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Caught in transition: Germany's dilemma over strategic recalibration with China

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An inflection point in Germany-China economic relationship

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Germany's economic relationship with China — long a pillar of its export-driven growth — has reached an inflection point. Once marked by mutual benefit and industrial complementarity, ties are now strained by growing asymmetries, intensified competition, and geopolitical pressures. German companies and policymakers alike are being forced to reassess longstanding assumptions as economic engagement faces unprecedented political and structural headwinds.

At the heart of Germany's China dilemma is a convergence of three complications: First, Chinese companies have accelerated their catch-up on the value chain across a broad range of industries, leading to a relative erosion of German firms' global competitiveness. Second, China's broad-based economic slowdown has hurt German economic competitiveness. Third, global geopolitical challenges developments, especially in the transatlantic alliance with the US, pose deep new risks and trade-offs for Germany, Europe's largest and the world's third-largest economy in 2024, and a country deeply invested in multilateralism and the rules-based order.

It is the last complication that poses perhaps the most vexing questions for the foundations of Germany's economic engagement with China. China's continued economic and political support for Russia in the context of its war on Ukraine, along with its growing military assertiveness around Taiwan and in the South China Sea, have added an overt security dimension to what was once primarily an economic relationship.

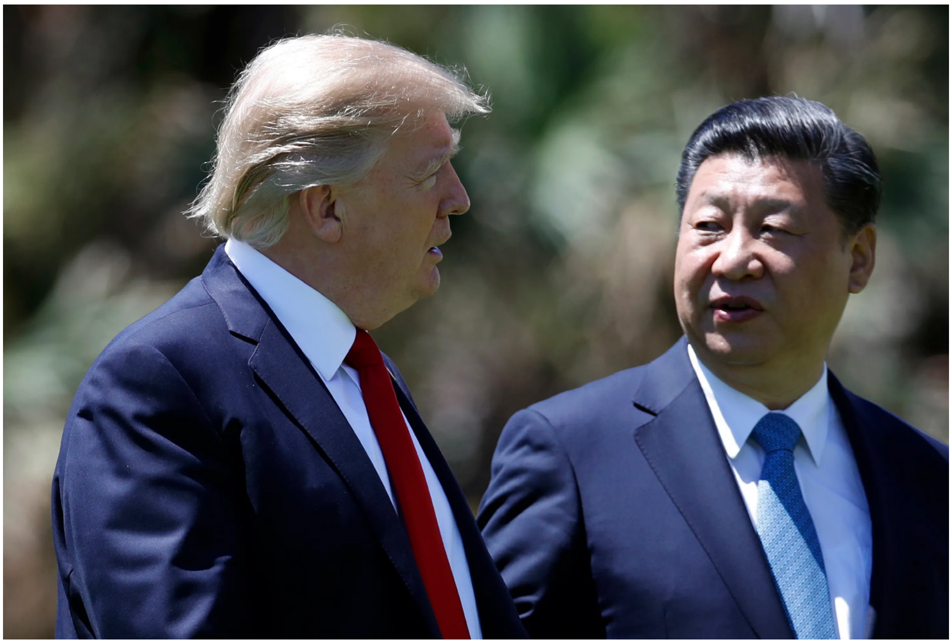
Once marked by mutual benefit and industrial complementarity, Sino-German ties are now strained by growing asymmetries, intensified competition, and geopolitical pressures.

The fragmentation of global tech stacks, driven by export controls, investment screening, and supply chain reconfiguration, is forcing German companies to navigate an increasingly bifurcated global economy.

Meanwhile, the re-escalation of US-China economic and strategic tensions — expanding from ordinary merchandise trade into the realms of high technology, semiconductors, data, and financial linkages — has revived and intensified the dynamics of economic decoupling. The fragmentation of global tech stacks, driven by export controls, investment screening, and supply chain reconfiguration, is forcing German companies to navigate an increasingly bifurcated global economy. As the US doubles down on its strategic competition with China — likely to be accelerated under the second Trump administration — European firms must make difficult decisions about where and how to position themselves.

Against this backdrop, German corporates and the incoming government will face a set of strategic choices with long-term consequences. Should Germany seek to stabilize and re-engage with China, preserving a high level of economic interdependence despite the political costs? Should it align more closely with the US and other like-minded partners, deepening transatlantic coordination on trade defense, tech sovereignty, and economic security? Or should it prioritize a rapid buildup of European capabilities — through reshoring, diversification, and a stronger common industrial policy — to reduce reliance on China?

Each of these paths entails significant trade-offs. But navigating them successfully will require not just tactical responses, but a deep understanding of the economic reordering already underway. The old model of engagement — based on commercial complementarity, gradual liberalization, and political compartmentalization — is no longer sustainable. What comes next depends on Germany's ability to reassess its economic assumptions, manage new forms of interdependence, and forge a forward-looking strategy in a rapidly changing global order.



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The implications of the shift in Germany-China economic ties

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In key sectors such as automotive, machinery, and chemicals — longstanding engines of the German export economy — China is no longer simply a lucrative sales market or low-cost production site. It is an increasingly formidable competitor and driver of innovation. The sense of complementarity that once defined Germany-China economic ties has given way to head-to-head competition, not only within China but in third-country markets worldwide and deepened dependencies.

