

ANALYSIS

A Pro-Competitive Approach to the EU's China Problem

November 2026

Executive summary

China's state-driven economic model directs resources to politically prioritised sectors, contributing to overinvestment and distorted global competition. Combined with weak domestic demand, this pushes excess production onto foreign markets, putting downward pressure on prices and profitability for European firms at home and abroad. Chinese trade-distorting measures, in particular manufacturing subsidies, also undermine the rules-based trading system and violate the spirit, and possibly the letter, of the WTO. In this analysis, we propose a pro-competitive approach that addresses this challenge without sacrificing EU economic productivity and competitiveness. Ultimately, geopolitical realism must be matched by economic realism when designing policies.

In the current EU debate on new trade-restrictive measures to address the China problem, we see a gap between discussions at an abstract level and the likely effects on EU businesses in practice. To avoid adverse effects on competitiveness, any instruments should be selective, evidence-based and meet certain criteria. The EU's new steel regime has already imposed high downstream costs on EU firms and met resistance from close EU trading partners. It should not serve as a template for other sectors.

Irrespective of whether the EU applies existing trade-restrictive instruments more effectively or develops new ones as part of an enhanced toolbox, we consider the following criteria important:

- Since China is the problem, the response should target China – not other EU trading partners.
- Target Chinese measures that distort competition and create an uneven playing field, particularly industrial subsidies.
- Priority should be given to measures that are market-based, transparent and easy to apply, preferably tariffs. As far as possible, EU instruments should avoid price commitments and the freezing of import quantities or market shares.
- Additional red tape for EU businesses should be minimised.
- Avoid targeting intermediate goods as far as possible and take full account of the interests of downstream producers, exporters and users.

As before, EU trade policy instruments must be WTO compatible and comply with EU treaty requirements and rule-of-law standards. The fact that China can impose discretionary trade restrictions quickly and without transparency is not a reason for the EU to become more like China. The criteria apply to all options, but together they suggest that the best way forward is to develop a fast-track model for anti-dumping and countervailing duties by streamlining the procedures associated with current instruments.

Ultimately, trade restrictions cannot solve macroeconomic imbalances or EU competitiveness problems. They treat the symptoms, not the underlying causes. We therefore make the following additional recommendations.

- The EU should work with other countries and international institutions to pressure China to rebalance its economy. The focus should be on policies that boost household income, reduce precautionary savings and cut manufacturing subsidies.
- The EU should remain focused on single market reforms that channel savings into European investment, create framework conditions for broad-based innovation and allow European firms to exploit the full scale of the EU single market.
- The EU should design pro-competitive industrial policies that address clearly identified market failures while preserving incentives for competition and innovation.
- The EU should not design policies that draw European labour and capital into low-productivity sectors. The objective should be to expand EU production and exports in activities with high value-added and scope for quality upgrading. The vision should be 'global Switzerland' – not 'China's image'.
- The EU should continue to negotiate improved market access in China. In line with Commissioner Šefčovič' approach in the run-up to his visit to China, the EU should seek further concrete commitments to remove barriers affecting European trade and investment.

The lessons from the United States and China are different but complementary. The US experience illustrates the limits of trying to improve competitiveness through protectionism. US policies, including Section 301 of the 1974 Trade Act, have not improved the US current account while adding costs and red tape for US businesses. The Chinese experience illustrates the problems with trying to raise productivity through state-led support for certain types of production. Neither model is attractive for Europe. Instead, Europe should build a pro-competitive model that is sustainable in the long term.

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The analysis was written by Per Altenberg and benefited from valuable advice and comments from the following colleagues at the National Board of Trade Sweden: Shasa Aziz, Sophie Berner-Eyde, Mai Bojang, Louise Corselli, Alexander Dannerhäll, Aline Forsström, Anna Graneli, Jonas Hallberg, Isaac Ouro-Nimini Hansen, Vilgot Hassler, Maria Johem, Patrik Karpaty, Felinda Livgård, Ebba Lundqvist, Hillevi Pårup and Petter Stålenheim.

1 Introduction: The China problem

In Homer's epic The Odyssey, Odysseus famously navigates a narrow strait with deadly dangers on either side. On one side is Scylla, a terrifying six-headed monster, each head capable of seizing a sailor from a passing ship. On the other is Charybdis, a monstrous whirlpool. Similarly, the EU today faces hard choices in its trade policy towards China.

It is often argued that the EU's trade policy on China must be clear-eyed and recognise that China systematically uses economic policy, including trade policy, to advance geopolitical objectives. While this is undoubtedly true, geopolitical realism must be matched by economic realism when designing policies. Otherwise, we risk replacing one form of naivety with another.

Our recent report (Kommerskollegium 2026a) concludes that China's state-driven economic model systematically directs resources to politically prioritised sectors, contributing to overinvestment and distorted competition. Combined with weak domestic demand, this pushes excess production onto global markets, putting downward pressure on prices and profitability for European producers at home and in third markets. We argue that these are structural features of the Chinese economic system. Other analytical contributions draw similar conclusions (IMF, 2026a; MERICS, 2025, European Parliament, 2026).

In her 2026 State of the European Union address on 16 September 2026, the President of the European Commission, Ursula von der Leyen, described the EU's China problem as follows:

> 'Our deficit with China is now €1 billion a day. It has reached a tipping point. Some say the second China shock is looming, but it is already here! It shows in our communities and factories across our union. It leads to deindustrialisation in the industrial heartland of Europe. This is unsustainable, and this is why we are engaged in a dialogue with China to rebalance our trade. But this dialogue must lead to results. China's weaker domestic demand means it also needs our European market. So it is in both our interest to work together and find solutions.'

During Commissioner Maroš Šefčovič's visit to Beijing on 8–9 October 2026, the EU and China announced an understanding to limit EU imports of hybrid electric vehicles (HEVs) and plug-in hybrid electric vehicles (PHEVs) from China by 50 per cent compared with projected imports of 800,000 vehicles in 2026. The understanding is expected to be implemented through a safeguard measure, which could enter into force as early as December 2026.

On 15–16 October 2026, the European Council:

> ‘took stock of global macroeconomic imbalances, and [invited] the Commission to continue to engage in results-oriented dialogues, to make effective use of the EU’s instruments, and to urgently enhance the EU toolbox with new instruments to better address these imbalances.’

With this development in mind, the purpose of this analysis is to propose a pro-competitive EU approach to the strategic and economic challenge posed by China without sacrificing EU economic productivity and competitiveness.

First, we revisit the basic facts, economic theories and macroeconomic identities that form the backdrop to the EU’s China debate, including basic notions such as the current account balance and the implications of comparative advantage. We then examine how US trade policy currently addresses China, as well as China’s own model of industrial policy. Finally, we make a number of recommendations and offer cautions that together form a pro-competitive approach.

The EU’s China policy

EU characterises China simultaneously as a partner for cooperation, an economic competitor and a systemic rival. This three-legged approach has underpinned EU-China relations since 2019. Three years ago, it was complemented by a policy of ‘de-risking, not decoupling’, aimed at reducing critical dependencies and economic vulnerabilities while maintaining an open economic relationship with China.

