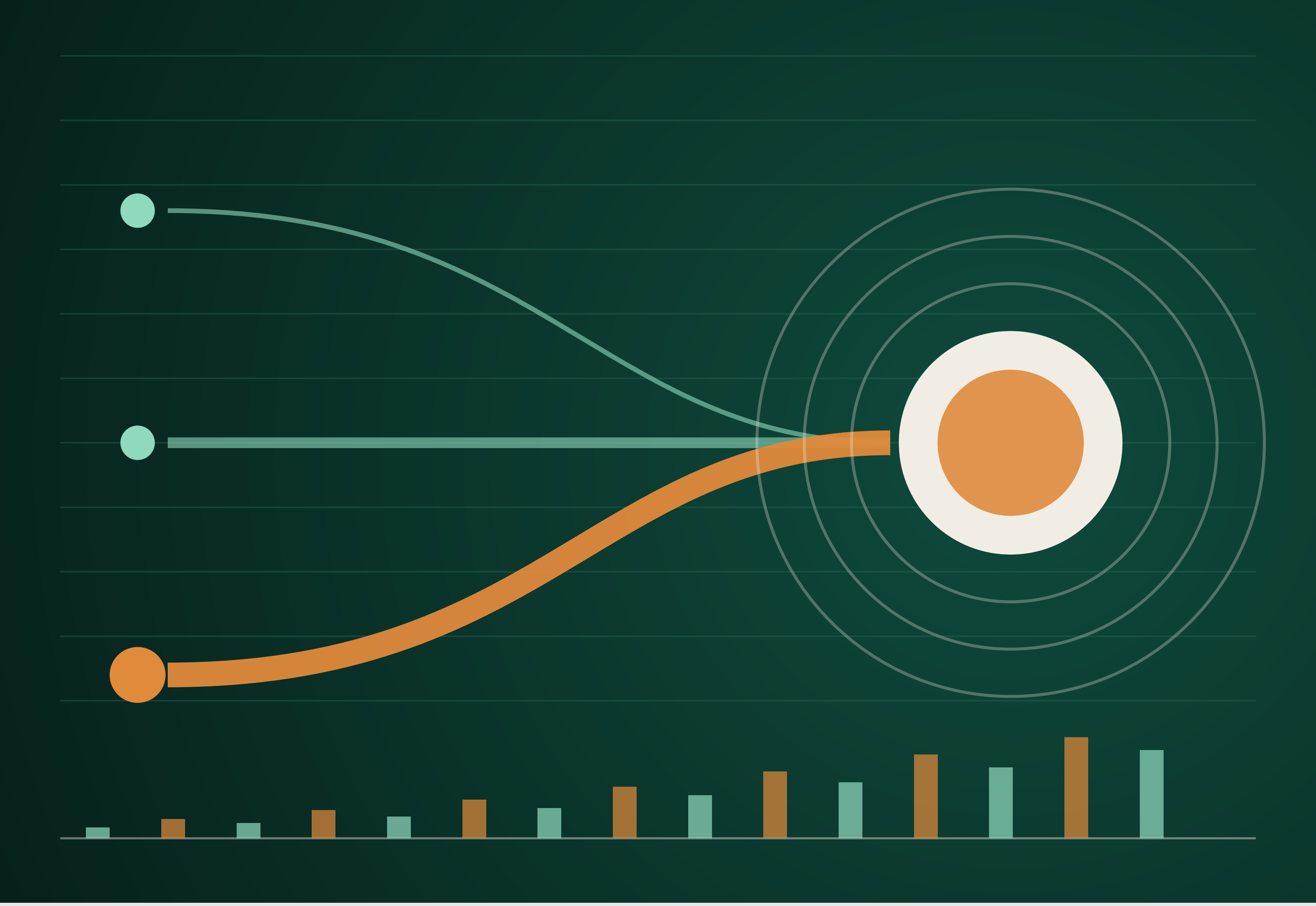

The New Frontline of Great-Power Competition: The Structure of Global Demand and Its Implications for the EU