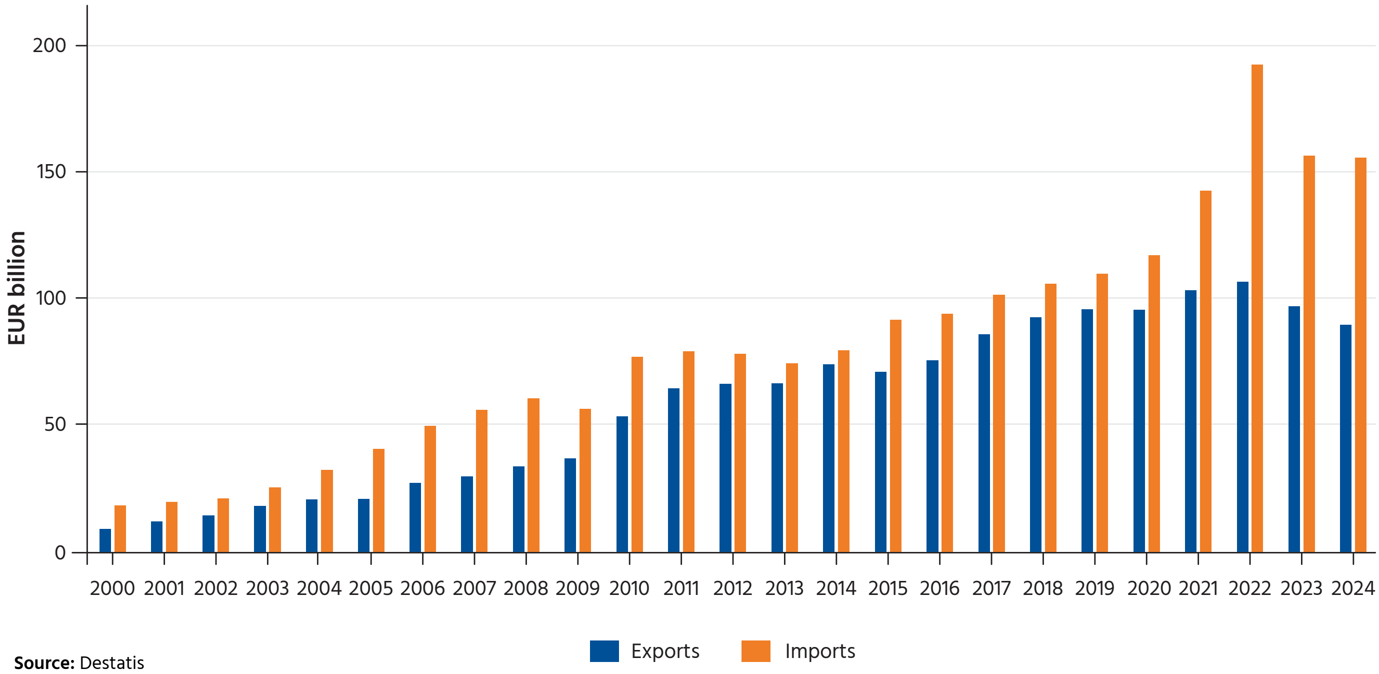
This shift is perhaps most visible in the automotive sector. German carmakers such as Volkswagen, BMW, and Mercedes-Benz have historically relied on China as both their largest single market and a critical growth driver. But their position is increasingly under threat. Chinese electric vehicle (EV) manufacturers — most notably BYD, NIO, and XPeng — have rapidly gained technological ground and market share in China at the expense of German cars, supported by China's industrial policy and an expanding innovation ecosystem. BYD, for example, recently overtook Volkswagen as the best-selling car brand in China, underscoring a dramatic reversal in fortunes. German automakers now face the double challenge of declining margins in China and mounting pressure from Chinese EVs in global markets, including in Europe itself.

The mechanical engineering and industrial automation sectors, long symbols of German manufacturing prowess, are experiencing similar pressures. Companies such as Siemens and Bosch are finding themselves in tighter competition with Chinese firms like Huawei, Haier, and Hikvision, not only in China, but across Asia, Africa, and Latin America. In chemicals, BASF's decision to double down on China with its €10 billion investment in China's southern port city of Zhanjiang contrasts with growing unease in the industry about over-dependence on an increasingly state-dominated Chinese economy, particularly as European regulatory and political risk rises.

These shifts are not isolated developments. Rather, they reflect a deeper transformation in macroeconomic complementarities between Germany and China. Where once German capital goods and engineering filled critical gaps in China's development, China's industrial upgrading and indigenous innovation have narrowed the technology gap. Many foreign companies are finding themselves overcommitted to the Chinese market, finding it hard to adjust to a rapidly deteriorating outlook for growth and market opportunities in a geopolitically loaded environment. Simultaneously, German firms face persistent challenges to fair and reciprocal access to the Chinese market. Despite years of dialogue and negotiation, structural barriers to investment, procurement, and data freedoms remain deeply entrenched in the Chinese system.

The evolution of German-China economic ties has far-reaching implications not only for the two countries involved, but for the global economy more broadly. Germany remains China's largest trading partner in the European Union (EU), accounting for over 30% of total EU goods exports to China. In 2024, trade with China reached €246 billion, trailing only the US after seven consecutive years

Figure 1 – German trade with China (EUR billion)



Source: Destatis

as Germany's top trading partner. German direct investment in China continue to reach record levels in recent years, driven in part by industrial giants hedging against deglobalization risks by localizing production.

But the depth of the relationship also exposes Germany — and by extension, the EU — to concentrated vulnerabilities. As the largest European economy and a key architect of Europe's economic integration, Germany's strategic orientation toward China plays an outsized role in shaping the EU's collective China policy. The traditional model of globalization, built on liberal economic integration and geographic neutrality, is being tested and undermined by both China and the US — and Germany is at the frontline of its consequences.

From political engagement to pragmatic balancing

Unlike others that suffered from the "China Shock," Germany's manufacturing sector thrived by supplying China with machinery, chemicals, and automobiles essential to China's industrialization. As China's economy grew, Germany became the main European beneficiary.

Germany's economic relationship with China was long defined by mutual benefit, industrial complementarity, and minimal political interference — setting it apart from the approaches of other major powers. Economic ties expanded rapidly throughout the 2000s and early 2010s, becoming the cornerstone of bilateral relations. While countries like Japan and the United States balanced economic interests with national security concerns, Germany viewed China primarily as an economic opportunity.

This distinct perspective stemmed largely from the structure of the two economies. Unlike others that suffered from the "China Shock," Germany's manufacturing sector thrived by supplying China with machinery, chemicals, and automobiles essential to China's industrialization.[1] As China's economy grew, Germany became the main European beneficiary, accounting for nearly half of the EU's exports to China.[2] In 2020, China overtook the United States as Germany's largest export market, helping to power Germany's economic recovery after the 2008–2009 global financial crisis.