In this analysis, the EU’s ‘China problem’ refers to the potential impact of China’s policies on *European economic performance*, particularly in the context of global imbalances and industrial overcapacity. Within the three-legged approach, it therefore falls under ‘China as an economic competitor’. It builds on our recent report *From Economic Growth to Economic State Craft – What China's trade policy means for Europe* (Kommerskollegium 2026a). Issues relating primarily to economic and national security (‘China as a systemic rival’), such as economic resilience (including a new diversification instrument), vulnerable dependencies and their potential weaponisation, dual-use technologies and cybersecurity have recently been analysed in a number of other reports (e.g. Kommerskollegium 2025, Kommerskollegium 2026b, Kommerskollegium 2026C).

2 The economics of the China problem

2.1 The current account balance as a policy target

A country's *current account,* or *aggregate trade balance*[1]*,* is not inherently good or bad. It reflects the relationship between aggregate savings and investment (IMF 2026b). A deficit mirrors low aggregate savings or high borrowing, while a surplus reflects high savings or low consumption relative to investment. In the national accounts, a current account surplus is mirrored by a financial account deficit (net capital outflows). According to the IMF (2026c), 'any attempt to change a country's external position must operate through policies that alter saving and investment decisions.' Consequently, an aggregate current account surplus, or any specific current account balance, is unsuitable as a policy target. Instead, the IMF aims to identify 'excessive balances'. Excessive balances arise when economic fundamentals 'are amplified by policy-induced distortions that systematically raise saving or depress investment – or vice versa – beyond levels implied by fundamentals and desirable policies'.

Bilateral trade balances are even less useful as a target for economic policy. The example of how we as individuals run a trade deficit with the grocery store but a surplus with our employer is often used to illustrate this. Sweden offers another example. Last year, Sweden ran an overall surplus in trade in goods of SEK 320 billion. At the same time, it had a SEK 233 billion deficit in trade in goods with the rest of the EU. There is no reason this should concern Sweden, much less serve as a policy target. As shown by the launch of last year's 'Liberation Day' tariffs, however, the Trump administration places great emphasis on bilateral trade balances. Indeed, as Thierry Mayer, Professor of Economics at Sciences Po, argued at the time, the guiding logic of the tariff formula presented in the White House Rose Garden ceremony on 2 April 2025 was 'the obsession for President Trump with bilateral deficits' (Jones and Nilsson-Julien, 2025).

The distinction between aggregate and bilateral trade balances matters. An aggregate deficit or surplus may reflect underlying macroeconomic or policy distortions, such as unusually low or high savings, low consumer confidence or a large fiscal deficit. But trade barriers aimed at individual countries cannot address such underlying distortions.

2.2 Comparative advantage

China's industrial policy can shift relative prices and artificially strengthen firms in selected sectors, but it cannot abolish fundamental economic laws. By definition, no economy has a comparative advantage in everything. As the IMF (2026b) points out, 'industrial and trade policies reallocate activity, boosting output and net exports in targeted sectors while reducing them elsewhere.' The fact that China's economic model generates substantial problems for its trading partners therefore does not mean that China will outcompete the EU, or other countries, in all sectors with devastating

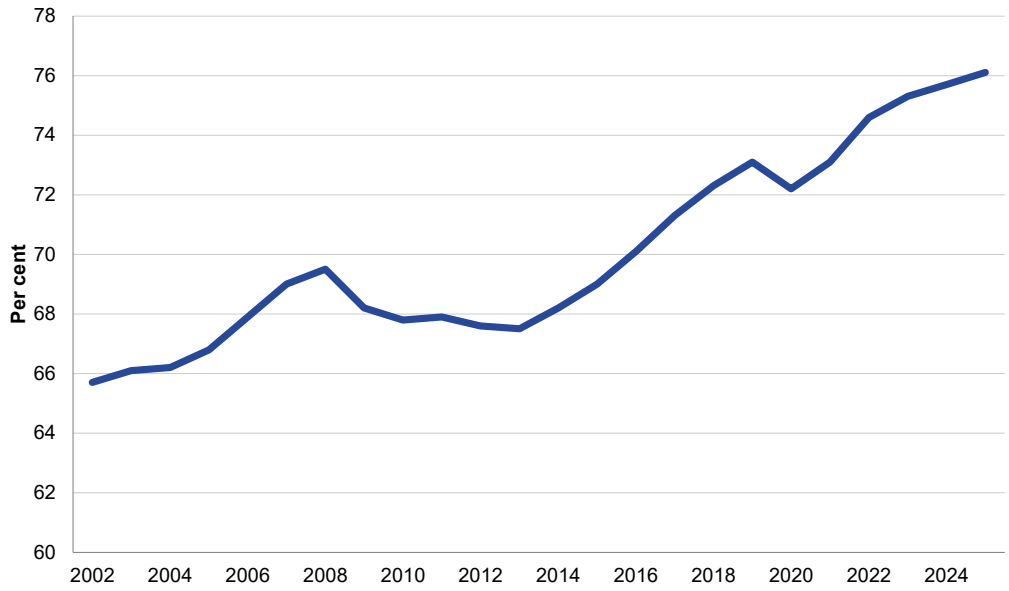
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[1] The trade balance is the largest component of the current account. Besides the balance of trade for goods and services, the current account also includes net income (dividends, interest, and wages earned abroad) and net transfer payments (foreign aid, remittances, and pension payments).

effects on output and employment. During China's export surge in the 2000s, the EU in fact experienced a long period of *rising* employment (Figure 1a) and falling unemployment (Figure 1b). The two periods of rising unemployment shown in Figure 2b from 2009 to 2013 and from 2020 to 2021, were caused by very different shocks.

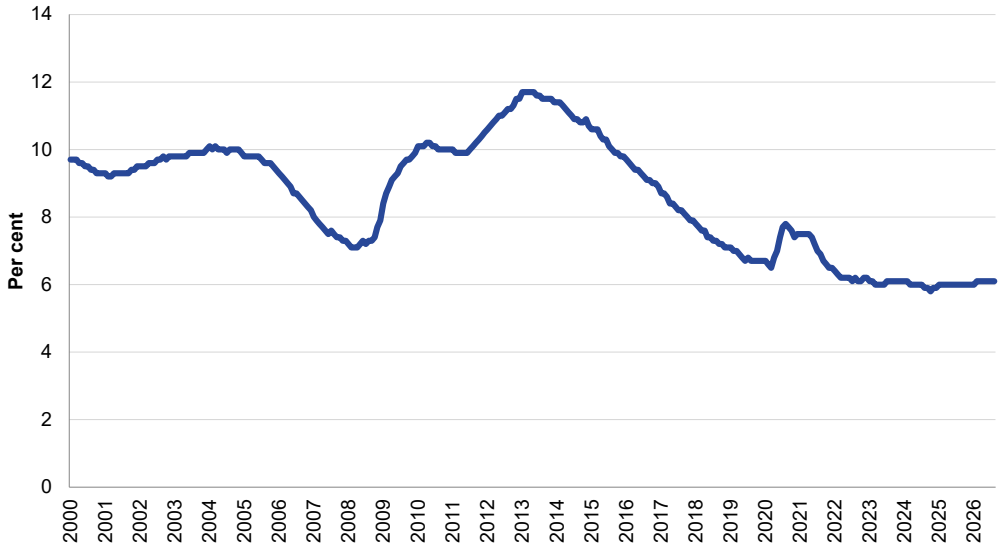
The challenge for Europe, therefore, is not to defend all economic activity against Chinese imports, but to distinguish between cases in which Chinese distortions create genuine economic or security problems, and those in which adjustment and specialisation are a more efficient response. What is needed is a targeted response, not blanket protectionism.

