

1.1 China's Macroeconomic Involution: Is this an Opportunity for Foreign Firms?

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Something novel is happening in China; a major economy is heading towards an unprecedented state in modern times. This has been discussed in many articles, including in the *Wall Street Journal*, headlined “A New Challenge for China's Economy: ‘Involution’”:

China is gripped by an insidious problem that is eroding its economy: It is trapped in a cycle of competition so fierce that it is destroying profits, driving a brutal rat race among workers and fueling a deflationary spiral. (Miao, 2025)

Razor-thin profits are often seen as a hallmark of dynamic capitalism: value extraction and rent seeking are constrained by competition, while deflation increases the purchasing power of ordinary citizens. Yet, as Miao (2025) notes, “Beijing is fighting to limit damage from a pattern of price wars and excess capacity.” Why?

Philippe Aghion, winner of the 2025 Nobel Prize in Economics, famously postulated along with his colleagues an inverted-U relationship between competition and innovation (see Figure 1.1). In short, these authors suggest that too little competition leads to excessive profits and weak incentives to innovate, while too much competition erodes profits to the point that innovation becomes unsustainable. In this sense, involution can be understood as the curse of excessive competition, first reflected in lower margins but eventually compromising innovation and productivity gains. One might argue that in the West, the dominant problem is too little competition and innovation, whereas China's current challenge reflects the opposite extreme and that this may be the lesser of two evils. But is it?

The inverse U-shaped relationship between innovation and competition

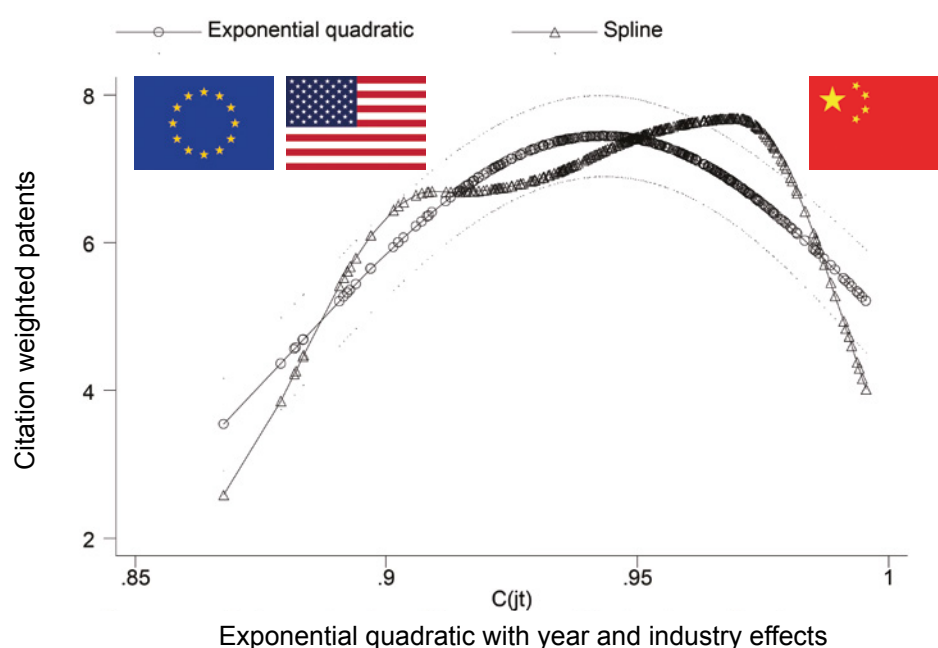


Figure 1.1: Innovation and product market competition: Exponential quadratic and the semiparametric specifications: with year and industry effects (Aghion, Bloom, Blundell, Griffith, & Howitt, 2005, Figure 8). Flags added by the authors.

Deutsche Bank provide data on what involution means in practice for the EV industry where “despite [...] rapid growth, profitability has plunged: total profits in the automotive industry reduced by 33% between 2017 and 2024, despite a 21% increase in sales” (see Figure 1.2). They suggest:

The “anti-involution” policy push is set to reshape China’s economic landscape, with critical implications for China and Europe. While potentially leading to a near-term slowdown in China’s headline growth as capacity is rationalized, successful “anti-involution” could alleviate persistent deflationary pressures and reduce China’s trade imbalances in the long run. Success in reflating China’s economy could also lead to a stronger Renminbi. (Deutsche Bank, 2025)

In this article, we argue that the origins of involution arise from several interacting factors: persistently low consumption as a share of GDP; local protectionism and subsidies; and an excessive expansion of the monetary base. The latter challenge is highly complex to resolve, particularly given the seemingly irreversible trend of broad money expansion (see Figure 1.3).