Crucially, the economic relationship remained relatively insulated from political turbulence. Unlike Japan, which faced serious fallout from Tokyo's disputes with Beijing, Germany experienced only minor political frictions, such as the suspension of the rule-of-law dialogue in 2007 after Chancellor Angela Merkel met the Dalai Lama — the exiled Tibetan leader whom Beijing describes as a dangerous "splittist" of the Chinese state — with little impact on economic ties.[3] Germany

Figure 2 – **Growth in German exports and GDP, year-on-year**

Source: Destatis

Germany's 2023 China strategy calls for reducing dependencies in critical sectors, protecting critical infrastructure, and countering Chinese espionage, while maintaining cooperation in areas like climate change.

was also largely spared from the economic coercion China increasingly directed at politically adversarial countries in the 2010s.[4] This absence of major disputes delayed Germany's recognition of the emerging vulnerabilities in the relationship.

For years, strategic economic engagement prevailed over geopolitical caution. The belief in *Wandel durch Handel* ("change through trade") — that deepening economic ties would encourage political liberalization in China — reinforced Germany's expansive commercial engagement. Under Merkel, this engagement was institutionalized as part of the Sino-German government consultation in 2014 to form an innovation partnership resulting in around 100 cooperation agreements, especially in technology and industrial upgrading.[5]

However, starting around 2016, concerns grew as Chinese acquisitions of German high-tech firms, such as KUKA and Aixtron, raised alarm about the loss of strategic technologies to China.[6] Optimism about endless economic complementarity gave way to a more sober view as China's industrial policies evolved. By 2019, both the European Commission and the Federation of German Industries (BDI) publicly redefined China as not just a partner, but also a "systemic rival," acknowledging China's divergence from market economy norms and the challenge it posed to European and German competitiveness.[7]

This shift in thinking laid the groundwork for more cautious policy responses. Germany's 2023 China strategy formalized a new approach: China is now officially viewed as a "partner, competitor, and systemic rival," with an emphasis on "de-risking" rather than decoupling. The strategy calls for reducing dependencies in critical sectors, protecting critical infrastructure, and countering Chinese espionage, while maintaining cooperation in areas like climate change.

Despite growing tensions, Germany continues to pursue a pragmatic balance. Chancellor Olaf Scholz's April 2024 visit to China exemplified this dual-track approach: raising concerns over market access, unfair competition, and industrial overcapacity, while also affirming China's lasting importance to German industry, especially in green energy and innovation.[8] Accompanied by a major business delegation, Scholz's visit signaled that Germany aims to defend its interests without allowing disagreements to derail broader economic cooperation. Beyond government-level strategies, German corporates are grappling with their own recalibration challenges.

Contested corporate recalibration

The idea of embracing a more assertive political stance toward Beijing especially on contentious issues like human rights or limiting business ties for security and strategic reasons has historically been a hard sell to German corporates.

This evolving political context is mirrored — and in some cases resisted — by corporate strategies on the ground. The idea of embracing a more assertive political stance toward Beijing especially on contentious issues like human rights or limiting business ties for security and strategic reasons has historically been a hard sell to German corporates. For decades, the economic promise of the Chinese market outweighed concerns over strategic or normative misalignments. This dynamic continues to shape corporate responses to calls for a recalibration of ties with China, especially in the context of de-risking and supply chain diversification.

From the perspective of many German executives, the new regulatory instruments implemented by the German government and the European Union including tighter investment screening, supply-chain scrutiny, carbon-border adjustment, and anti-foreign subsidy regulations still pose a more immediate threat to German business interests than Beijing's industrial policy ambitions. For example, the European Commission's anti-subsidy probe into Chinese electric vehicles sparked concern among German automakers, who fear that punitive tariffs could jeopardize their access to the Chinese market and provoke retaliatory measures. Reflecting these concerns, Germany notably voted against supporting the EU's imposition of tariffs on Chinese EVs.

For key German companies in automotive, chemicals, pharmaceutical, and machinery sectors, China is viewed as essential to their global strategies and corporate success. Many are heavily invested in the Chinese market and are

US imports from Cambodia, Thailand, and Hungary have seen significant increases in recent years. These countries are also some of the biggest recipients of Chinese ODI during the same time period.

Rather than pulling back, German firms are embedding themselves more deeply into the Chinese economy to shield their operations from external political shocks and potentially benefit from the next wave of globalization of Chinese firms.

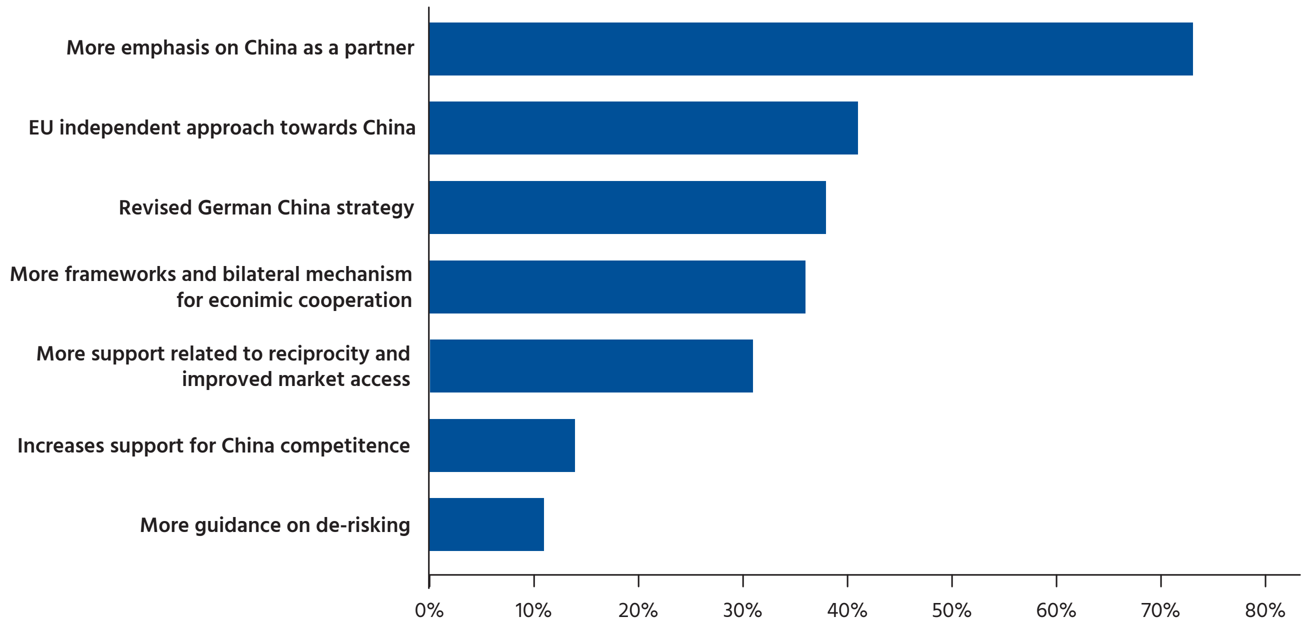
particularly wary of any political move that could destabilize their deeply embedded operations in China. There was and is no appetite for the decoupling concept which emerged as tensions between China and the US heated up in 2018. Instead, the German corporate sector is only hesitantly embracing a more malleable concept of "de-risking," which – in theory – should allow for strategic adjustments without severing commercial ties.