Dr. Enrico Fardella

THE FLETCHER SECURITY REVIEW

The global economy is entering a phase in which monetary policy, trade balances, and industrial strategy are increasingly shaped by geopolitical competition. Recent analyses by institutions such as the International Monetary Fund, the Federal Reserve, the Bank of England highlight how macroeconomic tools are now being deployed in support of strategic objectives. This shift is particularly relevant for the European Union, whose openness exposes it directly to the reconfiguration of global demand and great-power competition. [i]

One of the clearest manifestations of this shift can be observed in the growing tensions surrounding China's currency management. As brilliantly explained by Brad Setser, for years, the dominant assumption was that a stronger currency for China could undermine exports at a time when external demand is crucial for sustaining growth.[ii] Exchange-rate stability was therefore treated as an economic necessity rather than a political choice. That assumption is now under strain. China's recovery since the pandemic has relied heavily on exports, while domestic consumption has remained subdued. Foreign markets have absorbed an increasing share of Chinese output just as political tolerance for such imbalances has declined. What once appeared as a technical debate over exchange rates has evolved into a question of strategic exposure.

Chinese authorities remain committed to tight currency management, seeking to avoid large swings that could destabilize growth or trigger volatile capital flows. Yet this position increasingly collides with the strategic environment abroad. Large trade surpluses are no longer interpreted merely as macroeconomic side effects, but as manifestations of structural power. In a world shaped by industrial competition and geopolitical rivalry, persistent imbalances are viewed as sources of dependency.

For several years, this contradiction was obscured by capital outflows from China. Higher U.S. interest rates, uncertainty about domestic growth, and fears of renewed trade conflict encouraged money to leave the country, offsetting upward pressure on the yuan. That phase is ending. Outflows have slowed, the surplus remains large, and - as Setser points out - Beijing is therefore likely to intervene more actively to manage its currency.

This leaves China facing a familiar dilemma. A slow appreciation risks leaving its competitive position largely unchanged, sustaining external surpluses and intensifying foreign backlash. A faster adjustment could attract speculative inflows and undermine financial control. Either way, currency policy alone cannot deliver the deeper rebalancing toward household consumption long urged by external partners.

In theory, a stronger yuan could support such a transition by increasing purchasing power and reducing dependence on exports. In practice, China's consumption weakness is structural. High precautionary savings, limited welfare provision, and an income distribution favoring firms and local governments constrain household demand. Without political choices that redistribute income internally, exchange-rate movements remain marginal.

It is precisely this impasse that has drawn the issue into the realm of strategic competition. The United States increasingly views global imbalances not simply as economic inefficiencies, but as vulnerabilities within the international system. In its 2025 National Security Strategy (NSS), Washington makes explicit that America's persistent current account deficit is unsustainable and that allies must play a role in reshaping global trade patterns.[iii]

The objective is not primarily monetary. Rather, it reflects a broader effort to constrain China's ability to project economic power through surplus production and external dependence. Washington's assessment is straightforward: if China can continue to export its excess capacity into open advanced economies, it can postpone domestic rebalancing indefinitely. If it cannot, internal adjustment becomes unavoidable.

"Great power competition... is being fought not only through military posture or technology controls, but through the structure of global economic demand."

From this perspective, currency appreciation is only one element of a much larger contest. Trade defense (i.e., tariffs), subsidy control, industrial policy coordination, and standards-setting become tools of geopolitical leverage. The aim is to reduce the external outlets available to China's export model and thereby alter its internal incentives.

This strategy, however, cannot succeed unilaterally. As the United States' NSS correctly points out, regions such as Southeast Asia, Latin America, and the Middle East lack the scale to absorb China's surplus output.[iv] This is evident both in absolute market size and in the composition of trade flows: while Chinese exports to these regions have increased, they remain fragmented across smaller economies and are heavily concentrated in sectors such as machinery, intermediate industrial goods, consumer electronics, and increasingly green technologies like solar panels, batteries, and electric vehicles. These inflows often generate local tensions, as they compete directly with nascent domestic industries, compress prices, and can contribute to deindustrialization pressures or trade frictions, particularly in sectors already affected by global overcapacity.[v]

Container ships call on the North Charleston Terminal in North Charleston, S.C., part of the Port of Charleston, Sept. 27, 2022. | U.S. Army photo by Patrick Bloodgood (public domain)

If the United States tightens access while others do not, the imbalance is merely redirected, worsening these tensions further on. This is why Washington may increasingly emphasize coordination with Europe, Japan, and other advanced economies on this matter. Great power competition, in this sense, is being fought not only through military posture or technology controls, but through the structure of global economic demand - in other words, which economies are able, or willing, to absorb excess supply in sectors ranging from consumer goods and industrial inputs to strategic industries such as clean energy and advanced manufacturing.

