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CHINA'S NEW ERA: DECOUPLING, DUAL CIRCULATION, AND THE RESHUFFLING OF GLOBAL SUPPLY CHAINS

Jacob Gunter, Senior Analyst, MERICS



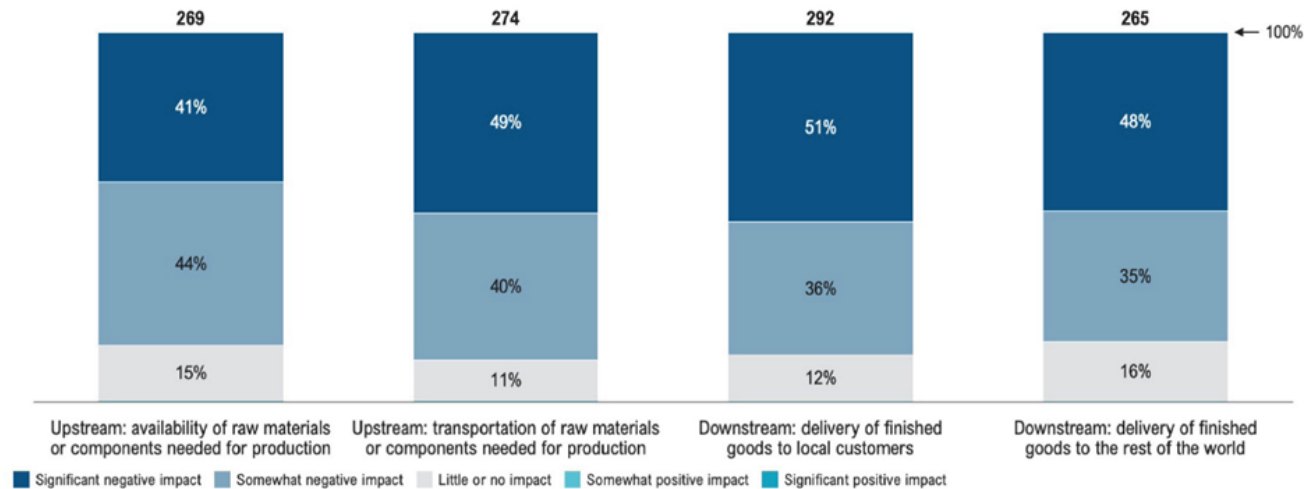
Economic and supply chain impacts likely to be worst since early 2020

Industrial clusters are increasingly dysfunctional, and foreign business sentiment is in the gutter

Supply chains are profoundly disrupted

Supply chains severely compromised, both up- and downstream

What has the impact on your supply chain been since the more stringent COVID-19 control measures were introduced? ¹⁾



