Chapter 1

Introduction

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CHAPTER 1

INTRODUCTION

World trade and production are increasingly structured around global value chains (GVCs). Typically, a value chain includes the following activities: design, production, marketing, distribution, and support to the final consumer. These activities can be performed within the same firm or divided amongst different firms (De Backer and Miroudot, 2013). The fact that they are increasingly spread over several countries explains why the value chain is regarded as ‘global’ or ‘regional’.

The emergence of GVCs during the last two decades has implications in many policy areas, starting with trade, investment, and industrial development. Open trade and investment policies, greater access to resources and markets, reductions in transportation costs, and the information technology revolution have dramatically altered the world economy, resulting in increasing fragmentation of world production patterns into GVCs. World merchandise trade increased by 10% in value to $19.48 trillion in 2018 (WTO, 2019). However, trade grew by just 2.6% in 2019 as it was weighed down by several factors, including new tariffs and retaliatory measures affecting widely traded goods, weaker global economic growth, volatility in financial markets, and tighter monetary conditions in developed countries, amongst others.

The global investment scenario in 2019 was also tepid. Global and regional foreign direct investment (FDI) trends were contracting, and investment policies were gearing towards greater regulatory checks. In 2018, global flows of FDI fell by 13%, to $1.3 trillion. This was the lowest level since the global financial crisis and underlines the lack of growth in international investment in this decade (UNCTAD, 2019).

These lukewarm trends in global trade and investment have further resonance on the dynamics of GVCs in terms of customers, suppliers, location, and government policies towards investments in new production centres. Economies have become more interconnected and increasingly specialised in specific activities and stages of value chains, rather than in whole industries – trading large volumes of intermediate goods and services. Since 1995, trade in intermediate goods has contributed more to the growth in total manufacturing trade than trade in final goods, contributing a little more than half to its growth in 2009–2018 (World Bank, 2018).

At present, GVCs account for 84% of the international production networks of multinational corporations and represent a dominant feature of world trade and investment. Through GVCs, countries trade more than just products. They also exchange know-how and technology, which flow internationally from one firm to another in the different stages of production. Since GVCs function around a regional hub, they can be shaped by the level and geographical location of investments. While GVCs tend to be regional in Europe, Asia, and North America, the situation is different in Africa, where most of the domestic value added is exported outside Africa.

1. GVCs and Investments in Asia

The East and Southeast Asia region has been performing the role of 'factory of the world' for more than two decades. China surpassed Germany in 2011 to become the largest exporter of merchandise to the rest of the world. China was also the largest recipient of FDI in manufacturing until 2018, although the level of investment in South Asia, Africa, and Central Europe has gradually increased (UNCTAD, 2019). China is graduating from low-skilled manufacturing and moving up the ladder in the value chain of production. Some other important Southeast Asian economies, such as Thailand, Singapore, the Philippines, and Viet Nam, are also moving upward in the value chain in some sectors. These economies are also attracting increased investment in manufacturing and jobs which utilise automation, robotics, and artificial intelligence for manufacturing and related activities. East and Southeast Asia's multidimensional approach to industrialisation, which included facilitative regulatory frameworks and integration in the GVCs, made it an automatic choice for foreign investment in the manufacturing sector from across the world. The sophisticated production networks and continued investment made East and Southeast Asia, especially China, the global supplier of parts and components and finished goods. Years of research and development, coupled with timely financial and policy support from its government, have made China the preferred supplier of parts and components as well as finished goods to manufacturers and consumers in the rest of the world.

It is no surprise that Asia has been the largest recipient of global investment in the past decade and a half. Within Asia, China, Hong Kong, Singapore, and India are the top recipients.

2. Structural Changes in GVCs

The coronavirus disease (COVID-19) pandemic, which originated in China at the beginning of 2020, has created an unprecedented crisis for both the developed and developing world. What started as disruption and, in some cases, a temporary breakdown in the supply chain of goods and services due to the closure of factories in China has become a test for the endurance of GVCs. Factory production in Germany, France, and parts of the US came to a spluttering halt as the supply of parts and components was disrupted at one end – China. From the manufacturing of automobiles to the supply of essential items such as face masks and protective equipment, all stood disrupted.

Even though Europe, North America, Africa, and Asia are still in the grip of the pandemic, the current deadlock in the global economy has brought about a discourse amongst policymakers and businesses on the diversification of investments and the restructuring of supply chains. While much of the governments' attention is focused on saving lives, vaccinations, and saving livelihoods, short- and medium-term plans for the revival of the economy are already being put in place. The US, the European Union, the United Kingdom, India, China, Japan, and other major economies have announced multi-trillion-dollar aid for the revival of economic activities and the provision of support to small businesses and families. Multilateral development banks such as the World Bank, the International Monetary Fund, the Asian Development Bank, and the Asian Infrastructure Investment Bank have also come forward to support the developing economies.

There is a case for examining the performance of GVCs and investments in manufacturing to establish structural and geographical changes in GVCs, in which new centres of production and the consolidation of supply chains may emerge in Asia, Africa, and Europe. Important evidence of change in GVCs and investment patterns, both geographically and industry-wise, has started to emerge in Asia in the past few years. Some of the important features are the following:

- GVC integration has been declining since the global financial crisis.
- China has become increasingly vertically integrated, resulting in companies in Asia moving supply chains to Southeast Asia.
- The diversification began much before the pandemic-induced breakdown/disruption in supply chains.
- Asian countries' value chain participation with China has declined, except for Bangladesh, Singapore, and Viet Nam, which are driven by China's vertical integration.
- The current pandemic-led disruptions in supply chains may create an additional incentive for investment in new centres of production and shortening (of distance and number – or consolidation) of supply chains.
- Europe's dependency on the supply of intermediate goods from China may continue, but sectoral dependencies in environmental goods, batteries for electric cars, etc. may decrease.

The following sections examine the changing dynamics and emerging trends in the GVCs in East and Southeast Asia, with a special note on Asia's participation in the GVCs of the digital economy.