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WILL COVID-19 COST CHINA ITS 'WORLD'S FACTORY' TITLE?

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The Covid-19 pandemic has dealt a severe blow to more than public health; global trade, particularly the global value chain (GVC) system, has also suffered. The global economy has experienced significant shock, given the closing of international borders, travel restrictions, and nationwide lockdowns. The rate of spread of the contagion has become proportional to the impact on the globalized economy, resulting from the disruption of the global demand-supply chain.

In assessing the economic risks of the pandemic, the OECD June Report suggested that annual global GDP could decline by as much as 7.6% in 2020, depending on recurrences of the virus, with added negative growth in the first quarter of 2021. Foreign direct investment, as suggested by the United Nations Conference on Trade and Development, will witness a 5-15% shrink, as compared to the earlier forecasted marginal growth for 2020–2021.

This raises alarm, given China's position as the epicenter of the pandemic and its centrality to the GVC. Such concern is seen in countries looking toward alternative markets. Dependency on a foreign supplier, in this case China, has become a national security concern for some countries; this stems from the heightened risk of sustaining domestic markets, compounded by a weakened global economy. In the process of finding alternatives, the key concern remains: not just any country can replace China as the "world's factory."

Still, the Sino-US trade war hastened a trend toward diversification. The shift of Japanese companies' production units, like Ricoh, Sony, and Asics Corporation, away from China in order to escape US trade tariffs, evidence this trend. For instance, Ricoh shifted production to Thailand, while Nike shifted its base to Vietnam and Thailand. Apple, which mainly assembles its iPhones in China, is gradually shifting its manufacturing units to other countries, beginning with establishing a manufacturing base in collaboration with Foxconn in India.

The pandemic has accelerated the diversification process. It is important to note that, prior to the pandemic, such shifts were aimed at moving smaller units across Southeast Asia to reduce overdependence, and not completely move away from China. However, Covid-19 acted as catalyst, causing countries to contemplate a total shift in production units from China. For instance, Japan has set aside $220 billion yen ($2.08 billion) for companies in high value-added manufacturing to bring their production bases back to Japan, and another 23.5 billion yen to shift their production lines to other countries. European Union members also plan to cut dependence on Chinese suppliers. Additionally, concerns regarding increasing labor costs and a work force shortage have factored into the "exit China" plan. With the advent of the "China blame game" over the virus, such a withdrawal plan can also be seen as a way of "making China pay" over its handling of the virus.

Against the twin crises of Sino-US tensions and Covid-19, finding an alternative to the Chinese supply chain has become a core concern for sustaining the GVC. Behind this concern is the significant impact on global trade ties and international investment infrastructure brought about by moving resources out of the world's second-largest economy to diversify supply chains. For China, retaining its position as the "world's factory" has become an issue of concern and prestige.

Amid this, we see the rise of new markets in other Asian nations with low-cost labor. The key beneficiaries are most likely to be Thailand, Bangladesh, Vietnam, India, Taiwan, Cambodia, and the Philippines. For instance, Japanese brands, such as Nintendo, Sharp, and Kyocera plan to shift production from China to Vietnam, and Korean tech giant Samsung closed operations in China and relocated manufacturing units to Vietnam and India. However, uncertainty remains regarding the capacity and capability of these countries to seamlessly replace China in the global supply chain network. Even if one or many can come together to do so, those businesses cannot know or forecast which country or countries will manufacture certain products or become a potential production hub, creating stress for the economy. In addition, relocation anxiety and heightened costs in making these changes will bring about the undercurrents of strangled investment and uncertainty for the existing rules-based trading system.

A production retreat from China will come with costs—both symbolic and substantive. "Made in China" was a lucrative option for most investors, because of China's strong business ecosystem, lack of regulatory compliance, low taxes and duties, and competitive currency practices, with the enormous Chinese market as a bonus. Alternative countries might fail to provide this entire package.

In this scenario, as countries seek to push the exit button from China, it will be tough for any country to match, at least initially, the high standard already set by China as a manufacturing hub. This will invariably make the exodus from China not just cost-intensive, but also heavily weight competence in comparison with China's manufacturing skillset.

Thanks to Covid-19, China's position as the world's factory has become vulnerable; a predicament shielded somewhat by the need to discover suitable alternatives.