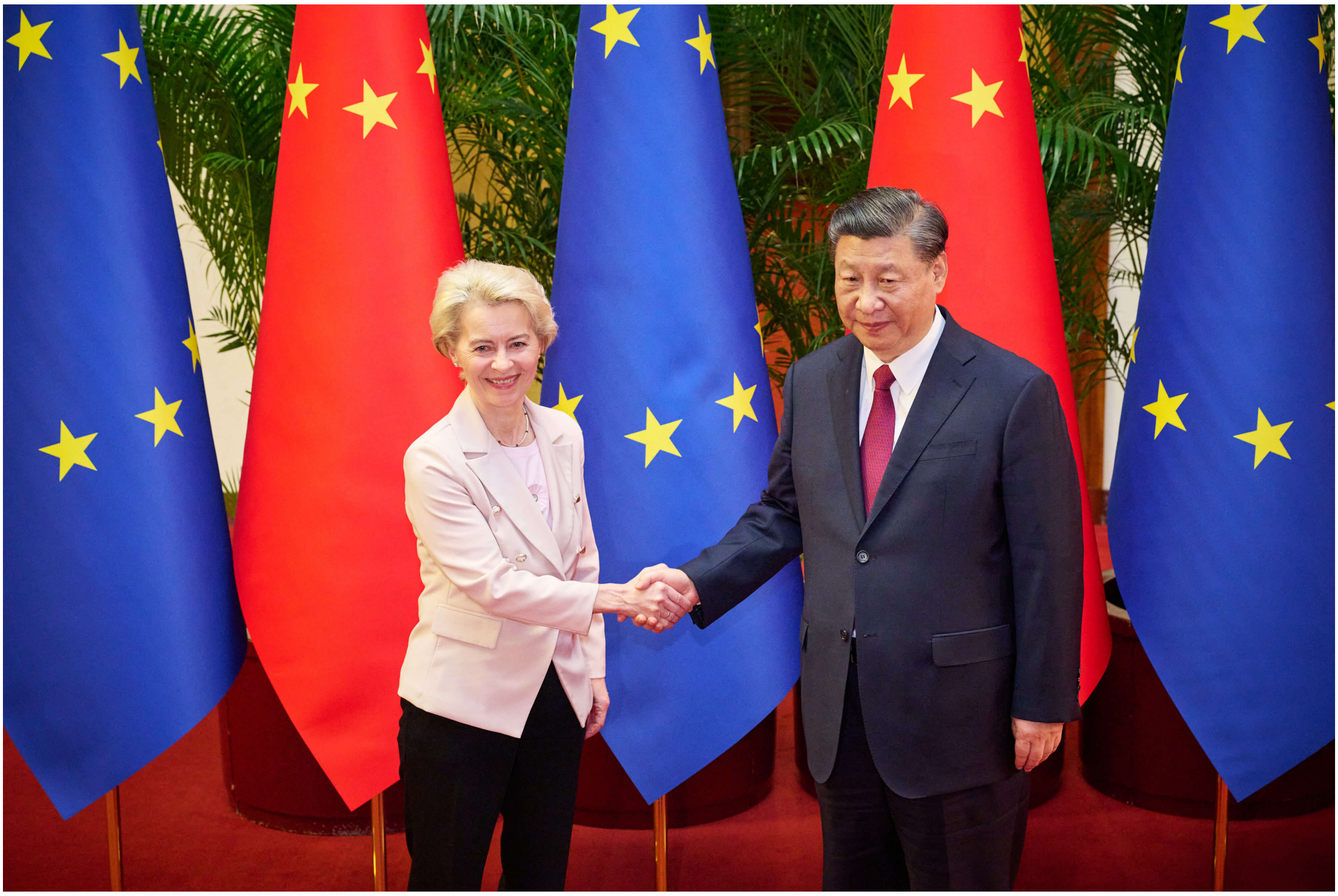
Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Dalia Marin

Europe must not squander its leverage over China



As German Chancellor Friedrich Merz prepares to visit China, evidence of the growing imbalance between the two countries is piling up.

Germany, Europe's largest economy, reports that its GDP grew just 0.2% in 2025, whereas China recorded a record-high trade surplus of $1.19 trillion.