For Europe, this shift is consequential. The continent is not merely an observer of the U.S.-China rivalry, but one of its principal theaters. If Europe fails to act collectively, it risks becoming the residual market into which redirected Chinese exports flow. Adjustment would then take place not in Beijing, but in Europe - through compressed industrial margins, declining investment, and rising political fragmentation.

This vulnerability reflects Europe's institutional design. The European Union possesses a single currency but lacks a unified external-economic strategy. Trade defense, investment screening, procurement rules, and industrial policy remain unevenly coordinated. As a result, global imbalances are not filtered at the border but transmitted inward, transforming external competition into internal strain.

As Michael Pettis and I have argued in a recent article, the danger is not a sudden crisis but a gradual process of strategic erosion. Sustained inflows of competitively priced Chinese exports compress margins in Europe's tradable sectors, particularly in manufacturing industries exposed to global competition. This reduces incentives for domestic investment and innovation, especially in capital-intensive sectors where scale and long-term planning are critical. Over time, production capacity shifts abroad or contracts, while employment is reallocated toward lower-productivity services. At the same time, the counterpart of persistent trade imbalances - capital inflows into Europe - tends to strengthen the euro, further undermining external competitiveness and reinforcing the cycle. In this way, adjustment occurs internally within Europe rather than externally through rebalancing in surplus economies. Europe absorbs the pressures generated by global imbalances without shaping the conditions under which they are produced.[vi]

Internal asymmetries exacerbate the problem. Surplus economies rely on wage restraint and external demand, while deficit economies absorb the resulting leakage through debt or unemployment.[vii]In the absence of surplus discipline, global pressures are converted into intra-European political conflict. What begins as great-power rivalry abroad ends as fragmentation at home.

GOVERNING OPENNESS, STRENGTHENING FROM WITHIN

To remain a geopolitical actor rather than a geopolitical space, Europe must close this gap. That does not require abandoning openness but governing it. A coherent external-economic framework - aligning trade instruments, investment screening, standards, and procurement - is essential to prevent foreign industrial strategies from dictating European outcomes. Such governance is not protectionism; it is sovereignty under conditions of interdependence.

Equally important is strengthening Europe from within. As several European leaders - including Emmanuel Macron, Mario Draghi, and European Commission officials - have argued, a small but permanent fiscal capacity at the euro area level would help cushion economic shocks more symmetrically, reducing the need for adjustment to fall repeatedly on the same member states. At the same time, updating EU state-aid rules would allow Europe to support key industries that generate growth and employment across the continent, without turning national subsidies into a zero-sum competition between member states. In the short term, this means reinforcing sectors already under immediate pressure from global competition, such as automotive (especially electric vehicles), renewable energy technologies, batteries, and basic industrial inputs like steel and chemicals. Over the next five years, the priority will increasingly shift toward scaling capabilities in semiconductors, artificial intelligence, data infrastructure, and advanced manufacturing. Looking further ahead, Europe will need to invest in next-generation technologies, including quantum computing, biotech, clean hydrogen, and space-related industries, that will define future competitiveness and strategic autonomy.

The Berlaymont building, headquarters of the European Commission, Brussels, Belgium. | Photo by EmDee, CC BY-SA 4.0, via Wikimedia Commons

Above all, Europe must recognize that its social model is not a liability in strategic competition, but a source of resilience. Household income growth and welfare provision support domestic demand without debt, reducing dependence on volatile external markets. As brilliantly shown by Michael Pettis, in a global system increasingly shaped by wage repression and state-directed cost advantages, Europe cannot compete by abandoning its own foundations.[viii]

As monetary tensions between the United States and China intensify, the space for ambiguity narrows. If Washington withdraws from its role as global absorber while Beijing resists deep rebalancing, adjustment will be forced somewhere. Without coordination, it will be forced onto Europe.

