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GERMANY'S ECONOMIC RELATIONS WITH CHINA WITHIN THE WITHIN THE FRAMEWORK OF THE INDO-PACIFIC STRATEGY

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Germany and China are two leading countries in the global economy and, at the same time, two important economic partners. China remains Germany's most important trading partner for the eighteenth year running and is by far China's most important trading partner in Europe. Conversely, China is Germany's most important economic partner in the Indo-Pacific region.

In 2019, the Federation of German Industries (BDI) prepared and submitted a position paper to the German government and the European Commission on strengthening the European Union (EU) against China.[1] The BDI report, which was initially adopted by the former German government, outlined 54 demands addressed to Berlin and Brussels in order to better meet the growing challenges posed by the state-dominated Chinese economy.[2] Soon after, in September 2020, the Federal Government put into force its political guidelines on the Indo-Pacific as a whole with the aim of strengthening Germany's role in the region in the long term. This document is titled "Germany – Europe – Asia: shaping the 21st century together. Germany is making an active contribution to shaping the international order in the Indo-Pacific."[3]

Since then, the German government has included developments in the Indo-Pacific among its foreign policy priorities. One of the central objectives of the German strategy for the Indo-Pacific region is dealing with China as a geopolitical challenge: For today, China is a partner, competitor, and system rival for the German government all at the same time.[4] Among Germany's other priorities in the region is peace and security in the Asia-Pacific, diversifying and deepening relations, open shipping routes, open markets and free trade, digital transformation and connectivity, access to fact-based information.

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[1] "China – a partner and systemic competitor," BDI Berlin, 10 January 2019, https://english.bdi.eu/article/news/strengthen-the-european-union-to-better-compete-with-china/.

[2] The BDI position paper is divided into four central propositions: first, the strengthening of competitiveness in Germany and Europe; second, a strong and unified EU; third, effective instruments to safeguard the market-based economic order; and fourth, closer international cooperation with like-minded partners. "Milestone in the China Debate: BDI Presents Strategic Position Paper," BDI Berlin, 21 February 2019, https://english.bdi.eu/article/news/milestone-in-the-china-debate-bdi-presents-strategic-position-paper/.

[3] Germany – Europe – Asia: shaping the 21st century together": The German Government adopts policy guidelines on the Indo-Pacific region,Federal Foeign Office.01.09.2020. https://www.auswaertiges-amt.de/en/aussenpolitik/regionaleschwerpunkte/asien/german-government-policy-guidelines-indo-pacific/2380510.

[4] "Progress report on the implementation of the Federal Government's policy guidelines for the Indo-Pacific in 2023," German Federal Office, n.d., https://www.auswaertigeamt.de/blob/2617992/61051683e7e1521583b3067fb3200ad8/230922-leitlinien-indo-pazifik-3-fortschrittsbericht-data.pdf.

Germany's economic relations with China within the framework of RCEP+I

One of the main factors behind the increased interest in the Indo-Pacific region is the implementation of the Regional Comprehensive Economic Partnership (RCEP), which is composed of 15 members from Indo-Pacific states, with non-member India (RCEP+I). The RCEP is a free trade agreement and an exemplary regional economic integration service covering almost a third of the world's population and GDP. Germany's bilateral cooperation with RCEP+I focus on its leading and strongest member, the People's Republic of China, which has been at the centre of German Indo-Pacific policy for decades.

China, as a central member of the RCEP+I market, is one of Germany's most important trade centres. China is Germany's largest trading partner, and Germany is China's biggest trading partner in Europe. In 2023, China's share of Germany's foreign trade will be around 8.8 per cent, while the USA will have a share of around 8.6 per cent of German foreign trade. Accordingly, China is being upgraded as Germany's first trading partner, replacing the United States in terms of total trade volume. [5]