Figure 1a. EU rate of employment 20–64 years



Source: Eurostat

Figure 1 b. Unemployment in the EU



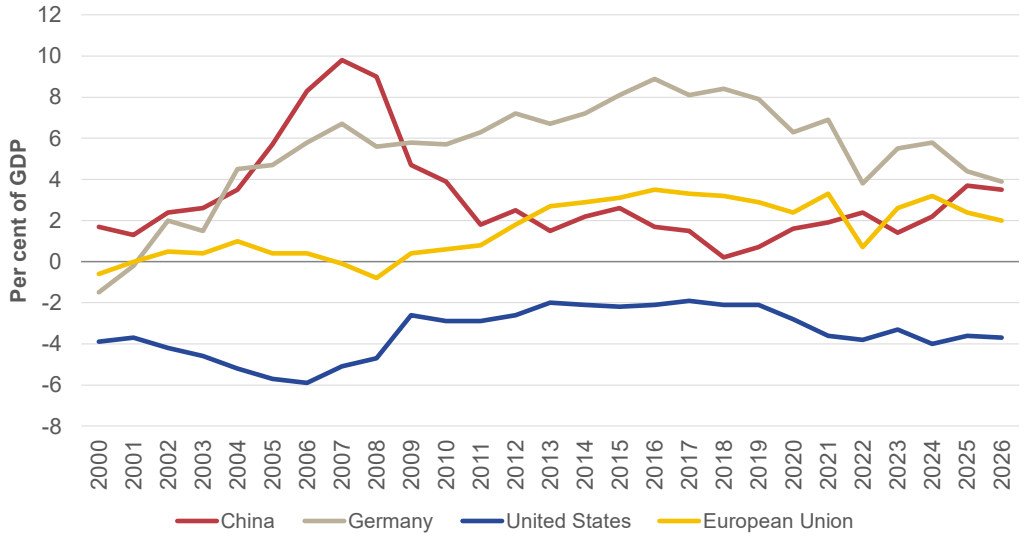
Source: Eurostat

2.3 China's current account surplus in comparison

As shown in Figure 2, China runs a large current account surplus with the rest of the world. In 2025, it was 3.5 per cent of GDP. According to the IMF's 2026 excessive balance assessment, China's surplus 'was stronger than the level implied by medium-term fundamentals and desirable policies' (IMF, 2026a). The upward trend in China's current account surplus after 2018 reflects weak domestic demand and a high savings rate. These, in turn, can be traced to China's growth model and macroeconomic policies, as well as to a weak social safety net, precautionary saving, falling property prices and unfavourable demographic trends (Kommerskollegium, 2026a).

What is sometimes lost in the debate is that the EU and several EU member states run current account surpluses of similar magnitude. EU export industries remain competitive worldwide and analysts agree that the downward trend in the surplus of countries such as Germany, from nearly 9 per cent of GDP before the pandemic to 4 per cent in 2026, is explained by higher domestic spending and lower savings during this period – an explanation in line with standard macroeconomic theory.

Figure 2. Current account balance for selected countries



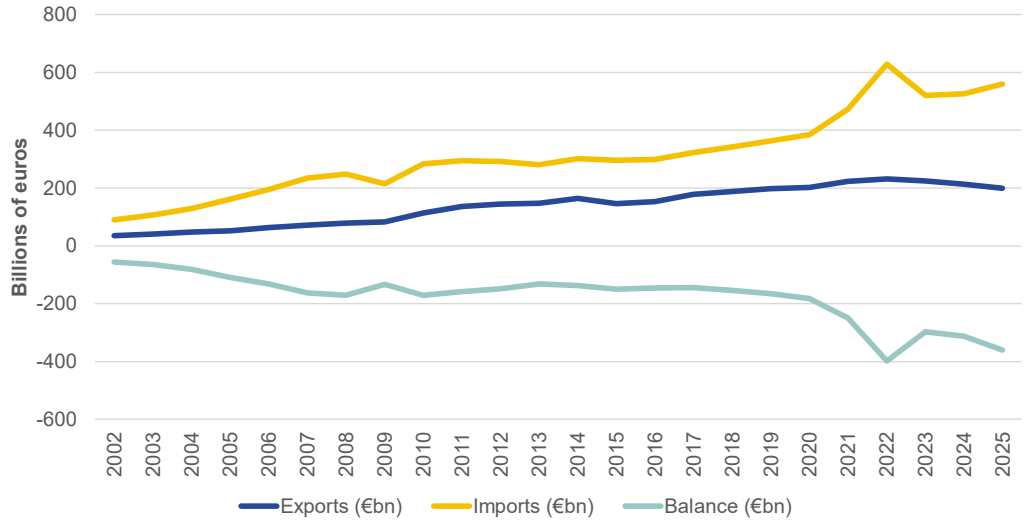
Source. IMF 2026

Since the EU's concern is competition with China globally – in China, in third-country markets and in the EU – the EU's aggregate current account, or trade balance, is more informative than the bilateral balance in trade in goods. The EU's stable current account position over the past 10–15 years contradicts the notion that China's integration into global markets has caused a sudden economy-wide collapse in EU competitiveness. Chinese-related distortions clearly create problems for the EU, but there is no reason to panic.

2.4 The EU's bilateral trade with China

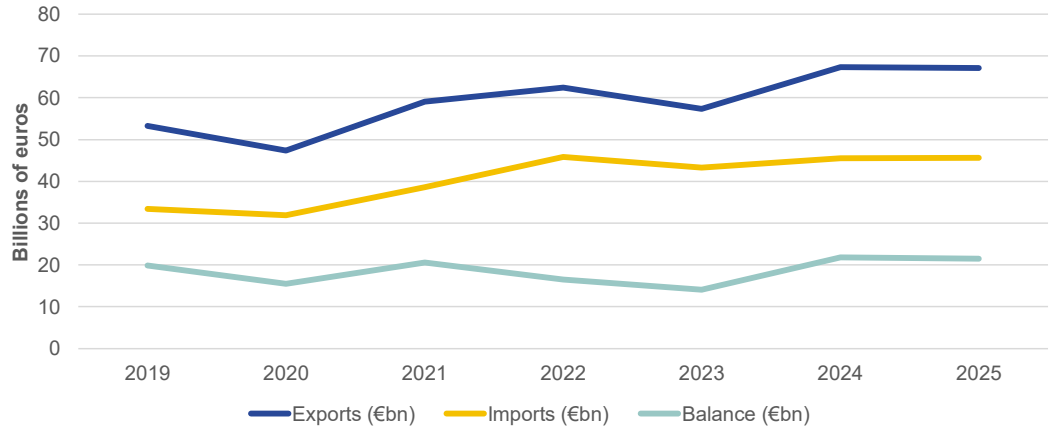
The EU's bilateral deficit in trade in goods with China is large and has doubled since 2019 (Figure 3a). For trade in services, the picture is different. The EU runs a surplus with China, although it is much smaller than the goods deficit (Figure 3b).