1) "Not Applicable" removed

This time, it's different

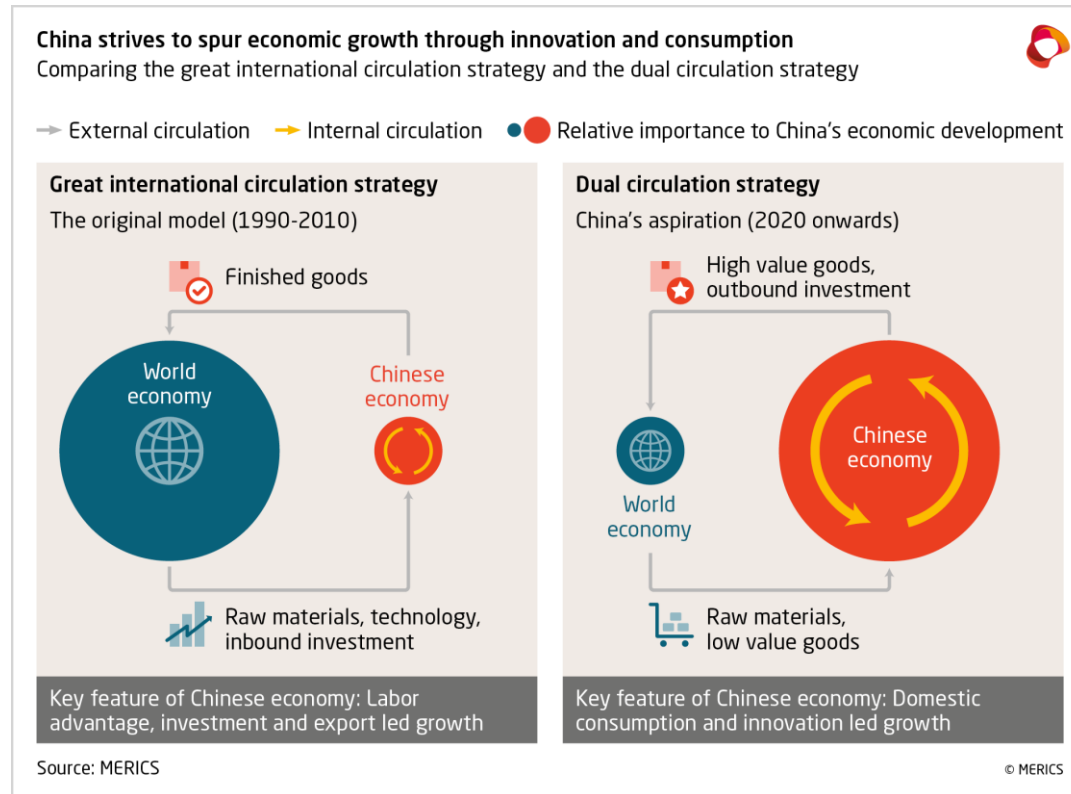
- Locked down regions are struggling to keep production up and running, disrupting unaffected regions as well
- Demand is also broken in locked down cities, profoundly affecting sales and cashflow for suppliers
- Even accessing supplies from overseas through normally functioning ports is a challenge with testing and quarantine requirements
- Impact will be strongest on the Shanghai and Northeast industrial clusters, which can basically write off April and probably May
- Foreign business sentiment has all but collapsed, and the foreigner exodus is spiking again, risking long-term people-to-people ties

Source: European Union Chamber of Commerce in China Flash Survey, May 5th

Beijing's 'Dual Circulation Strategy' is struggling

But if Xi gets his way, there will be major shifts in how China trades with the world

Dual Circulation – Xi's shift away from export-driven growth



Source: MERICS

The details

- Dual Circulation Strategy (国内国际双循环)
- On the surface: The 2020 “Dual Circulation Strategy” (DCS) is meant to facilitate a shift from an export- and investment-led growth model to an innovation- and consumption-led one
- In practice: the DCS is about external/cross-border risks – building up a toolkit to ensure stability in technology and supply chains while also exerting party-state control over sources of risk like cyberspace and data transactions
- Yet, this is not about China striving for autarky. It is instead about building a system that is self-reliant technologically, and a strong importer of materials and cheap goods, and an exporter of high-value goods