"De-risking" means more China for many German companies

In practice, de-risking for many German companies has largely translated into an "in China, for China" strategy. This approach focuses on deepening local operations, partnerships, and supply chains within China to ensure market resilience and competitiveness in a key global market. Rather than pulling back, German firms are embedding themselves more deeply into the Chinese economy to shield their operations from external political shocks and potentially benefit from the next wave of globalization of Chinese firms.

The German Chamber of Commerce in China has publicly questioned the value and feasibility of de-risking. In its 2023/24 annual business confidence survey, which reflected the views of 566 member companies, over 90% indicated they intended to maintain their operations in China, with more than half planning to increase investments over the following two years. The Chamber has been explicit in advocating the "in China, for China" approach as the most viable means to mitigate risks associated with geopolitical tensions while maintaining German economic competitiveness in an increasingly localized market environment.[9]

Figure 3 – "What do you expect from the German Governemnt in the future?", share of responses in Business Confidence Survey 2024/5



Source: German Chamber of Commerce in China

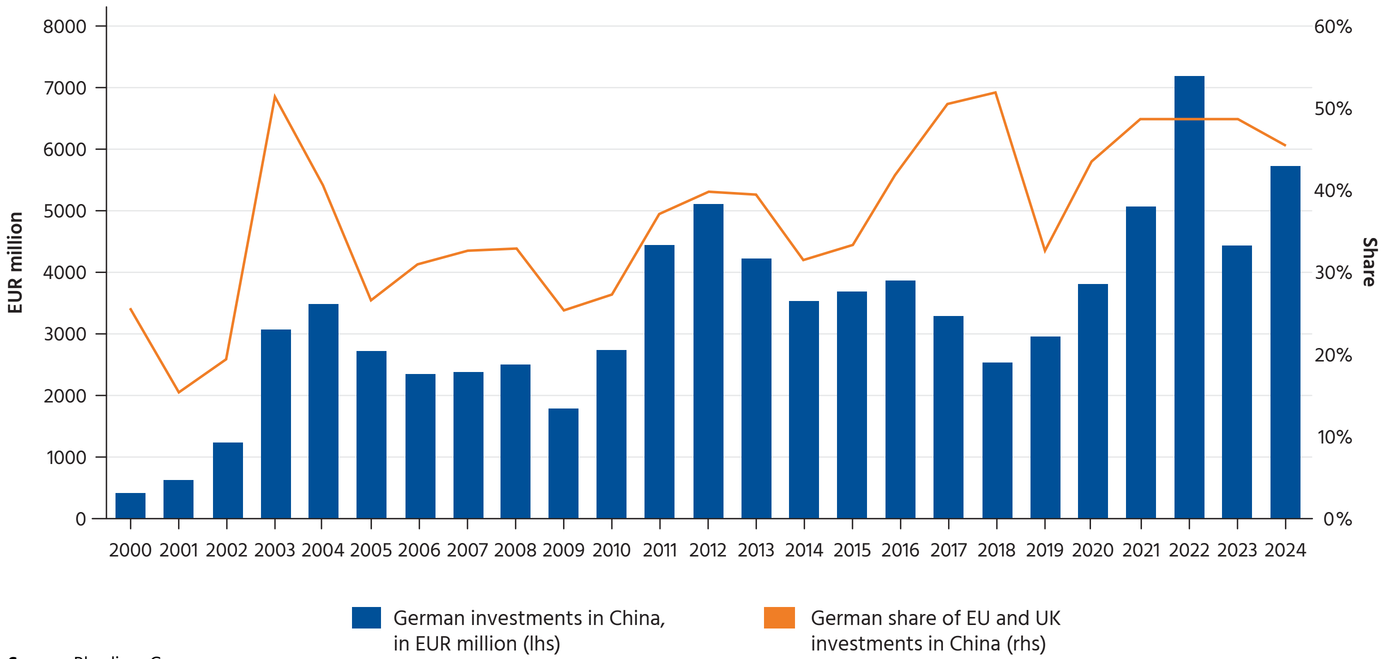
The next chapter of Sino-German economic engagement will focus on innovation partnerships, particularly in the fields of intelligent mobility, digitalization, and green energy. This is most visible in the automotive sector.

The chamber's 2024 annual report underscored this position, stating that efforts should focus on "strengthening Sino-German business ties and laying a solid foundation for future investment and trade cooperation." While acknowledging concerns about market access and growing local competition, China is clearly not seen a threat to be distanced from, but a vital partner with which closer collaboration can ensure continued industrial strength.

This view is also reflected in continuously strong investments by German companies in China. In 2024, German firms invested €5.7 billion in China, accounting for 45% of all foreign direct investment into China from the EU and the United Kingdom. The automotive sector alone made up €4.2 billion, with its share of total German FDI in China rising from 56% in 2023 to 73% in 2024. Original equipment manufacturers (OEMs) are leading the charge, expanding production, forming partnerships, and boosting local R&D to counter increasing competition from Chinese electric vehicle manufacturers.