These data are not unrelated: Goldman Sachs estimates that, were it not for Chinese competition, German growth would have reached 0.5%.

For decades, Germany's trade surplus contributed to China's industrialization.

As a fast-growing Chinese economy sucked in huge volumes of German exports (mainly capital goods), German growth got a boost, too.

But in recent years, Chinese exporters have claimed an expanding share of the global market for advanced manufacturing products, such as electric vehicles, putting competitive pressure on these sectors elsewhere.

Since 2020, Germany has been feeling the effects of this shift, with pressure from China increasingly threatening the survival of the sectors, such as automobiles and machinery, that long formed the backbone of its economy and the engine of its export-led growth model.

These sectors also account for a disproportionate share of the country's total spending on research and development.

China shock

This "China shock" has lately been compounded by protectionist US trade policies, as China has responded by channeling more goods to Europe.

Chinese exports to the US fell by around 20% last year, while exports to Europe rose by more than 8%. Small wonder that observers like Financial Times commentator Ron Harding are now asking whether Germany will soon run out of goods to sell to China.

Economists would instinctively reject this idea. Under the logic of comparative advantage, wages and relative prices should automatically recalibrate, so that every economy retains some area of specialization.

If China were to outcompete Germany across the board, Chinese wages would rise, along with the exchange rate, to the point that competitiveness in at least some German industries would be restored.

But such an adjustment depends on well-functioning market mechanisms, including exchange rates.

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Unfortunately for Germany, China carefully manages the value of its currency. As a result, the renminbi's real effective exchange rate has plummeted by almost 20% since 2021. And it appears likely to continue falling.

Unlike the nominal effective exchange rate, the real effective exchange rate accounts for differences in inflation across countries.

China is currently experiencing deflation, driven by intense domestic price competition, and Europe is coming out of a period of inflation, driven by pandemic-related supply disruptions and the energy shock caused by Russia's invasion of Ukraine. This has severely distorted the playing field.

Minimum pricing systems

None of this means that Germany – and Europe more broadly – lacks options.

With the United States showing no sign of abandoning its protectionist policies, China cannot afford to lose access to the European consumer market.

If it does, it will rapidly accumulate excess capacity in a range of sectors, not least EVs. This gives Europe significant leverage – which the European Commission is now at risk of squandering.

Last month, the Commission issued a guidance document for carmakers to submit "price undertaking offers," including minimum import and retail prices, volume commitments, and promises of future investments in the European Union.

The idea is that manufacturers operating in China – including German brands – may sidestep the 35% anti-subsidy duties the EU imposed in 2024 if they submit offers that are "adequate to eliminate the injurious effects of the subsidies and provide equivalent effect to duties."

> Minimum pricing systems eliminate competition and allow Chinese exporters to pocket the extra profit

But a price floor for a certain quota of goods shipped to Europe does not have the same impact as duties. Tariffs maintain competition between Chinese and European producers, while providing revenues that can help replenish European coffers, which are currently losing billions of dollars annually as a result of Chinese competition.

Minimum pricing systems, by contrast, eliminate competition and allow Chinese exporters to pocket the extra profit they gain from charging European consumers more.

While this shift to minimum pricing might be considered a diplomatic de-escalation, its economic logic is questionable, at best.

EU should emulate a strategy that China pioneered

Rather than enable Chinese firms to reap more profits from Europe, the European Commission should emulate a strategy that China pioneered.

For decades, China required foreign firms to enter joint ventures with local companies in order to access its market, thereby facilitating technology transfer to China.

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Now, Europe should start requiring Chinese companies that wish to sell high-tech products in its market to form joint ventures with local manufacturers.

Ownership would be equal, but the Chinese firms would have to share know-how and provide training to their European partners.

If Chinese firms have another option for securing free or cheap access to European markets, however, their incentive to form joint ventures disappears.

Why would they share their technical expertise (and profits) with European firms if they can simply raise the prices they charge European consumers and pocket the proceeds?

We have entered a new age of geoeconomics, in which tariffs and export controls are routinely deployed as instruments of pressure.

Europe can no longer afford strategic restraint. If it is to have any chance of competing, it must impose the right conditions on China's access to its market.

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