Figure 3a. EU trade in goods with China



Source: Eurostat

Figure 3b. EU trade in services with China



Source: Eurostat

EU goods imports from China were 6 per cent higher in 2025 than in 2024. During January-August 2026, EU goods imports from China were 9 per cent higher than in the same period in 2025. This is a substantial increase, particularly in sectors such as HEVs, PHEVs and chemical products.

2.5 A ‘China Shock’ for the EU?

In their original ‘China Shock’ paper, Autor, Dorn and Hanson (2013) found that US local labour markets more exposed to Chinese imports experienced declines in manufacturing employment, wages and labour force participation. Their main specification attributed 25 per cent of the decline in US manufacturing employment at the time to Chinese import competition. Other studies have criticised their focus on local labour markets and found smaller labour market effects for the US as a whole (Caliendo, Dvorkimn and Parro, 2019).

Despite von der Leyen’s assertions in her State of the union address, the employment effects of increased imports from China are less well known in Europe. As Figures 1a and 1b show, unfavourable labour market trends in the EU occurred during the global pandemic and in the aftermath of the global financial crisis and subsequent debt crisis in the EU. There is, however, some evidence of a ‘China shock’ in the earlier period leading up to the global financial crisis, particularly in France. Malgouyres (2016) estimates that Chinese import competition accounted for 13 per cent of the decline in French manufacturing employment during 2001–2007. Aghion, Bergeaud, Lequien, Melitz and Zuber (2024) find that Chinese competition in French firms’ output markets reduced sales, employment and innovation, with negative effects concentrated among less productive firms. At the same time, they find that increased access to Chinese intermediate inputs had a *positive* effect on employment, sales and productivity.

2.6 China’s manufacturing subsidies

According to the OECD (2026), Chinese manufacturing firms receive substantially more government support than their competitors in other countries. They estimate that Chinese firms received subsidies equivalent to six times those of European firms relative to revenue between 2005 and 2024. The most heavily subsidised sectors include solar panels, semiconductors, aluminium, steel and shipbuilding.

The OECD also finds that industrial subsidies have distorted global competition and market shares. Subsidies explain approximately 22 per cent of global market share gains by expanding firms between 2005 and 2023. For Chinese firms, the corresponding figure is almost 60 per cent, indicating that government support has played an important role in their expansion. However, the OECD finds no statistically significant positive effects on productivity or profitability. In other words, subsidies have helped firms expand their market shares but have not improved the performance of the Chinese economy as a whole.

By supporting commercially unsustainable production and investment, Chinese subsidies therefore contribute to excess capacity, downward pressure on prices and the displacement of more efficient competitors. Such effects are particularly relevant in capital-intensive industries characterised by high fixed costs and economies of scale.

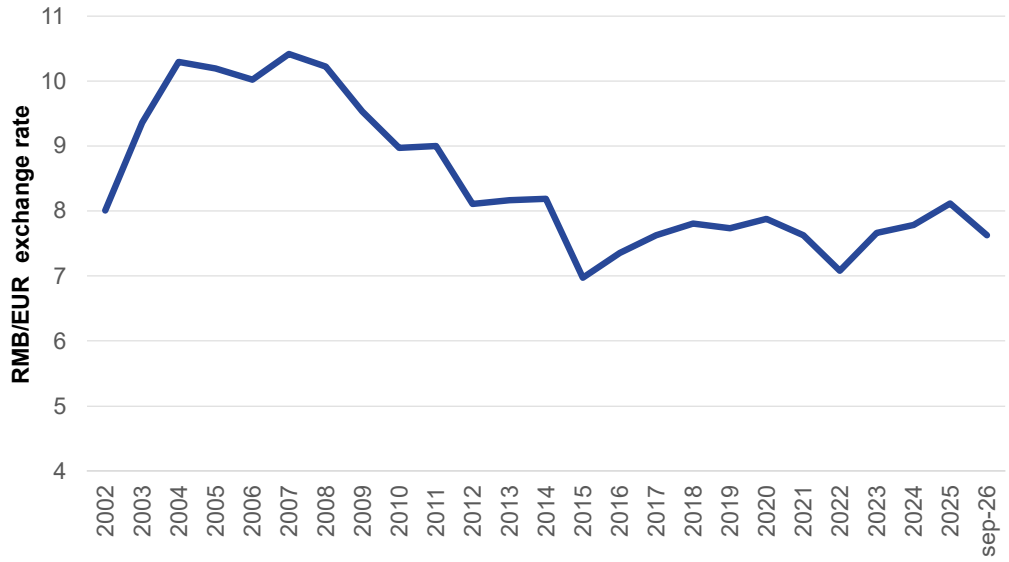
2.7 The significance of the exchange rate

China’s large external surplus has renewed calls from trading partners and international observers for an appreciation of the renminbi. While analysts agree that the currency is

undervalued, by 12–20 per cent according to the IMF, Figure 4 indicates that its current valuation is not extreme by historical standards. The main problem is that the real exchange rate depreciation since 2021, driven by China's low inflation and periods of falling prices, has not been accompanied by a nominal appreciation of the renminbi. Over the longer term, China's higher growth rates relative to other economies would also suggest gradual currency appreciation, which has not occurred.

Figure 4. Renminbi exchange rate against the Euro

Higher CNY/EUR = weaker renminbi



Source: ECB

Gopinath, Gourinchas and Rey (2026) argue that focusing on the exchange rate risks confusing a symptom with the underlying cause of China's external imbalance. China's exchange rate and current account surplus largely reflect the same domestic imbalance: exceptionally high savings, weak household consumption and a growth model excessively reliant on the tradable sector. An undervalued currency therefore does not necessarily imply currency manipulation.

This distinction matters for policy. Forcing a currency appreciation without strengthening domestic demand could put further downward pressure on Chinese economic activity and prices, causing part of the nominal appreciation to be offset. Sustainable rebalancing requires policies that increase Chinese household consumption and end the practice of directing Chinese labour and capital towards the tradable sector.

3 The Chinese model (effects on China)

While Chinese industrial policies constitute a part of the EU's China problem, it is far from clear that they provide a successful model for China itself (Wright, 2026). The external imbalances that cause problems for the EU are closely linked to domestic problems in the Chinese economy. On the one hand, Chinese policies have expanded manufacturing capacity and strengthened China's position in global markets. On the other, they have contributed to lower productivity growth, overinvestment, weak domestic demand and deflationary pressures. Below, we summarise some of the problems associated with the Chinese model.

3.1 High savings and weak domestic demand

China continues to save an exceptionally large share of its national income. According to the IMF (2026a), gross national saving amounted to 42 per cent of GDP in 2025, while capital formation amounted to 39 per cent. The gap between saving and investment is mirrored in China's growing current account surplus.