The emerging contest over currencies, trade, and consumption is therefore not peripheral to geopolitics. It is one of its central arenas. Europe's choice is not between alignment and autonomy, but between shaping the rules of competition and being shaped by them. In an era where balance-of-payments arithmetic increasingly becomes a strategy by other means, inaction is no longer neutral. It is a decision, just not one made in Europe's favor.

ABOUT THE AUTHOR

Enrico Maria Fardella is an Associate Professor in the Department of Social and Human Sciences at the University of Naples 'L'Orientale' and Adjunct Professor at the School of Advanced International Studies (SAIS) Europe of Johns Hopkins University. He serves as the Director of the ChinaMed Project and Associate Director of the Guarini Institute for Public Affairs at John Cabot University in Rome. He is an Honorary Life Member of Trevelyan College at Durham University and sits on the editorial boards of the European Journal of East Asian Studies and Orizzonte Cina. Previously, Fardella worked as Global Fellow at the Woodrow Wilson International Center for Scholars in Washington, D.C. and held the position of Associate Professor at Peking University, where he also served as Director of the Center for Mediterranean Area Studies. Additionally, he was a Fellow of the Science & Technology China Program of the European Commission. His research interests encompass the history of Chinese foreign policy, as well as China's relations with the European Union, the Middle East, and Italy, from the Cold War to the present.

NOTES

i International Monetary Fund. 2026. Understanding Global Imbalances. IMF Policy Paper, April 6, 2026. https://www.imf.org/en/publications/policy-papers/issues/2026/04/06/understanding-global-imbalances-575234; Federal Reserve Board. (2026). China’s trade dominance and the role of industrial policies. FEDS Notes. https://www.federalreserve.gov/econres/notes/feds-notes/chinas-trade-dominance-and-the-role-of-industrial-policies-20260323.html; Bank of England. 2026. Global Imbalances Are Back. Bank Underground (Bank of England blog), 2026. https://www.bankofengland.co.uk/bank-insights/2026/global-imbalances-are-back.

ii Setser, Brad W. “China’s Currency Is Now Facing Substantial Appreciation Pressure | Council on Foreign Relations.” Council on Foreign Relations, January 9, 2026. https://www.cfr.org/articles/chinas-currency-now-facing-substantial-appreciation-pressure.

iii The White House. 2025. National Security Strategy of the United States. Washington, DC: The White House, December 2025. https://www.whitehouse.gov/wp-content/uploads/2025/12/2025-National-Security-Strategy.pdf iv Michael Pettis and Enrico Fardella. “How Europe can harness its economic power.” Essay. Engelsberg Ideas, December 3, 2025. https://engelsbergideas.com/essays/how-europe-can-harness-its-economic-power/

v Rodrigo Balbontin. 2026. Global Trade Battleground: U.S.-China Competition in the Global South. Information Technology and Innovation Foundation, April 6, 2026. https://itif.org/publications/2026/04/06/global-trade-battleground-us-china-competition-in-the-global-south/; Xue Gong, 2024. The Challenges Behind China’s Global South Policies. Carnegie Endowment for International Peace, December 2024. https://carnegieendowment.org/posts/2024/12/the-challenges-behind-chinas-global-south-policies; Camille Boullenois and Charles Austin Jordan 2024. How China’s Overcapacity Holds Back Emerging Economies. Rhodium Group, 2024. https://rhg.com/research/how-chinas-overcapacity-holds-back-emerging-economies/

vi Michael Pettis and Enrico Fardella. “How Europe can harness its economic power.” Essay. Engelsberg Ideas, December 3, 2025. https://engelsbergideas.com/essays/how-europe-can-harness-its-economic-power/

vii Michael Pettis, and Erica Hogan. 2024. Trade Intervention for Freer Trade. Carnegie Endowment for International Peace, October 2024. https://carnegieendowment.org/research/2024/10/trade-intervention-for-freer-trade

viii Michael Pettis. 2026. Europe’s Wage Paradox. Engelsberg Ideas, 2026. https://engelsbergideas.com/notebook/europes-wage-paradox/