

# Executive Summary

The dependence of Mittelstand enterprises on supplies from China

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## **Executive Summary**

The People's Republic of China ranks among Germany's most important trading partners. The close economic ties are increasingly viewed with scepticism, as China has been leveraging trade relations for political purposes. Consequently, policymakers in Germany and across the European Union (EU) are seeking to reduce unilateral economic dependencies on China. Despite supportive measures such as the EU Critical Raw Materials Act (CRMA), companies have so far undertaken so-called "de-risking"—which is meant to reduce reliance on Chinese raw materials and intermediate goods—only to a very limited degree.

### **Mittelstand enterprises are aware of existing dependencies**

Mittelstand enterprises engaged in trade with China are well aware of their dependencies on this country and the associated risks. The awareness, however, tends to be lower among companies that are positioned towards the end of a value chain or are part of particularly complex value chains.

### **Companies weigh political and economic risks against each other**

Mittelstand enterprises generally regard the current geopolitical risks associated with trade with China as significant. At the same time, however, they are also aware of the economic risks which would arise from terminating their long-established business relationships and establishing new partnerships. From the perspective of Mittelstand businesses, de-risking therefore often represents merely the substitution of one risk for another, which is not necessarily lower. Many Mittelstand enterprises consider this additional economic risk to be more serious than their dependence on China.

### **Multiple obstacles hinder de-risking**

Even when business leaders conclude that de-risking measures are worthwhile, their implementation faces a variety of obstacles. In some cases, this is simply due to the unavailability of alternatives, although such instances are rare. The main barrier relates to the high cost associated with de-risking. Due to price-sensitive demand on global markets, it is often difficult for companies to pass these costs on to their customers. In some cases, de-risking measures also entail significant bureaucratic burdens or are hindered or even rendered impossible by regulatory obstacles.

## **Improve framework conditions instead of mapping dependencies**

Many political efforts, particularly at the European level, focus on gathering information about existing dependencies. This approach, however, is to be viewed critically. On the one hand, the benefits of such information are questionable; on the other, its collection entails (bureaucratic) compliance costs for companies, arising from new monitoring obligations with regard to their direct and indirect suppliers. Moreover, in terms of the intended purpose—reducing dependence on China—these efforts can sometimes even be counterproductive. Attempts at diversification, for example, may fail because new suppliers refuse to disclose information about their supply chains.

Instead, the focus should be set on improving the overall framework conditions. In particular, trade barriers with third countries should be reduced, raw material partnerships strengthened, and regulatory obstacles—such as those affecting the trade of waste within the EU—lowered. This not only increases the opportunities to access potential alternative supply sources but can also unlock creative potential within companies, enabling them to find innovative ways to reduce dependence on China.

It is equally important to recognise that regulations in seemingly unrelated policy areas—such as environmental protection or healthcare—can adversely affect companies' de-risking initiatives.