This strategic rationale is entering a new phase, particularly in the domain of technological collaboration. It is referred to as "Cooperation 2.0" by BMW Chief Executive Officer Oliver Zipse or "Localization 3.0" by the German Chamber in China.[10] According to these views, the next chapter of Sino-German economic engagement will focus on innovation partnerships, particularly in the fields of intelligent mobility, digitalization, and green energy. This is most visible in the automotive sector with German automakers increasingly embedding R&D capabilities in China to create products tailored specifically for local consumers. At the April 2025 Shanghai Auto Show, Volkswagen unveiled its first vehicle developed entirely in China, a clear sign of this evolving dynamic.[11] In the span of

Figure 4 – German investment in China, in EUR million euros and share of total EU and UK investment



Source: Rhodium Group

With transatlantic relations strained and protectionist rhetoric rising, many German firms view China not just as a growth market but increasingly as a predictable and stabilizing partner amid global volatility, overriding any other concerns stemming from China's geopolitical or industrial policy agenda.

just a decade, Germany has shifted from being a highly sought-after innovation partner to a position where its companies are now struggling to keep pace with rapidly advancing Chinese competitors.

This perspective aligns with the broader sentiment among German businesses that, despite political pressures to diversify, China's market remains indispensable. The corporate approach indicates a preference for pragmatic engagement over disengagement, highlighting the complexities of balancing economic interests with geopolitical considerations.

The turbulent first months of the second Trump administration reinforced this pragmatism. Donald Trump's policies continue to put US ties with European and German business interests at risk. With transatlantic relations strained and protectionist rhetoric rising, many German firms view China not just as a growth market but increasingly as a predictable and stabilizing partner amid global volatility, overriding any other concerns stemming from China's geopolitical or industrial policy agenda.

Corporate enthusiasm was further underscored during the 2025 China Development Forum in Beijing, where European CEOs and particularly German executives played a prominent role.[12] Seven of the 10 EU-based firms represented at the event were German, including CEOs from Siemens, BMW, Mercedes-Benz, Bosch, and Thyssenkrupp, while CEOs of Asian companies were fewer and less prominent. This turnout not only reflects the significance of the Chinese market to German firms but also underlines the strong emphasis Beijing places on engagement with German companies to help shape a positive narrative in China's international economic relations. Concerns over China's overcapacities and Chinese-driven de-industrialization of Germany are countered by the need for the Chinese market for economic growth in Germany and as a key partner in innovation to safeguard the future competitiveness of German industry in automotive, chemical, machinery, and pharmaceutical sectors.

New structural realities in Sino-German economic relations

When ranking opportunities in the Chinese market, the internationalization of Chinese companies emerged as the only category to show growth year after year. China is now seen as the leading area of market opportunity.

The emphasis on cooperation by major German companies signals a concerted pushback against a political framework of heightened confrontation with China taking shape in Berlin and Brussels. It underscores how, despite well-documented challenges in the Chinese market, many leading global firms continue to view their future in China with guarded optimism. This stance is rooted in the historical evolution of Sino-German economic relations, which have progressed through distinct phases.

Initially, China was a geographically distant, underdeveloped export destination. It then transformed into a key manufacturing hub and domestic market, offering scale and growth opportunities. More recently, China has become a crucial innovation partner, instrumental in the global competitiveness of German industry. The latest phase in this evolution reflects a further shift: German firms are positioning themselves not just to compete in China, but to become partners in the globalization of Chinese companies.[13]

This shift is illustrated by recent business sentiment data by the German Chamber of Commerce in China. When ranking opportunities in the Chinese market, the internationalization of Chinese companies emerged as the only category to show growth year after year. China is now seen as the leading area of market opportunity. This trend suggests a deepening integration, where German firms innovate and manufacture in China not only for China, but increasingly from China,

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for the world, aligning German corporates' global strategies with Chinese industrial ambitions.

However, this optimism is far from universal. A survey by the Cologne Institute for Economic Research (IW Köln), affiliated with the Federation of German Industries (BDI), paints a more sobering picture.[14] It highlights growing concerns over Chinese state-backed competitors, not just within China but increasingly in third markets — posing a direct threat to the export-driven German business model. The fear is not just about losing market share but about competing against Chinese firms bolstered by strategic state support, which distorts global competition.

Sectoral divisions further illustrate this divergence. While the German Automobile Association (VDA) remains largely committed to continued engagement and market access, the German Engineering Federation (VDMA) has struck a more cautious tone.[15] It warns of risks of losing Germany's dual-use technologies and calls for coordinated strategies on export controls, especially in sectors with security-sensitive applications. The German Chemical Industry Association (VCI) reports growing competition from Chinese companies.[16] This reflects broader tensions in Germany between maintaining open trade and protecting strategic technologies.

Given the scale and complexity of China's economy, it is unsurprising that German views on future business prospects are diverse. Yet, as economic ties pivot toward innovation-led collaboration, the immediate economic benefits for Germany, and by extension, Europe's industrial base, may become less tangible. This shift introduces new friction points between the German government and its corporate champions. The fundamental dilemma is clear: what benefits individual German companies may no longer align with what benefits Germany as a state. This marks a significant departure from the traditional alignment between corporate interests and German foreign economic policy that defined much of the past three decades.

Set against today's complex geopolitical backdrop, the recalibration of Germany's economic relationship with China will not be dictated solely by values or security concerns. Instead, it will be shaped by evolving economic realities and whether German firms can successfully forge a collaborative model that balances competitiveness with resilience. The risk is that they may instead find themselves pursuing an increasingly elusive opportunity, chasing a mirage of market opportunity that ultimately slips beyond reach.

A new economic reality is already rapidly unfolding for German companies in China. While German companies and exports have avoided backlashes other industrial countries have encountered earlier on, the tides started to turn around 2020 with key figures beginning to slip.

China's intensifying focus on key sectors traditionally dominated by German industry

The new reality will also be shaped by what China's party-state does.

Since 2021, Chinese fixed asset investment in manufacturing has outpaced overall fixed asset investment — a trend that accelerated further in 2024 as capital flowed away from real estate and into industrial capacity. This surge has been particularly concentrated in core German industrial strengths such as automotive, machinery, and chemicals.

In 2024, Germany's export share to China declined to 5.8%, its lowest level since 2015 and broadly in line with levels in the early 2010s. The drop in German exports is not merely cyclical but indicative of deeper shifts in trade dynamics.

However, unlike during the industrial build-up of the 2010s, German companies are not benefiting to the same extent this time around.[17] Firms that have struggled to gain traction in recent years are unlikely to see a turnaround soon. Instead, they face mounting pressure as Chinese competitors increasingly target not only the domestic Chinese market but also third markets and even Germany itself.

