

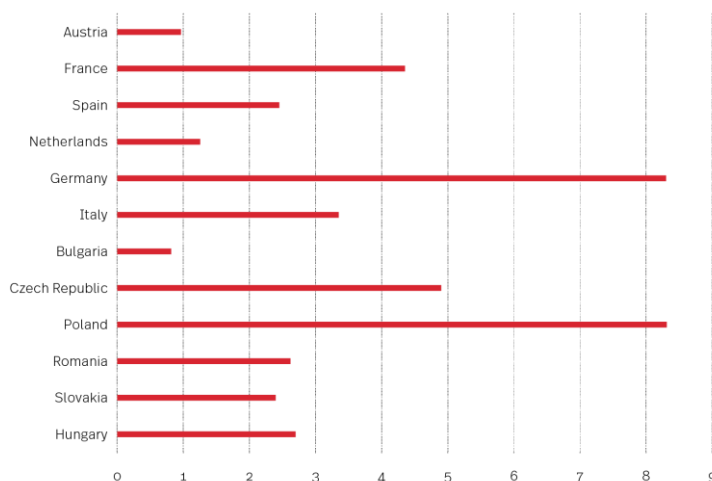
China may lose as much as USD 172 billion annually due to production delocation

In its report entitled 'Trade routes after the COVID-19 pandemic', the Polish Economic Institute presented four scenarios for a new pattern of global trade routes resulting from potential relocation of part of production from China to other countries, likely to push down China's GDP by as much as 1.64 per cent. In the version most favourable for the EU Member States, the greatest beneficiary of delocation would be Poland (USD 8.3 billion), followed by Germany (USD 8.3 billion), the Czech Republic (USD 4.9 billion) and France (USD 4.3 billion). What other changes in China's future role in global supply chains could be expected?

Experts from the Polish Economic Institute estimated potential effects of partial delocation of production from China based on the characteristics of global trade flows at the brink of the pandemic. Four scenarios were presented:

- partial delocation of production from China to South-East Asian countries and India;
- 'national patriotism' – the replacement of part of supplies from China with individual countries' domestic output;
- the strengthening of Central European countries in their role of 'the EU's factory' through the relocation to their territories of part of EU imports from China;
- a combination of the national patriotism and the EU's Central European factory scenarios.

➤ Estimated changes in value added in selected EU Member States relating to the relocation from China of part of the manufacture of semi-finished products and final goods – the maximum impact scenario (in USD billion per year after the adjustment period)



The maximum impact scenario: a combination of national patriotism and an increased role of Central European countries – the replacement in EU Member States of 10 per cent of supplies of semi-finished products and final goods from China with domestic output, and of another 10 per cent with deliveries from the six new EU Member States.

Source: calculations by the PEI based on: Trade in Value Added (2018).

The arrangement of beneficiaries of production delocation from China depends on the assumptions adopted in specific scenarios. The EU Member States would benefit the most from a combination of national patriotism and the strengthening of new Member States

from Central Europe (the Czech Republic, Poland, Slovakia, Hungary, Romania and Bulgaria) in their capacity as factories for the EU. In addition to Poland (USD 8.3 billion), other major beneficiaries in the region would be the Czech Republic (USD 4.9 billion), Hungary (USD 2.7 billion) and Romania (USD 2.6 billion).

In the scenario assuming a decrease in deliveries of semi-finished products and finished goods from China by 10 per cent and their replacement with domestic output, the greatest absolute benefits would be derived by North American countries, followed by the EU-14 (the 'old' EU Member States without the United Kingdom) and East and South-East Asian countries. Depending on the region, it would entail an annual increase in value added creation by 0.2 per cent to 0.48 per cent. In Europe, the effect would be markedly stronger in the new EU Member States (EU-13) than in the EU-14: 0.31 per cent and 0.20 per cent respectively.

China as 'the world's factory'

According to the WTO calculations, the coronavirus pandemic is anticipated to decrease world trade by 13 per cent to 32 per cent in 2020. International trade must be expected to experience the acceleration and intensification of trends already observed before. *'We can expect a fall in the volume of international trade, its regionalisation and increased protectionism as well as the diversification of supply chains. Another natural step will be a greater focus on the security of supply in strategic sectors in national trade policies. China will also diminish in importance in global supply chains,'* explains Jan Strzelecki, an analyst in the foreign trade team of the Polish Economic Institute.

In 2019, Asia accounted for 35.3 per cent of world exports and 33.8 per cent of global imports, i.e. 8.8 pps and 9.4 pps, respectively, more than in 2001.

Global manufacturing significantly relied on Chinese semi-finished products. Materials originating in China represented 3.5 per cent of materials used globally in the production of manufactures. The highest shares of inputs imported from China were noted by South-East Asian, East Asian and North American countries. In terms of industry, the greatest dependence on deliveries from China characterised the global manufacture of computer, electronic and optical products, textiles and wearing apparel as well as of electrical equipment, non-electric and domestic appliances.

'For the Chinese economy, the relocation of the manufacture of certain semi-finished products and final goods from China would result in a loss of value added which might total – depending on the version – from USD 22.4 billion to USD 172 billion per year. It would mean a decline in Chinese GDP by 0.21 per cent to 1.64 per cent on the initial level,' explains Łukasz Ambroziak from the foreign trade team of the Polish Economic Institute.

On 24th June, the report was discussed with leading experts from all over the world. The full debate can be watched at our YouTube channel:

<https://www.youtube.com/channel/UC-pj4cTAI-5TO1grfYjsvdQ>

Here we present general insights of the panelists on the issue:

Simon Evenett – Professor of International Trade and Economic Development, University of St. Gallen

The immediate trade policy responses after outbreak of the pandemic were really concentrated in the medicine and medical goods sectors. There has been a significant shift in direction of curbing the exports of those goods. Another element which should be underlined is that we observe increase of subsidies. In Europe they are undermining the single market as half of the subsidies goes to Germany and the third to France. In terms of shortening the supply chains and reshoring, it has to be noted that referring to the international data the over-dependence on China does not exist, so proponents of repatriation of supply chains have to present a more clear picture of why they actually claim the necessity of reshoring and what the exact benefits of this process would be. I think that for Poland improving the business environment and investing in human capital would provide much more benefits value chains repatriation.

Zhi Wang – Research Professor of Schar School of Policy and Government at George Mason University

The partial relocation of the production from China had already been happening before the pandemic. But it is not a mass process and I don't think the reorganization of global value chain will be an immediate effect of the pandemic.

Nadeem Ilahi – Senior Resident Representative of IMF Regional Office for Central, Eastern and Southeastern Europe

Observing the data, we see that the shipping activity just completely collapsed between the first week of February and the first week of March 2020. And there was a pickup in a subsequent month, as China restarted its economic engines and reduced its lockdown. We have to remember that Europe is relatively highly integrated into global value chains. Although majority of linkages are intra-Europe, extra-Europe linkages are still sizable (Asia and Americas). Moreover, pandemic is only one of the factors that will matter in the longer term as the global trade will be affected by weakening multilateralism, climate change, automation and digitalization which has been accelerated by the pandemic. For CEE, for example, we already observed a structural shift towards electric vehicles even before the COVID-19.

The Polish Economic Institute is a public economic think-tank dating back to 1928. Its research spans trade, macroeconomics, energy and the digital economy, with strategic analysis on key areas of social and public life in Poland. The Institute provides analysis and expertise for the implementation of the Strategy for Responsible Development and helps popularise Polish economic and social research in the country and abroad.

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