Germany's share of total EU trade with China is 34,2 % in 2023.[6] The total volume of trade between Germany and RCEP+I countries (including Hong Kong) was almost USD 3 trillion between 2018 and 2023. Germany's main export partner among the RCEP+I countries is China, with a 54% share of all exports from the region when including Hong Kong. Concerning Germany's import relations with the RCEP+I, the picture is similar to its export relations with the RCEP+I. Germany's main import partners are China and Hong Kong, which have a 59% share in all imports from the region. China's share in Germany's total trade deficit in trade with RCEP+I countries is around 61%.[7]

German FDIs in China and in other Indo-Pacific Countries

EU investment in China is being driven by Germany and its car manufacturers to a greater extent than in the past. German FDI accounted for 57% of total EU investment in China in the first half of 2024, 62% in 2023 and a record 71% in 2022, primarily from the automotive sector, which has accounted for around half of all EU investment in China since 2022.[8]

The distribution of German investment in the Indo-Pacific is as follows: at the top of the list are China + Hong Kong with a 58.2% share, India with 9.0%, Singapore with 8.1%, Australia with 6.8%,

[5], China's share of Germany's foreign trade until 2023,Published by J. Rudnicka 09.08.2024, Statista, [Chinas Anteil am Außenhandel von Deutschland bis 2023 | Statista]

[6] In 2023, the People's Republic of China will be Germany's most important trading partner for the eighth time in a row, with a foreign trade volume of 253.1 billion euros. China is the EU's second largest trading partner for goods after the United States. Bilateral trade reached €739 billion in 2023. The share of Germany's trade with China will be €253/€739 bn 34.2% in 2023.

[7] International Trade Center, Trade Map (www.trademap.org), author's own calculations.

[8] Don't Stop Believin': The Inexorable Rise of German FDI in China,Rhodium Group, October 31, 2024, [Don't Stop Believin': The Inexorable Rise of German FDI in China – Rhodium Group]

Japan and South Korea with 4.8% for each in the period from 2010–2021 based on data from Deutsche Bundesbank.[9]

In recent years, German investors have increasingly turned to China and Hong Kong. Among the German companies that have invested in China are Germany's three major carmakers (Volkswagen, BMW, and Daimler) and the chemicals group BASF, which have led the way in China. These four companies alone account for 34% of all European FDI in China by value between 2018 and 2021.[10] Automobiles are Germany's most important export commodities—motor vehicles and motor vehicle parts accounted for over a quarter of exports to the People's Republic in 2021.[11] However, China is developing into a new power in the automotive industry, particularly through BYD. It is revolutionising car production, which has put the powerful German car manufacturers under intense pressure and fierce competition. As we observed in October, when the German government voted against EU tariffs on imported Chinese electric cars, the reputation of such reactions could increase tensions and disputes within the EU and between Europe and the US in the future.[12]

FUTURE CONSIDERATIONS FOR GERMANY/EU-CHINA RELATIONS

Today, Berlin has three major questions on the table regarding its economic relations with China: (1) How will Berlin resolve disputes in bilateral economic relations with Beijing? (2) Will the EU states continue to treat China as a single entity apart from Brussels' 'common Indo-Pacific strategy'? (3) Will relations between the EU/Germany and Washington under the Trump administration be characterised by close cooperation or tough confrontation in transatlantic relations and with China?

1. Disputes facing Germany's bilateral economic relations with China

In 2024, German Chancellor Olaf Scholz visited China for official talks for the second time while in office. The trip was in line with the German government's China strategy published last year under the motto 'acting sustainably'. According to Scholz, 'China should and will remain an important economic partner for Germany and for Europe as a whole.'[13]

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[9] "Bestandsangaben über Direktinvestitionen (nach dem Erweiterten Richtungsprinzip)," Deutsche Bundesbank Direktinvestitionsstatistiken, 28 April 2023, https://www.bundesbank.de/resource/blob/804098/723ed10658859047d43037185ee49bb4/mL/ii-bestandsangaben-ueber-direktinvestitionen-data.pdf.

