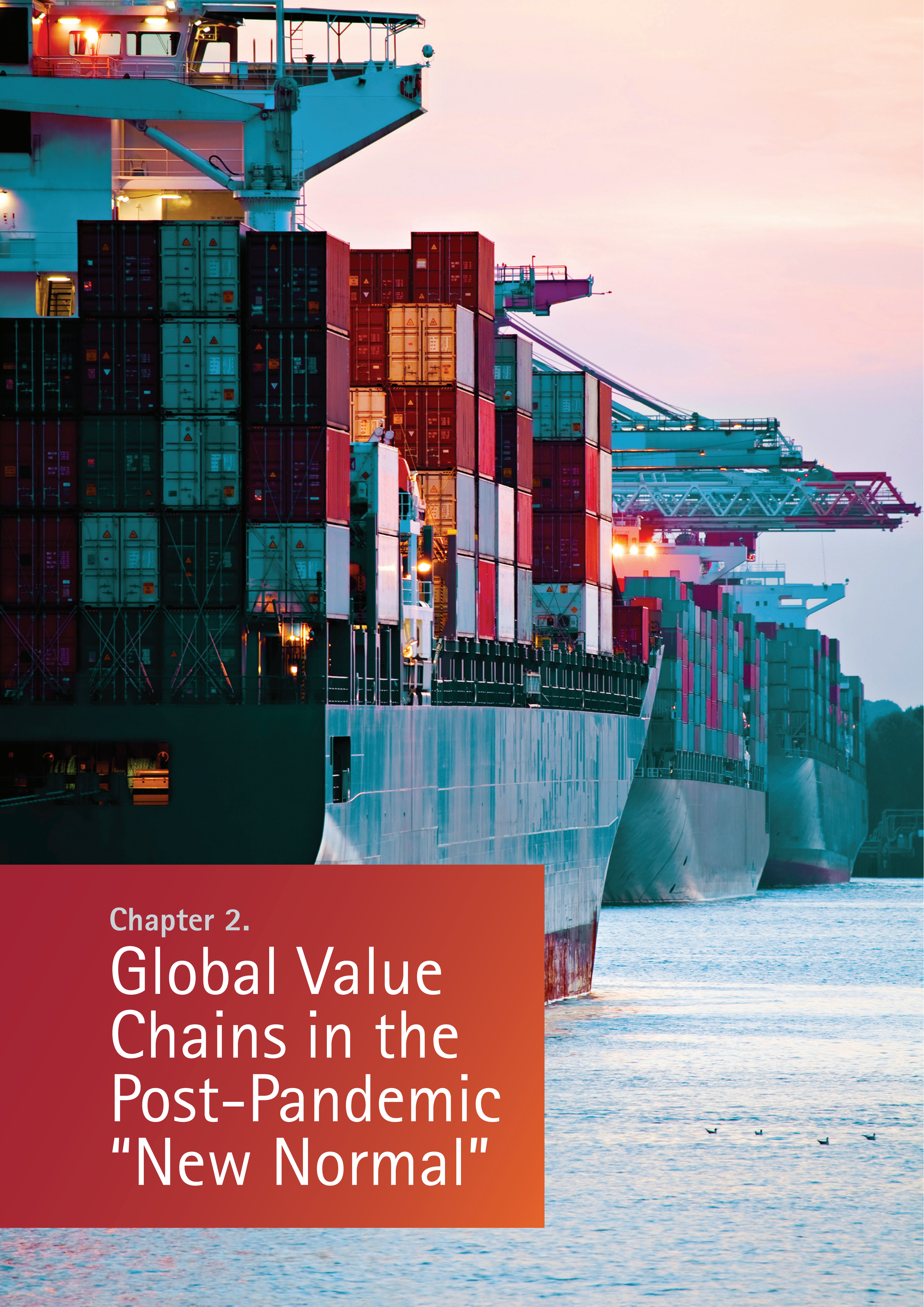

Chapter 2.

Global Value Chains in the Post-Pandemic "New Normal"

Highlights

- Natural disasters, trade tensions, and the COVID-19 pandemic have spurred greater emphasis on supply chain resilience. This trend has raised concerns that globalization is in retreat and global value chains (GVCs) would be reconfigured. Although some cross-border relocation movements have been observed globally, no evidence has as yet emerged of wholesale GVC restructuring or transfer away from China and from the ASEAN+3 region.

- Multinational enterprises (MNEs) are critical to a potential GVC reconfiguration, especially their decisions as to (re)organizing their network of suppliers. MNEs' relationships with their suppliers, the costs of switching location and partners, as well as other economic factors—including labor costs, soft and hard infrastructures, domestic market growth, and government incentives—influence their decision to locate in specific regions: to stay, or transfer to other locations.

- The ASEAN+3 region remains a highly attractive location for MNEs, given its rapidly growing middle-class consumers and dynamic growth prospects. Attractive labor costs aside, the region also fares relatively well in terms of infrastructure quality, skilled labor availability, and technological absorption, when compared to alternative locations such as in Africa, Latin America, or Eastern Europe.

- GVC reconfiguration, if it emerges, is likely to occur in particular stages of the global supply chain. In particular, stages that are labor-intensive or cost-sensitive and do not require highly technical skills, such as assembly operations, are more likely to be moved. Factories that have neither large exit costs nor require tacit knowledge exchange are also strong candidates for relocation if downside risks escalate.

- The pandemic accelerated the "flight to digital" for businesses and consumers, and this behavior is unlikely to be reversed in the future. The outlook for digital consumption thus remains highly positive, including in the ASEAN+3 region. But full deployment of new technologies will require the region to develop and install the necessary hard and soft infrastructures, especially for information and communication technology (ICT).

- Technology bifurcation could result from the ongoing tech competition between China and the United States, although history also shows that such bifurcation is likely to be resolved by interface technology over time. Advances in technology—and its adoption—can also be stymied by other challenging hurdles, such as data regulations and transfer restrictions, security issues, and geopolitics.

- The quality of institutions, human capital, and infrastructure will continue to remain relevant for the ASEAN+3 to attract future GVC investments. Nonetheless, in the post-pandemic world, the region should focus on (1) building infrastructures geared toward the Fourth Industrial Revolution (4IR); (2) developing stronger crisis management within their policy response frameworks; and (3) securing sustainable funding, considering the region's weaker fiscal positions now compared to its pre-pandemic conditions.