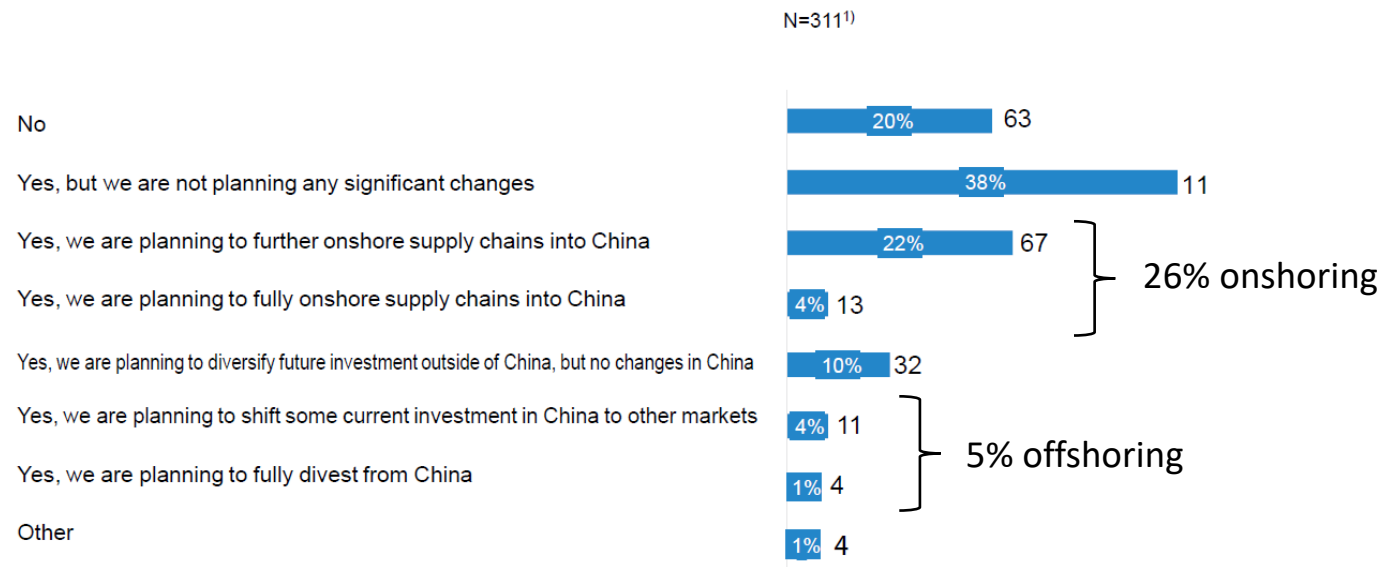
European companies increasingly decoupling their China ops from global ones

Technological divergence in China and trade/tech war dynamics abroad steer localization

Onshoring supply chains a growing priority

Figure 15: Five times as many onshoring as offshoring

Has your company reviewed its supply chain strategies in the last two years?