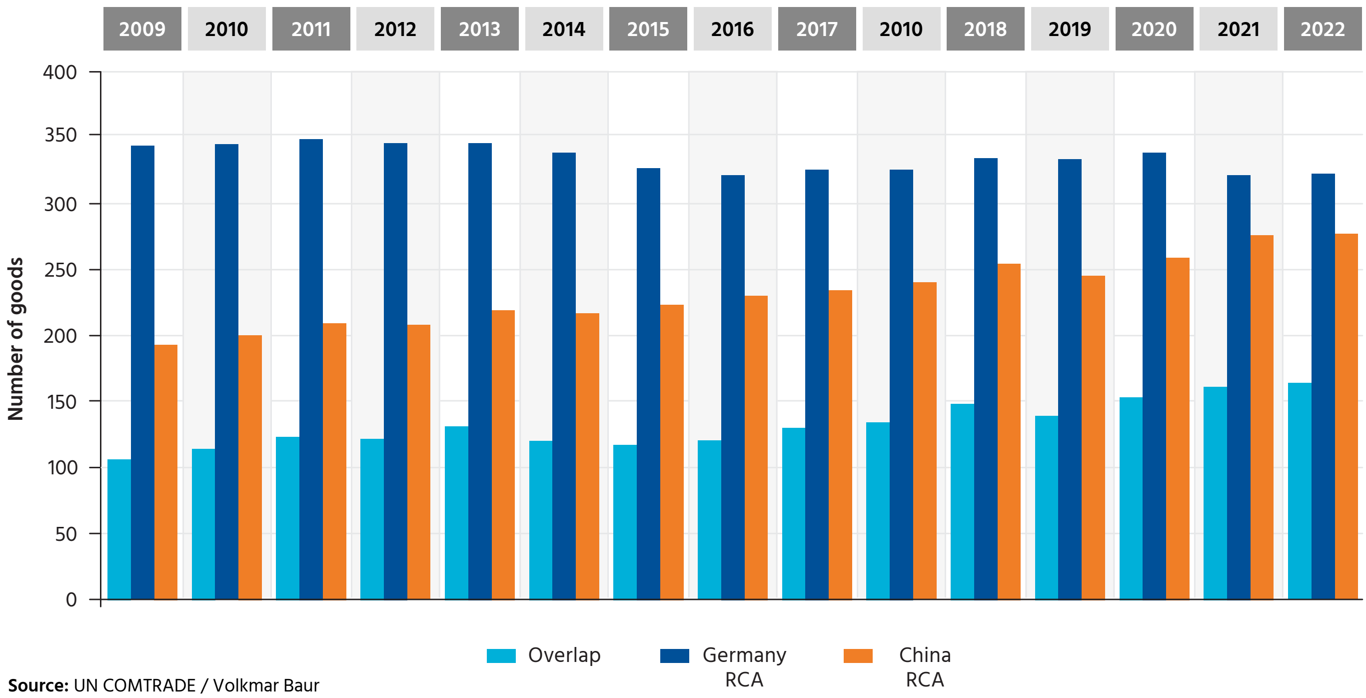
Out of 115 manufacturing sectors, more than half see an increase in Chinese imports to the EU and decrease of European production from 2021 to 2024.

After years of outperforming other advanced industrial economies, Germany's export model is now entering a period of structural transition. The country previously benefited from extraordinary export growth driven by Chinese demand for German automobiles and high-value industrial inputs such as chemicals and machinery. However, this phase appears to be ending.

China's and Germany's revealed comparative advantage, an econometric index of efficient production, is converging, a trend particularly visible in machinery.

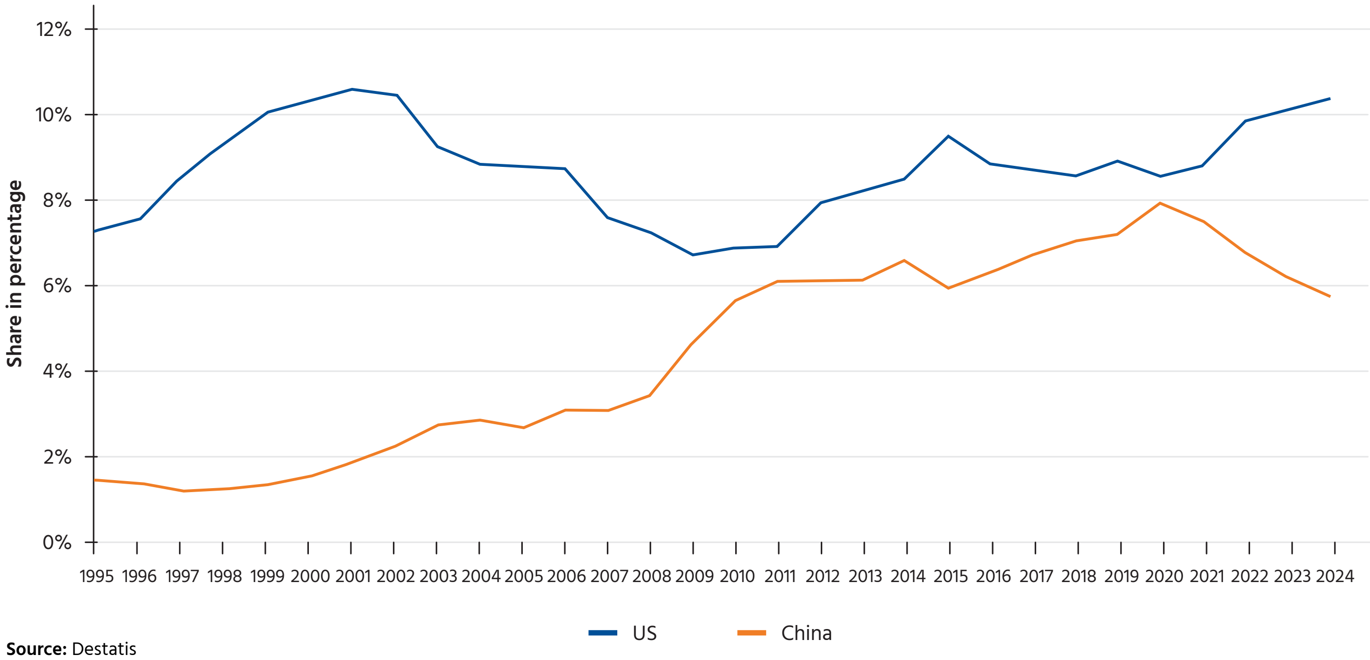
In 2024, Germany's export share to China declined to 5.8%, its lowest level since 2015 and broadly in line with levels in the early 2010s. A significant rebound seems unlikely in the near term, if at all. Notably, the current weakness in the Chinese economy is concentrated in the consumer and real estate sectors, while industrial production, the segment most relevant to German exporters, remains relatively strong. This suggests that the drop in German exports is not merely cyclical but indicative of deeper shifts in trade dynamics.

