

# Chapter 4

## Post-COVID GVCs in Asia

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## CHAPTER 4

### POST-COVID-19 GVCs IN ASIA

The COVID-19 pandemic has caused major changes in the global economy. Although data for the full year of 2020 are not yet available, the most recent WTO forecast is for a 9.2% decline (WTO, 2020), which is large in historical context. But even this sharp drop is considerably less than what had been forecast earlier in 2020, and so shows that mitigation measures and economic support helped ease the global economy through a period of extreme stress. While the WTO expects trade to rebound sharply in 2021, it is likely to stay below the previous trend for some time to come.

Importantly, it is not only countries that have struggled to manage the public health crisis that have seen major economic consequences. Given that the large markets of Europe and North America have been particularly hard hit by the pandemic and have had difficulty in containing the spread and limiting public health consequences, they have seen sharp falls on the demand side. In many places, consumer spending remains depressed due in part to lost income as a direct result of the crisis, but also through changes in preferences and risk assessment associated with in-person activities, as well as fallen demand as consumers engage in precautionary saving when possible, and defer purchases that require in-person interactions.

East and Southeast Asia has, in general, been very effective at containing COVID-19 from a public health perspective. But the economies of the region are generally very integrated into global movements of goods, services, ideas, people, and capital. As such, the reduction in consumer spending in most high-income countries has had an effect through the channel of reduced demand for exports, which has in turn put pressure on companies' cash reserves and has led to some shedding of labour, with attendant social costs from unemployment and lost income.

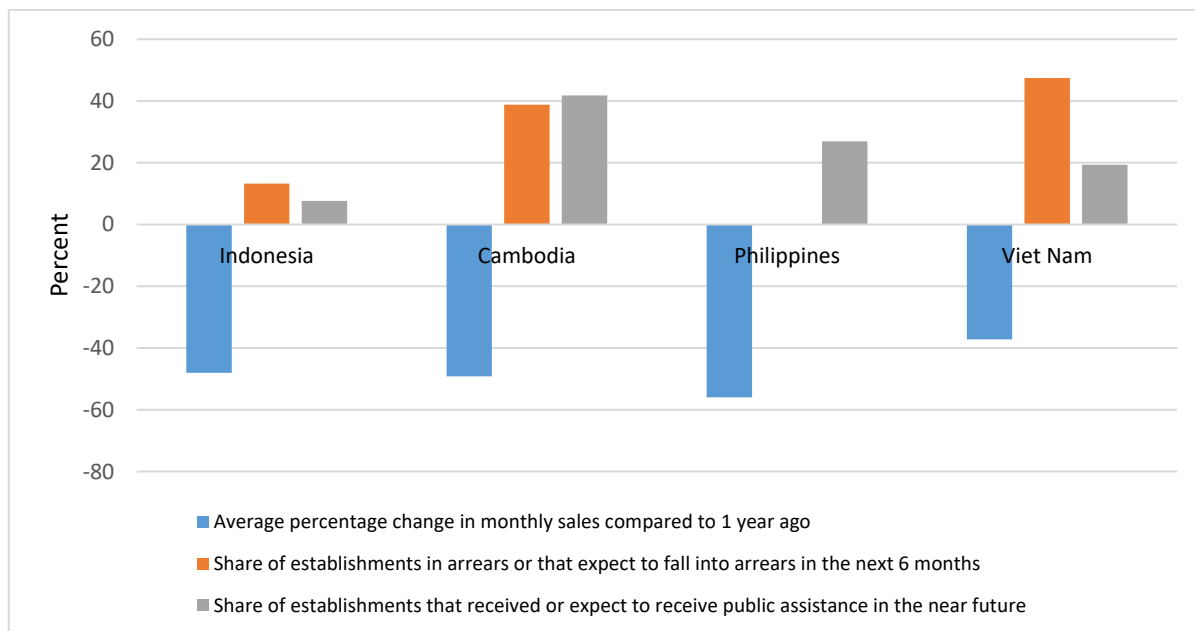
Information on the economic effects of the COVID-19 pandemic is still highly incomplete, as the situation is continuously evolving on the ground. Nonetheless, the World Bank's Business Pulse Survey provides a systematic picture of impacts and responses, including in East and Southeast Asia. It is a firm-level survey, covering 18 indicators of operations, financial risk, and policy. It covers 46 countries, including four in East and Southeast Asia. As such, it provides the best available picture of the situation on the ground, albeit one that is still only partial in scope.