Household consumption remains correspondingly low. It accounted for around 40 per cent of GDP in 2024, compared with an average of around 53 per cent in middle-income economies. The IMF (2026a) attributes high household saving partly to inadequate social protection and argues that strengthening the social safety net would reduce precautionary saving and help rebalance the economy.

The problem has become more pronounced following the downturn in China's property sector. The result has been an economy capable of producing considerably more than domestic demand can absorb.

3.2 Falling prices, low profitability and 'involution'

The problems with the Chinese industrial policy model are increasingly being felt by Chinese firms. China's producer prices fell by 2.6 per cent in 2025, following declines in previous years.

Chinese authorities have themselves identified excessive competition in sectors including electric vehicles, steel, solar panels, batteries and chemicals. The combination of rapid capacity expansion and weak domestic demand has contributed to intense price competition and pressure on profitability. This is the background to China's 'anti-involution' campaign. The authorities are attempting to discourage excessive price competition, restrict local industrial subsidies and reduce excess capacity. The 'anti-involution' policy represents an acknowledgement that policies encouraging capacity expansion have become counterproductive. Overcapacity[2] is not simply a problem that China exports to its trading partners. It is also a symptom of distortions within the Chinese economy.

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[2] There is no generally accepted definition of overcapacity in economics. According to Boullenois et al. (2024), however, overcapacity arises when production capacity exceeds the level that can be absorbed under normal market conditions and, thus, remains underutilised.

3.3 A negative effect on productivity

According to the OECD's subsidies synthesis report (OECD, 2023) government support increases manufacturing capacity but is negatively correlated with firm productivity. In fact, the OECD finds that the negative correlation 'is very strong for the 10 per cent of firms with the highest proportion of support'.

The negative effects are even clearer in studies of productivity effects arising from within-industry reallocation. Belloc and Lofaro (2026) find that subsidies encourage entry into targeted industries, but that entrants are on average 5.5 per cent less productive than entrants into comparable unsubsidised industries. Similarly, Garcia-Macia, Kothari and Tao (2025) find that industrial policies encourage excessive production in targeted sectors while diverting capital and labour from potentially more productive uses. They estimate that these distortions reduce aggregate total factor productivity in China by around 1.2 per cent and GDP by around 2 per cent.

3.4 Summary

Overall, China's industrial policy has succeeded in expanding production in targeted sectors while failing to increase economy-wide productivity. China has been successful in scaling new technologies and creating highly competitive firms in sectors such as electric vehicles, batteries and renewable-energy. But this should not be taken to suggest that Chinese industrial policies reflect long-term prudent and strategic planning with perfect foresight. Instead, the model has contributed to a range of problems that the EU would be wise to avoid.

4 The US model (to address China)

Since 2018, the US has maintained high tariffs on a large share of imports from China, initially through Section 301 measures and subsequently alongside a broader mix of trade restrictions and domestic-preference policies. Beyond tariffs, the US also applies a range of other measures, including market access restrictions on Chinese technology, investment screening and export controls. It also applies sanctions to Chinese companies and has introduced restrictive measures targeting Chinese shipbuilding, which are currently suspended until 9 November 2026.

At the same time, China has been able to leverage US dependencies on Chinese critical raw materials to de-escalate US trade policy towards China, illustrating the complexity and interdependence of the US–China trade relationship.

The US experience provides a useful test of whether protectionism and unilateral trade policy can strengthen competitiveness. Have US tariffs on China reduced global imbalances? Have they achieved their stated objectives relating to the trade balance, manufacturing employment etc?

4.1 Increased current account deficit

Since 2018, the US current account deficit has increased from 2 to 4 per cent of GDP (see Figure 1). During the same period, China's current account surplus has widened from 0.2 per cent to almost 4 per cent. After eight years of high US tariffs on China, nothing indicates that they have helped to reduce global macroeconomic imbalances. While this observation is not causal, it is consistent with current research on the topic. In a recent synthesis paper on the links between industrial policy, tariffs and global trade imbalances Gourinchas et al. (2026) conclude that '[tariffs] are poorly suited to rebalancing. Without accompanying changes in fiscal or saving behaviour, they risk fragmenting trade and generating inefficient distortions while leaving external balances largely untouched'.

4.2 No increase in manufacturing employment or production

US manufacturing payrolls were 253 000, or 2 per cent, lower in August 2026 than in January 2025, according to official statistics. Autor, Beck, Dorn & Hanson (2026) furthermore find that the China tariffs applied by the US since 2018 have not increased employment in protected sectors. Despite the frequent use of Buy American policies under the Trump and Biden administrations, there has been no surge in US manufacturing employment.

4.3 Tariffs at the expense of US firms and consumers

The cost of the tariffs has been borne overwhelmingly by US businesses and consumers rather than by foreign exporters. A growing empirical literature reviewed by Clausing and Obstfeldt (2026) finds that at least 90 per cent of the burden of the 2025 tariffs fell on US buyers of imported goods. This is broadly consistent with

evidence from the China trade war during the first Trump administration, when tariffs were passed through almost fully into the prices paid by US importers.

Tariffs operate as a tax on the domestic economy. Firms that rely on imported intermediate inputs face higher production costs and must either accept lower margins or raise their own prices, including on goods produced in the United States. Consumers bear the burden through higher prices and reduced purchasing power.

4.4 More red tape and uncertainty – ‘death by a thousand paper cuts’

Beyond the cost factor, observers agree that uncertainty, administrative costs and red tape associated with US trade policy have increased over the past few years. According to Bloomberg (2025), the administration's trade policy is ‘piling up mountains of extra work’ to comply with frequently changing tariffs and customs requirements, including requirements to document the origin, value and composition of inputs embedded in imported products. One trade compliance adviser summarises the cumulative burden as: ‘death by a thousand paper cuts’.

Since Bloomberg conducted its investigation in September 2025, the administration has introduced further vetting, certification and supply-chain disclosure requirements. Its June 2026 Executive Order on customs enforcement explicitly mandates new requirements, including additional importer identification and ownership information, recurrent vetting, enhanced supply-chain disclosures and certifications, detailed information on production methods, and the submission of documentation supplied to foreign customs authorities.

The US experience with Section 301

In the EU debate, US Section 301 is sometimes cited in discussions of new EU instruments (CER, 2026). Without explicitly referring to its US counterpart, a recent French-German non-paper also proposes new EU trade-restrictive instruments ‘for decisive and systemic reaction’. Given the extensive US experience with Section 301, we summarise it below.

Section 301 was enacted as part of the Trade Act of 1974 against the backdrop of perceived weaknesses in the GATT system. GATT disciplines did not cover many non-tariff barriers, and dispute settlement was weak. Section 301 therefore empowered the President to retaliate against foreign practices deemed ‘unjustifiable or unreasonable’ and burdensome to U.S. commerce.

During the 1980s and early 1990s, Section 301 was an important US trade policy instrument. Congress also increased administrative discretion by allowing the USTR to self-initiate investigations rather than rely solely on petitions from private interests.