Figure 5 – Revealed Comparative Advantage in machinery sector, by number of goods



Source: UN COMTRADE / Volkmar Baur

Figure 6 – **Share of German exports by destination**



Source: Destatis

The evolving landscape of German corporate engagement in China reveals a highly differentiated strategic reality across sectors.

Looking ahead, a critical question is where the new floor for German exports to China will settle and how China's growing export orientation, particularly in advanced manufacturing, will affect Germany's position in global markets. The outlook points to a difficult adjustment phase for German industry, as longstanding assumptions about China as a reliable growth engine are increasingly called into question.

Differentiated strategic responses across German industry

The evolving landscape of German corporate engagement in China reveals a highly differentiated strategic reality across sectors. In the automotive sector, firms like Volkswagen, BMW, and Mercedes-Benz are pursuing a strategy of "targeted deepening". They are localizing research, development, and production in China more aggressively than ever before, especially in electric vehicles and digital technologies. Yet, this deepening is highly selective, as companies hedge their bets against rising geopolitical and competitive risks by maintaining flexible supply chains and limiting the exposure of their most sensitive technologies. For example, Volkswagen has expanded its cooperation with American automaker Rivian Automotive in the US in preparation for the emergence of different tech ecosystems.

Among Germany's industrial and technology leaders such as Siemens, Zeiss, and SAP, the dominant strategy is hedging. These companies continue to value China's market scale but are taking care to protect strategic technologies from potential intellectual property transfer or political vulnerability. Growth initiatives focus increasingly on non-sensitive areas, while core innovations such as semiconductor metrology tools or cloud software architectures, are either controlled tightly

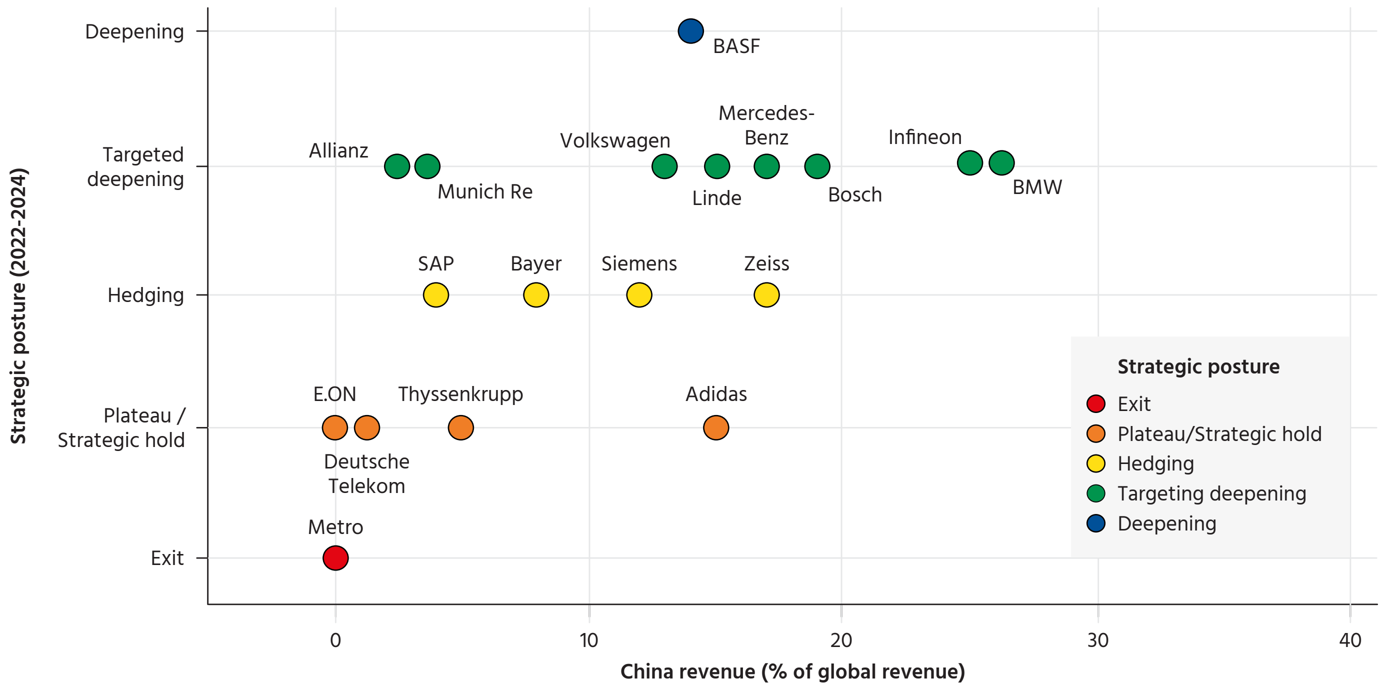
There is no one-size-fits-all German corporate strategy for China. Sectoral dynamics, regulatory pressures, and geopolitical risks are producing distinct and sometimes diverging paths across industries.

or kept outside China's jurisdiction. This contrasts sharply with the trajectory of consumer brands like Adidas and Metro, which have faced substantial setbacks in their China markets. These consumer firms' strategic posture has moved to "plateau or exit", following Chinese consumer boycotts, rising Chinese nationalism, and the rapid rise of competitive Chinese brands.