Figure 18 shows how firms have been affected by the pandemic in each of the countries in the region for which data are available. Falls in monthly sales have been large – about 40% or more. Firms in the Philippines have seen somewhat larger losses, while those in Viet Nam have seen somewhat smaller ones. Although data are scarce, there is good reason to believe that the ability to contain the virus and manage the public health consequences has helped provide firms with a less hostile environment. Nonetheless, the picture is more complex than that, as up to 40% or more of firms are already in arrears on payments or expect to become so in the next 6 months. Interestingly, the figure is highest in Viet Nam, and lowest in Indonesia; data are unavailable for the Philippines. Finally, a significant number of firms have already received or expect to receive public support: about 20% in Viet Nam and the Philippines, 40% in Cambodia, but less than 10% in Indonesia. Overall, the data suggest that

the crisis has been felt as a major negative shock in countries in the region, even those that have performed very well in terms of managing the public health side of the crisis.

**Figure 18: Business Pulse Survey Results for East and Southeast Asia**

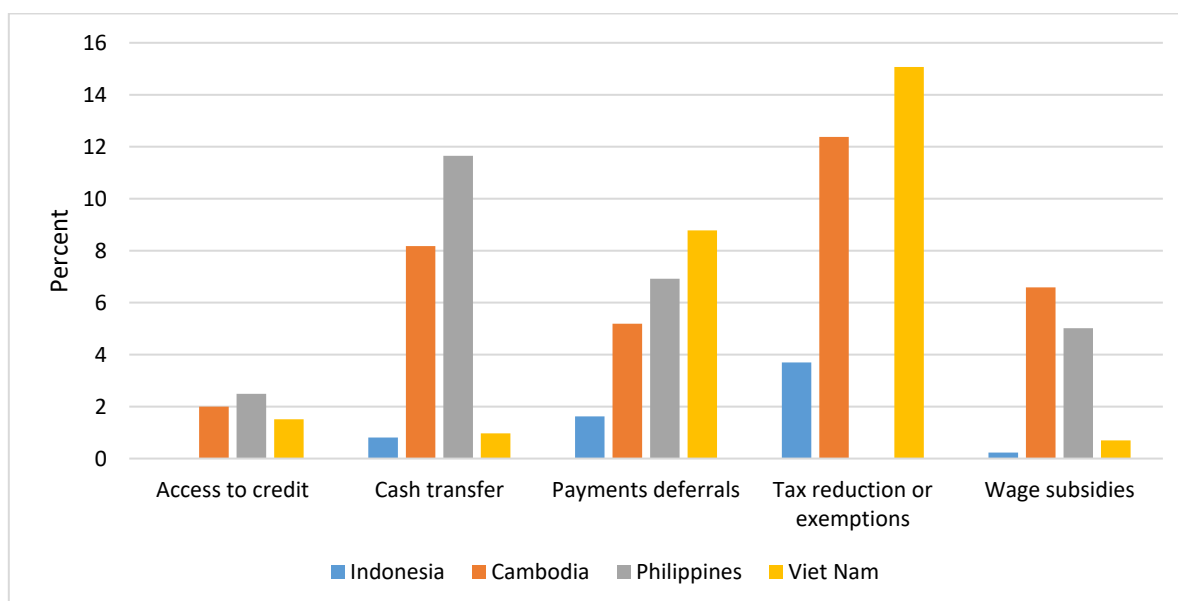
**(firm conditions, latest available data)**



Source: World Bank.

Figure 19 shows that policy responses have been different in important aspects across the countries for which data are available. Relatively few firms have received policy assistance in terms of access to credit, but tax reductions and exemptions – as well as cash transfers, payment deferrals, and wage subsidies – have been more common. Amongst the countries included in the survey, Indonesian firms have the lowest prevalence of policy support, while the other three countries have much higher levels of assistance. Still, the scale of the figure is important: no more than 15% of firms report having received a particular policy response. So, comparing this with the figures for firm-level financial stress reported above suggests that many firms have not yet received assistance to deal with the pandemic shock.