After 1995, WTO disciplines changed how Section 301 was used. In the Uruguay Round Statement of Administrative Action (SAA), the US committed to using WTO dispute settlement rather than retaliating unilaterally when an alleged foreign practice was covered by WTO rules. Section 301 thus became primarily a procedural gateway to WTO dispute settlement. In a 1999 EU challenge to Section 301, a WTO panel concluded that Section 301 could coexist with WTO obligations only because the US had committed through the SAA not to use it for unilateral retaliation in disputes covered by WTO rules.

When Donald Trump took office in 2017, he revived Section 301 as a unilateral instrument. The central cases concerned China. A 2017 investigation concluded that various Chinese practices were unreasonable or discriminatory. Instead of litigating these practices at the WTO, the US imposed successive rounds of tariffs. Eventually, Section 301 tariffs covered $370 billion of Chinese imports.

Under Trump, Section 301 was no longer used only to remedy the 'unjustifiable or unreasonable' practice identified in the investigation. Instead, the administration broadened its interpretation and shifted its use from enforcement to bargaining leverage. Eventually, the Trump administration threatened Section 301 action in pursuit of objectives far removed from the original complaint. The Biden administration largely retained Trump's Section 301 tariffs on China. In 2025, the Trump administration expanded section 301 measures against China further.

The most recent use of Section 301 has introduced tariffs on a range of trading partners, including China and the EU, over forced labour accusations. The president's power to use Section 301 in this broad sense is currently being contested in a case before the U.S. Court of International Trade.

The US experience illustrates the risk that discretionary trade instruments become susceptible to special-interest influence. Research on Section 301 tariffs under Trump finds that lobbying firms were substantially more likely to obtain tariff exclusions, with the effect particularly pronounced for large firms (Eldes, Lee and Osgood, 2025). Other research (Lopatin, Mendoza, and Westenberg, 2023) finds that the probability of obtaining an exclusion was related to local political support for the incumbent US administration.

4.5 Summary

The US shift towards protectionism has not been successful by almost any measure. The EU would be wise to avoid copying US trade policies as a way to improve European productivity and competitiveness.

Where the US has been more successful is in developing high-productivity, dominant technology platforms that are profitable and wield substantial market power beyond the US market. According to Aghion (2026), this can be explained by institutions, predating the Trump-Biden era, that support cumulative innovation. This offers important lessons for the EU about the relationship between capital formation, innovation and scale or market size. That insight is broadly, if imperfectly, reflected in the Draghi agenda, the EU Single Market Strategy and the One Europe, One Market Roadmap, to which we return in section 5.

5 A pro-competitive EU approach

Despite broad agreement on the nature of the China problem, there is no easy solution. The EU must navigate between Scylla and Charybdis. Given the need to chart a path that addresses the China problem effectively while avoiding negative effects on productivity and competitiveness, we offer the following recommendations and cautions.

5.1 Trade-restrictive options

It would be naïve to think that trade restrictions on China or other countries can solve macroeconomic imbalances or EU competitiveness problems. There is no theory or evidence to support that view. At the same time, China's political and economic model creates large global imbalances, and many policies associated with that model violate the spirit, and possibly the letter, of the WTO. Consequently, the EU must consider second-best options while not losing sight of the medium- and long-term solutions discussed in sections 5.2–5.6. To be compatible with a pro-competitive approach, such second-best options should meet a number of requirements.

1. Since China is the problem, our response should target China – not other EU trading partners.
2. Target Chinese measures that distort competition and create an uneven playing field, particularly industrial subsidies.
3. Priority should be given to measures that are market-based, transparent and easy to apply, preferably tariffs. As far as possible, EU instruments should avoid price commitments and the freezing of import quantities or market shares.
4. Additional red tape for EU businesses should be minimised
5. Avoid targeting intermediate goods as far as possible and take full account of the interests of downstream producers, exporters and users.

Any EU trade policy instruments should comply with EU Treaty and rule-of-law standards. This means that they should be WTO-compatible, transparent, tightly defined in scope and objective, proportionate, and demonstrably capable of achieving its stated aim. The fact that China can impose restrictions quickly and without transparency or legal safeguards is not a reason for the EU to become more like China.

The criteria apply to all options, but together they suggest that the best way forward is to develop a fast-track model for anti-dumping and countervailing duties by streamlining the procedures associated with current instruments.

5.1.1 Since China is the problem, target China

Since China is the source of the distortions the EU seeks to address, our measures should target China rather than restrict imports from other trading partners. Extending restrictions to countries that are not responsible for the underlying problem would raise costs for European businesses, undermine diversification efforts and risk

damaging relations with close trading partners. The EU's new steel regime illustrates these risks. Any broader application of trade restrictions should therefore be avoided.

5.1.2 Target trade-distorting measures

As discussed in section 2.6, Chinese industrial subsidies distort competition by artificially lowering production costs, encouraging excess capacity, putting downward pressure on prices and allowing firms to expand market shares without corresponding productivity gains. EU measures should therefore focus on correcting these distortions rather than restricting Chinese competition more broadly. Anti-dumping measures and countervailing duties are particularly well suited to this purpose, since they address the problem as businesses experience it while preserving market-based competition. Again, this suggests that the EU should streamline existing trade defence procedures rather than introduce broad-based trade restrictions.

5.1.3 Tariffs as the preferred instrument

EU countervailing duties on battery electric vehicles (BEVs) have reduced but not removed competition from China. Imported BEVs from China as a share of total European (EES, UK) BEV sales have declined from 22 per cent in 2024 to about 17 per cent during the first half of 2026 (T&E, 2026). The brand that has mainly lost market share during this period is US-owned Tesla. This suggests that distortions can be addressed without removing market signals or import competition.

When there is a choice between tariffs or duties, including trade defence measures in the form of tariffs or duties, and other instruments such as quantitative restrictions, tariff-rate quotas (TRQs), licences, price controls and voluntary export restraints (VERs), tariffs should be the preferred instrument. This ‘protectionism hierarchy’ is reflected in the WTO in that instruments other than tariffs or duties are banned under the GATT (article XI), and provisional safeguard measures must ‘take the form of tariff increases’ (article VI of the Agreement on Safeguards). There is sound economic reasoning behind this. Raising import prices without freezing import quantities minimises distortions. Tariffs also generate revenue for the EU and are mostly simple and transparent. Set at the appropriate level, they reduce import competition without eliminating it.

We therefore do not share the recommendations by the Centre for European Reform (CEF, 2026) or the Institute Jacques Delors (IJD, 2026) that the EU generalise its new (2026) steel regime by applying it to other sectors.[3] TRQs based on historical trade volumes, combined with a prohibitive tariff beyond the quota, would risk freezing

[3] Under the new steel regulation (EU 2026/1384), the EU applies a 50 per cent out-of-quota tariff combined with sharply reduced quota volumes for all countries. The CEF (2026) proposes that the EU apply the same approach to other sectors. They then move on to propose a ‘European Section 301’ that most likely violates EU WTO obligations. The IJD (2026) also wants to generalise the logic behind the new steel regulation. Their model pays close attention to WTO compatibility but is complex and applies to a broad range of EU trading partners, not only China. It targets quantity rather than price, and proposes VERs in combination with a TRQ and prohibitive out-of-quota tariffs. The IJD proposal also requires new rules of origin that they call rules of ownership. The fact that the trading partner’s commitment to restrain exports are linked to TRQ preferences, does not transform the VER into something else.

existing patterns of production and market shares. They would protect European producers irrespective of productivity or technological potential and would disadvantage small and medium-sized enterprises. In our view, this would not be pro-competitive.