[10] "The Chosen Few: A Fresh Look at European FDI in China," Rhodium Group, https://rhg.com/research/the-chosen-few/; Von Detlev Landmesser, "Wo die Abhängigkeit von China am größten ist," Tagesschau, https://www.tagesschau.de/wirtschaft/weltwirtschaft/china-aussenhandel-abhaengigkeit-100.html#:~:text=In%20den%20vergangenen%20Jahren%20sind.

[11] The main German export product: motor vehicles
Accounting for 17.3% of exports, motor vehicles and parts thereof were Germany's main export product in 2023.Machinery (14.4%) and chemical products (9.0%) ranked second and third, respectively, among the most important export items. https://www.destatis.de/EN/Themes/Economy/Foreign-Trade/_node.html.

[12] Don't Stop Believin': The Inexorable Rise of German FDI in China,Rhodium Group,ibid.

[13] Bundeskanzler in China, "Gemeinsam nachhaltig handeln," https://www.bundesregierung.de/breg-de/aktuelles/scholz-reise-nach-china 2269462#:~:text=Zum%20zweiten%20Mal%20in%20seiner%20Amtszeit%20ist.

Foreign Minister Annalena Baerbock confirmed in a press conference on 13 July 2023 that the German government has no intention of decoupling itself from the Chinese market in the future.[14] In the same speech, however, the foreign minister indirectly referred to de-risking: i.e., reducing dependencies in critical areas in order to minimise the specific risks of economic engagement with China.

However, as the Chinese market and the profits to be made there are 'simply too attractive',[15] opposite to expectations, German direct investment in China was higher in the first half of 2024 than for the whole of 2023. That brings the total for the first half of 2024 to €7.3bn, compared with €6.5bn for the whole of 2023.[16] A study carried out by the Munich-based IFO Institute found that reshoring would lead to Germany's gross domestic product (GDP) shrinking by around 9.7%. China, on the other hand, would only stand to lose only 0.17%.[17]

Another important issue in Germany-China relations is Germany's critical dependence on imports. In de-risking from the Chinese market, the safe import of urgently needed raw materials and intermediate products should be unproblematically guaranteed (i.e., supply chain security). It would take years to develop alternative sources of supply and production sites, if any could be found at all. At present, the German and Chinese economies are intertwined and dependent on each other. China has monopolised the processing of certain rare earth and other key raw materials. In addition, some chemical raw materials, including products for the pharmaceutical industry, are almost exclusively produced in China. Chinese manufacturers also have a high market share of electronic items such as notebooks, tablets, and smartphones. While rare earths from China are almost impossible to replace, it is unclear whether other products could be sourced from other countries or manufactured in Germany—and at what cost.[18]

The debate on European competition with China is dominated by the concern that Chinese companies have unfair advantages over European companies. Chinese companies, supported by subsidies or favourable credit conditions in their home countries, can sell their products in Europe at prices that are below the market price. When it comes to awarding public contracts in China, European companies are in a disadvantaged position.

2. A common and integrated EU policy towards China?

The first important question for Brussels is whether the 27 EU member states can agree to pursue the 'Common Indo-Pacific Strategy' with determination and implement it coherently. If the EU cannot agree on a common and unified policy for the Indo-Pacific region, each country will pursue a policy that prioritises its own national interests and act unilaterally at the national level.

[14] Geir Moulson, "Germany presents long-awaited strategy on China, stresses economic security," AP News, 13 July 2023, https://apnews.com/article/germany-china-government-strategy-relations-e5d34b9df4618a1ace3490dc07a5f961.

[15] "Detlev Landmesser, "Wo die Abhängigkeit von China." Tagesschau,20.06.2023.

[16] German investment in China soars despite Berlin's diversification drive, Financial Times, Guy Chazan in Berlin August 13 2024.

[17]"Wo die Abhängigkeit von China am größten ist",ibid.

[18] As a first step towards effective 'de-risking', economist Jürgen Matthes from the German Economic Institute calls for a correspondingly comprehensive analysis. See Jurgen Matthes, "China-Abhängigkeiten der deutschen Wirtschaft: Mit Volldampf in die falsche Richtung," IW-Kurzbericht Nr. 68, 19 August 2022.