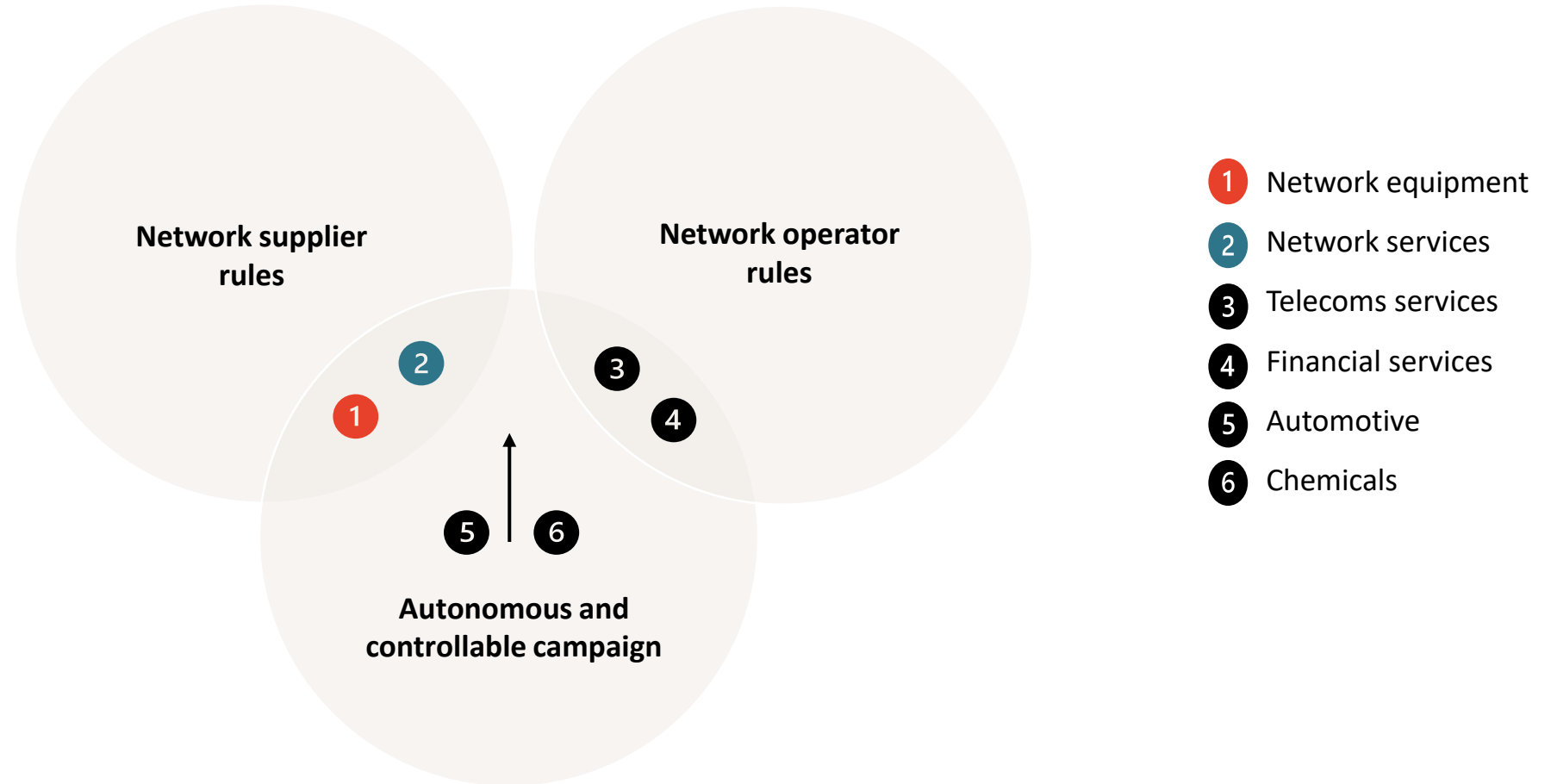
Source: European Union Chamber of Commerce in China Flash Survey, May 5th

This time, it's different

- China's long-standing push for self-reliance and localization (自力更生) has intersected with an impatient US, EU, and east Asian partners
- Tech and supply chain localization demands are the main driver of decoupling, forcing companies in China to replace foreign providers with indigenous ones
- CII (关键信息基础设施) equipment/service providers are being squeezed out of the market, while CII operators face growing demands to localize equipment/service providers – can push out some players, e.g., smaller foreign banks
- The A&C (自主可控) campaign is expanding rapidly, pushing all companies to opt for local suppliers, but also intersecting with CII rules

Dissecting China's technological decoupling

CII and A&C intersect for suppliers and operators, but all fall under A&C umbrella



The implications of Omicron, Dual Circulation, and Decoupling

If Beijing achieves its goals, the logistics industry will see considerable shifts

- If Xi Jinping achieves his goals, there will be major shifts in how China trades with the world
- Assuming Beijing gets its way and the liberal market economies of the world do nothing about it, China will eventually move away from needing to import European high-value goods and technologies, which make up the bulk of European exports to China. Meanwhile, China would be shipping higher and higher value goods into the EU.
 - This would greatly exacerbate trade imbalances, having obvious implications for ports, shipping, and logistics firms
- However, the liberal market economies of the world are unlikely to merely sit on the sidelines
- The more China goes down this path, the more we will see liberal market economies imposing restrictions on China's access to their markets and technologies
- Every step that China takes down Xi's preferred path will push liberal market economies to restrict China more; and every step that liberal market economies take to restrict China will push Beijing further down its current trajectory.
- This will have obviously negative impacts on China-EU trade over the long-run, but as divergence and decoupling proceed, companies will over time be leaning towards investing in other economies, perhaps resulting in an offsetting of trade flows declining with China
- In any case, it will be a disruptive time ahead for the ports, shipping, and logistics industries