Heavy industry, notably Thyssenkrupp and E.ON Group, is guided by "strategic hold": cautious defense of existing market presence without substantial new investments. In contrast, chemical giants like BASF and Linde are among the few still doubling down on China, expanding their asset footprint significantly and accepting greater political risk exposure in exchange for access to the world's largest industrial and energy transition markets. In the financial sector, companies such as Munich Re and Allianz are selectively expanding through "Targeted Deepening", leveraging regulatory openings in insurance and asset management while maintaining strict risk management procedures.

In high-technology sectors, the posture is nuanced: Infineon, Germany's leading semiconductor firm, is pursuing "Targeted Deepening" with extreme caution. As a critical supplier to automotive and industrial markets, Infineon's growing China footprint is tempered by the strategic sensitivity of its products and mounting global tensions over semiconductor technologies. This differentiated reality illustrates that there is no one-size-fits-all German corporate strategy for China. Sectoral dynamics, regulatory pressures, and geopolitical risks are producing distinct and sometimes diverging paths across industries.

Figure 7 – German companies' China exposure and strategic posture



Source: MERICS research

Strategic stress will require new corporate-policy alignment

The intensified pressure on global manufacturing competition will place particular stress on Germany's industrial base, threatening corporate and state positions both in China, in third markets, and at home.

The global environment in which German companies operate is undergoing a profound transformation. External risks are compounding a long list of internal weaknesses. China has emerged as a manufacturing superpower, expanding dominance in areas that are the backbone of Germany's own industrial power. This intensified pressure on global manufacturing competition will place particular stress on Germany's industrial base, threatening corporate and state positions both in China, in third markets, and at home.

At the same time, the United States has set course to give up its role as a global stabilizer. In this global environment of systemic uncertainty, German firms will face a far more complex reality: managing fragmentation and risk, rather than simply leveraging globalization for growth. In parallel, German policymakers will have to rethink industrial, technological, and foreign economic strategies to safeguard national competitiveness and resilience.

Ten key challenges and implications emerge from this trajectory:

- **From leadership to strategic vulnerability**: German companies risk significant erosion of their global leadership positions. Chinese competitors are expanding both in their home market and internationally, threatening Germany's traditional model of export-driven prosperity.

- **Compression into strategic niches**: Remaining opportunities in China and elsewhere will increasingly be confined to specialized, innovation-intensive niches. German companies unable to maintain technological edge risk being trapped between competing tech ecosystems in China and the US.

- **Globalization without guarantees**: Global markets will remain accessible but increasingly shaped by Chinese standards, firms, and financial systems. German economic diplomacy must prepare for an era where globalization no longer structurally favors Western business models.

- **The two-speed innovation trap**: Dual R&D systems — one aligned with China, one aligned with Western allies — will raise complexity and costs. Without coordinated support for technology sovereignty and innovation ecosystems, German firms could face declining global competitiveness.

- **Strategic ambiguity as liability**: Mixed corporate positioning between China, Europe, and the United States will increasingly expose firms to regulatory, reputational, and political risks. Clearer frameworks and expectations from Berlin will be necessary to guide corporate China strategies, particularly in critical sectors.

- **Erosion of industrial economies of scale**: Fragmentation of supply chains will disproportionately hurt German manufacturing sectors that depend on global scale efficiencies. Targeted industrial strategies at the European level will be needed to maintain cost competitiveness and innovation leadership.

Germany's government will need to actively define the national interest in foreign economic engagement — and ensure that corporate actors have both the incentives and the frameworks to align with it.

- **Innovation versus risk aversion**: Companies face a fundamental dilemma to pull back from China and risk missing technological shifts, or double down and face political backlash. Policy instruments must incentivize smart engagement and selective decoupling, rather than blunt disengagement.

- **A fragmenting Mittelstand base**: Germany's mid-sized industrial companies face existential challenges from diverging regulatory systems and standards. Without tailored support, the hollowing out of the Mittelstand is a real risk for Germany over the next decade.

- **Misjudging opportunities in China**: With rapidly deteriorating transatlantic ties, corporate China de-risking might be replaced by a renewed push for deeper engagement. Driven by their local China units, companies could chase potentially counterproductive long-term market opportunities in China, tying up valuable resources that might otherwise be needed for German diversification and to counter the inevitable rise of Chinese competition in third markets.

- **Balancing German multinational corporate interests with the European industrial base**: A lack of coordination — and, increasingly, open contestation — between corporate strategies and government policy geared at maintaining Europe's industrial base risks undermining a sensible recalibration of Germany's engagement with China. To safeguard its industrial base, greater alignment between business and political objectives will be of fundamental importance.

If these stress factors remain unaddressed, Germany could experience a gradual hollowing out of its industrial competitiveness, weakening not only economic prosperity but also strategic autonomy in an increasingly rivalrous global environment.

To prevent this outcome, a much closer alignment between German corporate strategies and government policy will be necessary. De-risking cannot succeed as company-by-company improvisation; it requires clear strategic guidance, coordinated investment in critical capabilities, and common standards for risk assessment and resilience.

Beyond national adaptation, Germany will also need to take a leadership role in shaping the new phase of contested globalization. A passive approach will leave German firms reacting to standards, ecosystems, and trade frameworks defined by others. Building European capabilities — in technology, trade, defense, investment, industrial policy, and standard-setting — must be the core platform for sustaining German competitiveness. Germany's influence will only be sustainable if exercised through the EU. However, given current domestic and European political dynamics, Germany's political leadership and its industrial community would need to shift its fundamental strategic mindset.

Germany's government will need to actively define the national interest in foreign economic engagement — and ensure that corporate actors have both the incentives and the frameworks to align with it.

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Max has over ten years of professional experience working on China-related economic issues. Before joining MERICS he was an economic analyst for the German Chamber of Commerce in Shenzhen and Beijing. He is an economist by training and has studied at the University of New York at Buffalo, the Berlin School of Economics and Law, the University of Hong Kong and the University of Kassel. He received his PhD from the University of Kassel in 2015.

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Executive Director, MERICS

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Mikko studied in Freiburg, Nanjing and Shanghai. He holds a PhD from Freiburg University and was a guest scholar at the University of California in San Diego in 2017/2018. In 2019, Mikko was appointed as one of 15 German representatives to the German-Chinese Dialogue Forum.

Endnotes

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