Already, the leaders of Germany and France prefer to travel to China alone to negotiate individual deals for their domestic companies. Nine EU members are already working together with China in the 17+1 format (now only 14+1 following the withdrawal of the Baltic states), which promotes regional cooperation between China and the countries of Central and Eastern Europe. As Russia is China's most important economic and security partner, it is expected that Beijing will try to expand its economic relations with Europe and side with the Europeans in the event of a deterioration in transatlantic relations under President Trump.

Member states such as Hungary and Greece have started to negotiate individually with Beijing in recent years as well, while the Chinese government and companies are pursuing a policy of 'divide and rule' against individual EU states. While some member countries, such as Germany and France, could be successful in economic relations with China, unfortunately Europe as a whole is facing an 'existential challenge' in the long term.

Recently, Mario Draghi, the former President of the European Central Bank, presented his report on the future of European competitiveness to the European Parliament on 17 September. In this report, Draghi clearly sets out Europe's economic and institutional weaknesses and makes recommendations on how Europe can finance and coordinate its policies in order to avoid falling behind on the world stage. Overall, he assesses that Europe's economic future is in serious danger.

The report also emphasises that European states and companies are investing far too little in Europe. The consequences are an inadequate education system, decaying infrastructure, too little innovation, and a lack of adaptability on the part of companies. Europe is in danger of being left behind when it comes to digital services and artificial intelligence. The EU has lost ground to its global competitors over the last two decades. To amend this, Draghi calls for comprehensive reforms and a reorientation of EU policy in order to keep pace with global competition against Chinese and American companies. However, he also adds that only a united and independent Europe that is economically, politically, and socially strong has an interest in uniting and joining forces against American and Chinese competition in the region as well as in the global economy.

As the strongest economy in the EU, accounting for almost 25 percent of the EU's total GDP, Germany could play a pioneering role in catching up with technological change and introducing reform measures at home. Berlin could then lead by example and convince its European neighbours to follow suit and work more closely together to create a new Europe. This could help the EU to become a global and regional economic power, with Germany.

3. EU/Germany–China relations under Trump

Berlin has set out to become a more engaged partner for China without jeopardising the economic and political interests of the EU and the US in the region. However, following the re-election of Donald Trump as President of the United States, most EU countries, including Germany, have begun to review their relations with Washington. One of the great advantages of the incoming Trump presidency is that we know his political and economic strategies and his stance on China and the Indo-Pacific region. President Trump pursued a protectionist trade policy towards both Europe and China during his first term in office. He imposed punitive tariffs on imports of steel and aluminium, citing US national security. Not only did he pursue a protectionist trade policy, but he also undermined the credibility of the World Trade Organisation (WTO).

Soon, the EU/Germany could find itself in the middle of two conflicting superpowers: China and US. On the one hand, the EU did not look favourably upon former President Trump's 'America First' policy during his first administration, which generally aimed to undermine international trade regulations and multilateral organizations. On the other hand, over the last eight years, the United States has continued to pursue a conflict-oriented approach to China by hampering bilateral economic and political relations. The disputes arising between the United States and China are not only focused on important economic issues, such as the bilateral trade deficit, but also include ideological and security matters. In contrast, the EU/Germany is more critical of China on trade and market opportunities. Europe seems to be primarily committed to preserving rules-based multilateralism and a liberal economic order, and the EU/Germany wants to make use of all options to preserve beneficial co-existence with China. When Trump takes office on 20 January 2025, the EU/Germany must prepare themselves on two fronts: first, how to manage and defend its transatlantic relations with Washington; second, developing a strategy for Brussels and Berlin to pursue vis-à-vis Beijing.

As underlined by Helena Legarda, Lead Analyst at MERICS, "If EU member states try to stay on the good side of both the US and China, the EU's China policy and de-risking strategy could become paralyzed. Without a clear strategy and set of objectives, Europe could turn into an arena of US-China competition."[19]

[19] "China Essentials Sonderausgabe: China im Jahr 2025," Merics, 5 January 2024.