
grossman@princeton.edu

Alejandro Sabal
Department of Economics
Princeton University
Princeton, NJ 08544
asb3@princeton.edu

Elhanan Helpman
Department of Economics
Harvard University
1875 Cambridge Street
Cambridge, MA 02138
and CEPR
and also NBER
ehelpman@harvard.edu