5.1.4 Avoid additional red tape for EU firms

Trade restrictions impose costs on European businesses not only through higher import prices but also through administrative burdens and uncertainty. As the US experience shows, complex and frequently changing trade measures can generate substantial compliance costs, including additional requirements relating to rules of origin, supply chains and customs documentation. New EU instruments should therefore be designed to minimise administrative burdens, avoid unnecessary reporting and certification requirements, and ensure predictable conditions for EU firms. These considerations are particularly important for small and medium-sized enterprises, which have fewer resources to manage regulatory complexity.

5.1.5 Avoid targeting intermediate goods

Research on French firms reveal contrasting 'China shock' effects for final and intermediate goods. While competition from imported final goods can adversely affect domestic producers, access to cheaper or better intermediate inputs strengthens downstream firms and supports sales, employment and innovation (Aghion, Bergeaud, Lequien, Melitz and Zuber, 2024). A new Swedish report confirms that imports of intermediate goods have positive effects on productivity and employment (SNS, 2026). Irrespective of the legal instrument or type of measure, the EU should therefore pay particular attention to the effects on downstream producers, exporters and users, as well as to the availability and cost of alternative inputs. We see a substantial risk that new EU trade-restrictive instruments would pay lip service to this lesson while ignoring it in practice.

5.2 Implement the Single Market Strategy

The EU should remain focused on single market reforms that channel savings to European investment, create the right framework conditions for broad-based innovation and allow European firms to exploit the full scale of the EU single market.

This priority should be understood as part of a broader reform agenda. The objective is to make the Single Market function as one market in practice: reducing regulatory and administrative barriers to cross-border trade in goods and services, ensuring more consistent implementation and enforcement of EU rules, and improving the conditions for capital, data, skills and innovation to move and scale across the Union. The Single Market Strategy and the One Europe – One Market roadmap provide politically actionable priorities within this broader reform agenda, but they should not be treated as exhaustive.

5.3 Design pro-competitive industrial policies

The field of economic research awarded the 2025 Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel (Philippe Aghion, Peter Howitt and Joel Mokyr) is likely to shape the industrial policy debate for years to come (see Aghion, 2026). The EU must not disregard it. Below, we set out what we see as some of the main policy implications of this research, together with the broader body of 21st-century research on innovation, productivity, trade and technology diffusion (see Kommerskollegium, 2023). We refer to this approach as 'pro-competitive'.

According to Aghion (2026), Europe is stuck in a middle-income trap in which productivity growth is driven mainly by imitation rather than innovation. He offers the following policy advice:

> 'As Mario Draghi (2024) puts it very clearly in his recent report to the European Commission, moving from imitation-based to innovation-based growth in Europe requires: (i) a truly single market for goods and services: (ii) more long-term funding for basic research; (iii) an adequate financial ecosystem to encourage break-through innovation and the growth of innovative firms: venture capital, institutional investors (pension funds and/or mutual funds), and a unified European capital market; (iv) the equivalent of the United States' ARPAs (Advanced Research Projects Agencies) in key areas such as defence and AI, energy and green transition, and biotech, to better reconcile industrial policy with competition policy.'

Aghion's and Howitt's research also shows that successful industrial policy must continue to expose firms to competition. Successful activities should be allowed to expand, while protection or support for unsuccessful ventures should be phased out. The risk is that a combination of subsidies and trade protection, local-content requirements, procurement preferences and restrictions on foreign investment shields European producers from precisely the competitive pressures that drive innovation and productivity. Again, the recent US experience should serve as a cautionary tale rather than a model for the EU.

In our view, these considerations are relevant across several current and forthcoming EU initiatives, including the Industrial Accelerator Act, Chips Act 2.0, the Cloud and AI Development Act, as well as new instruments to address global imbalances. A pro-competitive industrial policy must preserve competition within the Single Market. Interventions should target market failures such as knowledge spillovers, underinvestment in R&D, coordination failures or climate-related negative externalities. National security considerations may also justify intervention.

5.4 Avoid steering European resources into low-productivity sectors

A fundamental EU concern, expressed by Ursula von der Leyen in her State of the Union speech, is that Chinese subsidies and other policies that distort competition put downward pressure on prices and profitability in several key sectors in the EU's industrial heartland. This harms both Chinese and European firms, but it carries greater

social and political costs in a social market economy and democracy such as the EU. The subsidies create artificial cost advantages for Chinese firms and shift resources towards the subsidised sectors without generating productivity gains in China.

The EU should respond to this challenge without copying Chinese policies. Broad measures designed to match China in sectors with persistently low profitability risk drawing European labour and capital away from more productive uses. Ultimately, profitability, investment and growth would suffer. Our broader objective must remain the expansion of European production and exports in activities with high value added, strong profitability and scope for quality upgrading. The EU vision should be 'global Switzerland' rather than 'China's image'. Exceptions for genuinely strategic goods where vulnerable dependencies exist should be evidence-based, selective and explicit.

5.5 Put coordinated pressure on China to reflate its economy

While China's economic problems are structural, recent 'anti-involution' efforts suggest that the Chinese government increasingly recognises the need to rebalance at least some sectors of its domestic economy. This is unlikely to translate into a broader shift from production-led to consumption-led growth, but it may indicate that there are sectors in which Chinese and EU rebalancing interests overlap.

For the EU, stronger Chinese domestic demand would address the problem closer to its source. The EU should work with other major economies, including the US, to exert coordinated pressure on China to rebalance its economy. The focus should be on policies that boost household disposable income, reduce precautionary savings and scale back production subsidies.

Such an approach would also create scope for cooperation with China rather than framing the entire problem as a bilateral trade conflict. Stronger Chinese domestic demand is one of the few potential responses to global imbalances that could benefit China, the EU and the wider trading system at the same time.

5.6 Engage China in negotiations to roll back trade barriers

While much of the current EU debate concerns Chinese competition in the EU and in third-country markets, shrinking EU market shares in China are also part of the problem. So far in 2026, the aggregate value of China's goods imports has grown by 22 per cent, but EU exports to China have decreased by 2 per cent. In other words, European firms have captured little, if any, of the 2026 increase in Chinese import demand. This follows a 6.5 per cent fall in EU exports to China in 2025. In line with Commissioner Šefčovič's approach during his October 2026 visit to China, the EU should therefore continue to seek a negotiated market-access package with China, focusing on a limited number of commercially significant barriers where measurable improvements can be achieved. As always, it is important to be realistic and to prioritise issues where interests overlap. From an EU perspective, priority areas might include services, public procurement, SPS and TBT issues, as well as subsidies and issues relating to competitive neutrality. The objective should be to address concrete problems with concrete commitments that can translate relatively quickly into additional trade.