**Figure 19: Business Pulse Survey Results for East and Southeast Asia**  
(policy responses, latest available data)

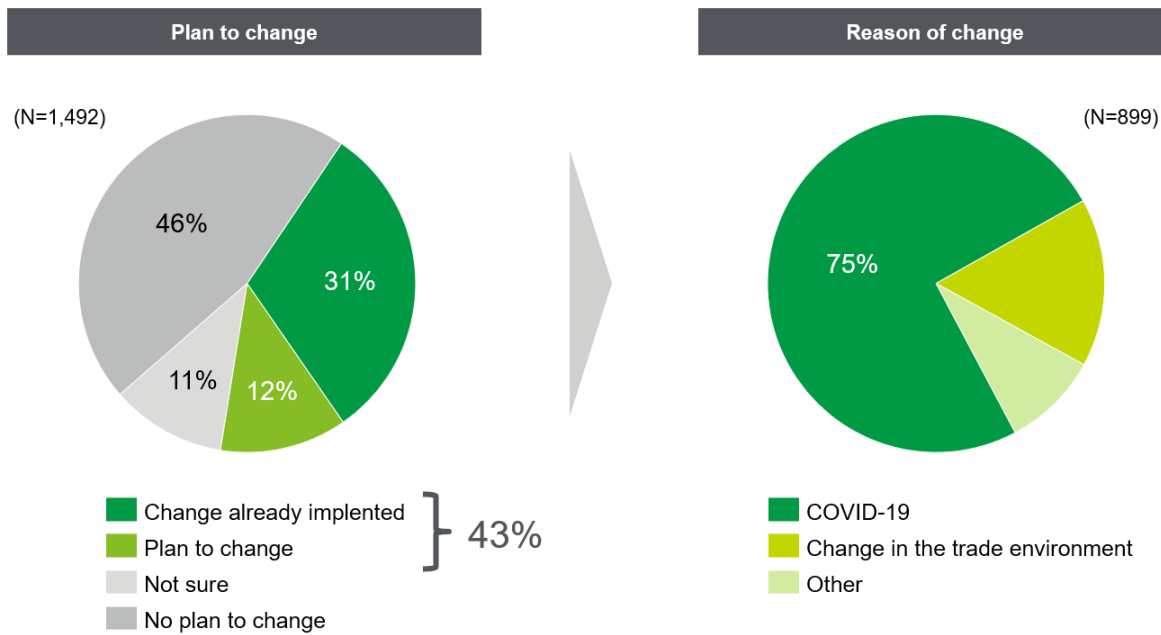


Source: World Bank.

It is impossible to know what the effect of the pandemic has been on GVCs in East and Southeast Asia because the necessary data only become available with a lag of some years. But the available indications suggest that the subdued growth in production sharing seen since 2009 is a trend that has likely been reinforced by the COVID-19 pandemic. As already noted, trade has fallen substantially, and is likely to remain below trend for some time. FDI in developing Asia is also projected to fall by up to 45% in 2020 (UNCTAD, 2020). Given that trade and FDI are two of the main underpinnings of GVC development, the available evidence suggests that in the short term, GVC expansion will be more muted than in the ‘golden age’ of the early 2000s.

The Economic Research Institute for ASEAN and East Asia (ERIA) conducted a questionnaire survey of business activities of 2,083 local and foreign companies in ASEAN and India from October 2020 to January 2021 to understand the impact of COVID-19 on corporate activities and supply chains, with the objective of utilising the results for policy recommendations to national governments and international organisations. Overall, the surveyed firms – especially large and medium-sized firms – have withstood the shocks to both customer and supplier activities in 2020, with an expectation of improved results in sales, profits, and exports in 2021. A large number of firms (Figure 20) answered the question on plans to change their production location, and the survey revealed that COVID-19 has been a greater motivator of changes in the location of production than the US–China trade tensions.

**Figure 20: Survey Results for Plans for Change in Production Locations Due to COVID-19**



COVID-19 = coronavirus disease.

Source: ERIA Survey, 2021.

Beyond the very short term, it is only possible to speculate as to the fate of GVC development in East and Southeast Asia. On the one hand, GVCs deliver important efficiency benefits, and many are backed by specific and costly investments that tend to promote resilience. Seen from that point of view, there is good reason to believe that global and regional production sharing will continue to expand over time, though probably no faster than the somewhat tepid pace seen just before the COVID-19 pandemic. The main risk to this scenario, as noted above, comes from policy. Political economy pressures to pursue reshoring, as well as reassessment of risk in the private sector, could combine to favour shorter supply chains, at least in some sectors. The extent of this phenomenon is still an open question, however. The economic costs imposed by policies designed to reshore in a major way appear to be very high, and it is unlikely that major economies will engage them in a context where recovery is a key objective for the medium term. The most likely scenario is therefore not a wholesale reshoring of GVC production, but rather a continuation of the pre-existing trend towards slightly shorter value chains, and more tepid growth in production sharing than was seen in the early 2000s.

From the upside, the major potential change in conditions facing GVCs is the rise of new sectors and modes of delivery. The digital economy (see box) looms large in this regard. But so too do environmental products, like renewable power generation equipment such as solar cells, as well as electric vehicles. Consumer tastes have been shifting in this direction for some time, and it is plausible that recovery programmes in the high-income markets will favour this shift through incentives and other measures. Provided that markets remain relatively open, East and Southeast Asia is well positioned to take advantage of these opportunities, given its established base in related sectors, such as electronics and motor vehicles. While retooling will be necessary, the existence of an effective supplier network and integrated GVCs could be an important advantage in developing GVCs further in the future.

## Digital Economy

The Southeast and East Asia region is the 'factory of the world'. The effect of the digital economy is, however, advancing in corporate applications and industrial systems; therefore, in investments, hiring, skills training, and trade facilitation policies. The Asian labour force is projected to grow by 0.5% annually from 1.9 billion in 2015 to 2.1 billion in 2030 and 2.2 billion in 2050 (ADB, 2018). India is projected to account for 30% of the regional total labour force by 2030, and countries with relatively young current populations, such as Nepal and Pakistan, will experience larger increases in their labour force and need policies to ensure an adequate number of productive jobs.

Structural transformation policies in developing Asia must understand, prepare for, and respond to the new digital economy, which will affect the patterns and geographical location of industries, employment, trade, and economic growth. Industrialisation and participation in global value chains are important for growth and employment generation. The traditional approach to gradual industrialisation and employment for a young population has been affected by Industry 4.0 and the new digital economy, which have abruptly arrived in developing Asia (Prakash, 2019).

Manufacturing is at the heart of industries integrated in the global value chains (GVCs) in Asia. Foreign direct investment facilitated East Asia's industrialisation and structural change, and its integration in the GVCs. While manufacturing activities and deeper integration in GVCs still matter in the digital economy, suitable policy focus and skill adaptations are required to participate in the GVCs of the digital economy.

Manufacturing will not diminish in the digital economy. The geographic span of the GVCs will expand and their concentration may also shift from current locations. Production and consumption of goods and services will occur in newer locations and platforms. Countries in Asia can resolve the important issue of engaging human capital, employment, growth, and industrial development in the digital age through three important policy actions.

**Investment facilitation:** Attracting investments in manufacturing *per se* helps in acquiring technology capacities and capabilities to move up the value chain of production or expand into digital technology. Additionally, the dynamic application of technology and skills between agriculture and industry, the digital economy, and agriculture will reduce any adverse impacts of the digital economy and automation on low-skilled labour.

**Higher education and skills training:** Robots and automation enhance the productivity of high-skilled labour, but they can replace low-skilled labour. Countries attracting investments in labour-intensive industries must continuously upgrade the skills of their workforce for better absorption in the workplace. Access to higher quality education should be made universal as it helps people to acquire the advanced skills and knowledge required in a digital economy. Higher education spending is a more efficient policy option as it adds to the human capital of low-skilled workers and allows them to profit from technological progress. It also makes low-skilled workers scarcer, boosting their wages (IMF, 2018).

Appropriate social security policies and social safety nets complement education policies and help bridge the income gaps between high- and low-skilled workers. Incentives for the domestic relocation of labour also help in the absorption of low-skilled labour in the job market.

**Leapfrogging and feedback of technology:** With an appropriate set of skills, the digital economy enables possible leapfrogging from the pre-globalised world to active participation in trade through

technology and connectivity. For example, in Africa, the export of cut flowers and horticulture is made possible through air transportation and commercial connection. Likewise, leapfrogging is possible in developing Asia through software outsourcing (Kimura, 2018). With the right amount of human capital and digital connectivity, software-related jobs can be created even in remote areas. These opportunities may be limited in size, but countries/regions should capture any new business opportunities and employment avenues made possible by the feedback and leapfrog of technology. These opportunities will, however, be possible when some moderate levels of trade facilitation, an investment enhancing policy environment, infrastructure, and human resource capacities are in place.

Employment in the digital economy is also possible through the feedback of new technologies to old industries. This is especially important for the structural transformation of labour, where even if the existing industrial structure is not fully transformed, new piecemeal technologies can be used for upgrading old industries. The development of food value chains, use of smartphones, and remote sensing in agriculture are some examples.

A calibrated combination of trade and investment facilitation measures, preparing the job market (especially the youth) with the skill sets and social security measures required for a new digital economy – along with flexibility in the domestic policy ecology to skip certain stages and leapfrog to a higher stage of development – is key to developing greater Asian participation in the GVCs of the digital economy. Closer partnership between governments and the private sector will be important, though the quality of human resources will likely become the decisive factor in a digital economy.