6 Concluding remarks

It would be historically inaccurate to suggest that international trade operated on a level playing field before China joined the WTO. Ask almost any developing country whether it agrees with the notion that the playing field is rigged *against* the US or Europe, now or in the past. Countries have always differed in institutions, tariffs, subsidies and industrial policies. The gains from trade do not disappear because the playing field is uneven.

As Philippe Aghion and Peter Howitt showed in their Nobel prize-winning research, countries can remain competitive at the technological frontier only if they maintain framework conditions that support innovation and allow structural adjustment to occur. There is a fine balance to strike here - the Scylla and Charybdis of our time.

While the gains from trade are reduced when China and the United States pursue protectionist or trade-distorting policies, it would be dangerous to infer that the EU should replicate them. The fact that China can impose restrictions fast, and without transparency or legal safeguards is not a reason for the EU to become more like China. We must continue to respect the rights of EU firms, and apply EU Treaty requirements and rule of law standards.

The lessons from the United States and China are different but complementary. The US experience illustrates the limits of trying to improve competitiveness through protectionism. US policies have not improved the US current account while adding costs and red tape for US businesses. The Chinese experience illustrates the problems with trying to raise productivity through state-led support for certain types of production. Neither model is attractive for Europe. Instead, Europe should build a pro-competitive model that is sustainable in the long term.

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Sammanfattning på svenska

Summary in Swedish

Kinas statsstyrda ekonomiska modell skapar betydande utmaningar för EU:s ekonomi och handel. Genom omfattande industrisubventioner och andra statliga ingripanden styr Kina kapital och arbetskraft till politiskt prioriterade sektorer. Detta bidrar till överinvesteringar och överkapacitet. I kombination med svag inhemsk efterfrågan leder det till att kinesiska företag söker avsättning på världsmarknaden, vilket pressar priser och lönsamhet för europeiska företag både inom och utanför EU. I denna analys föreslår vi en strategi som möter dessa utmaningar utan att äventyra EU:s produktivitet och konkurrenskraft.

I EU-debatten om nya handelsbegränsande åtgärder mot Kina ser vi ett glapp mellan diskussioner på en hög abstraktionsnivå och de konkreta konsekvenser som förslagen riskerar att få för svenska och europeiska företag. För att undvika negativa ekonomiska effekter bör åtgärderna därför vara selektiva, evidensbaserade och uppfylla vissa kriterier. EU:s nya stålregim har redan medfört betydande kostnader för europeiska företag i nedströms produktionsled och mött motstånd från nära handelspartner. Den bör därför inte tjäna som förebild för andra sektorer.

Oavsett om EU effektiviserar befintliga handelspolitiska skyddsinstrument eller utvecklar nya instrument anser vi att följande kriterier är viktiga:

- Eftersom Kina är problemet bör åtgärderna riktas mot Kina, inte mot EU:s övriga handelspartner.
- Åtgärderna bör motverka kinesiska åtgärder som snedvrider konkurrensen och skapar ojämlika konkurrensvillkor, särskilt industrisubventioner.
- Marknadsbaserade, transparenta och lättillämpade åtgärder, företrädesvis tullar, bör prioriteras. Prisåtaganden och åtgärder som låser importvolymer eller marknadsandelar bör så långt som möjligt undvikas.
- Ytterligare administrativ börda för europeiska företag bör minimeras.
- Åtgärderna bör så långt möjligt undvika insatsvaror och fullt ut beakta intressena hos tillverkare i senare produktionsled, exportörer och användare.

EU:s handelspolitiska instrument måste även fortsättningsvis vara förenliga med WTO:s regelverk och uppfylla EU-fördragens krav och rättsstatliga principer. Att Kina snabbt och utan transparens kan införa godtyckliga handelsrestriktioner är inget skäl för EU att efterlikna Kina. Kriterierna gäller för samtliga alternativ, men sammantaget talar de för att den bästa vägen framåt är att utveckla ett snabbförfarande för antidumpnings- och antisubventionsåtgärder genom att effektivisera de förfaranden som är kopplade till dagens handelspolitiska skyddsinstrument.

Handelsrestriktioner kan inte lösa makroekonomiska obalanser eller EU:s konkurrenskraftsproblem. De behandlar symptomen, inte de bakomliggande orsakerna. Vi lämnar därför följande ytterligare rekommendationer:

- EU bör tillsammans med andra länder och internationella organisationer sätta press på Kina att balansera om sin ekonomi. Fokus bör ligga på åtgärder som stärker hushållens inkomster, minskar försiktighetssparandet och begränsar industrisubventionerna.
- EU bör fortsätta prioritera reformer av den inre marknaden som kanaliserar sparande till europeiska investeringar, skapar goda förutsättningar för bred innovation och gör det möjligt för europeiska företag att fullt ut utnyttja den inre marknadens storlek.
- EU bör utforma en industripolitik som åtgärdar tydligt identifierade marknadsmisslyckanden, men som samtidigt bevarar drivkrafterna för konkurrens och innovation.
- EU bör undvika en politik som styr europeiskt kapital och arbetskraft till lågproduktiva sektorer. Målet bör vara att öka europeisk produktion och export inom verksamheter med högt förädlingsvärde och möjligheter till kvalitetsutveckling. Visionen bör vara ett ”globalt Schweiz” snarare än en europeisk kopia av Kina.
- EU bör fortsätta förhandla om förbättrat marknadstillträde i Kina i syfte att nå ytterligare konkreta åtaganden om att undanröja hinder för europeisk handel och investeringar.

Erfarenheterna från USA och Kina ger olika men kompletterande lärdomar. USA:s erfarenheter visar begränsningarna med att försöka förbättra konkurrenskraften genom protektionism. Den amerikanska handelspolitiken har inte förbättrat USA:s bytesbalans utan i stället ökat kostnaderna och den administrativa bördan för amerikanska företag. Kinas erfarenheter visar problemen med att försöka höja produktiviteten genom statligt styrt stöd till vissa typer av produktion. Ingen av dessa modeller är attraktiv för Europa. EU bör i stället utveckla en långsiktigt hållbar, konkurrensfrämjande ekonomisk modell.

The National Board of Trade Sweden is the government agency for international trade, the EU internal market and trade policy. Our mission is to facilitate free and open trade with transparent rules as well as free movement in the EU internal market.

Our goal is a well-functioning internal market, an external EU trade policy based on free trade and an open and strong multilateral trading system.

We provide the Swedish Government with analyses, reports and policy recommendations. We also participate in international meetings and negotiations.

The National Board of Trade, via SOLVIT, helps businesses and citizens encountering obstacles to free movement. We also host several networks with business organisations and authorities which aim to facilitate trade.

As an expert agency in trade policy issues, we also provide assistance to developing countries through trade-related development cooperation. One example is Open Trade Gate Sweden, a one-stop information centre assisting exporters from developing countries in their trade with Sweden and the EU.

Our analyses and reports aim to increase the knowledge on the importance of trade for the international economy and for the global sustainable development. Publications issued by the National Board of Trade only reflect the views of the Board.

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Kommerskollegium
National Board of Trade Sweden

Box 6803, S-113 86 Stockholm, Sweden
Phone +46 8 690 48 00
E-mail registrator@kommerskollegium.se
www.kommerskollegium.se