The EV revolution led to fast growth in China’s car production, but a drop in capacity utilization

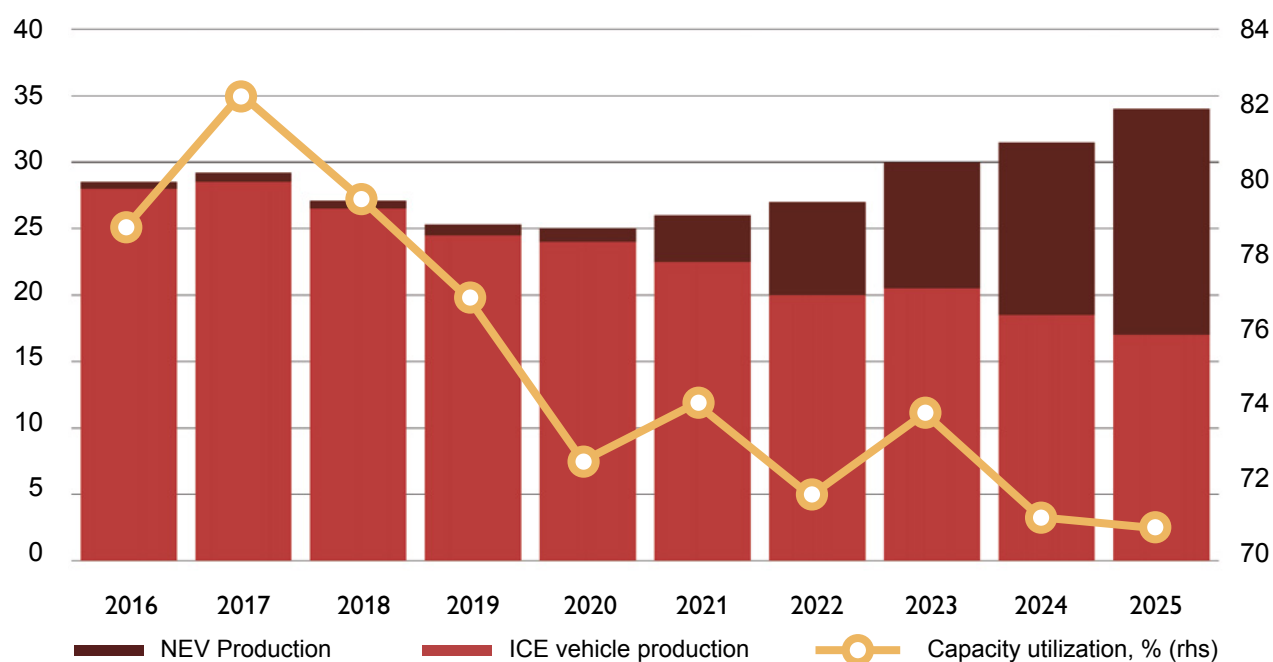


Figure 1.2: A growing market and growing excess capacity under declining profits (Deutsche Bank, 2025, Figure 1)

Source: Deutsche Bank Research, Haver Analytics.

The central question for macroeconomists and policymakers is how to consolidate markets and restore sustainable profitability without slowing the economy excessively. For practitioners—particularly foreign investors in Switzerland—the key question is whether this dynamic represents a threat or an opportunity.

At first glance, it appears to be a threat. In this survey, we show that foreign investors are increasingly concerned about Chinese competition (see Section 1.2, Section 2.3, Figures 2.12 and 2.14). Involution often produces highly innovative but intensely pressured Chinese competitors that are keenly aware that only a few players will ultimately survive and are determined to be among them. This dynamic fuels both aggressive price competition and rapid innovation. As a result, Chinese firms represent formidable opponents for Western companies. Where then does the opportunity for foreign firms now lie in China?

China's broad money supply tops USD 47 trillion, exceeding the US and EU combined

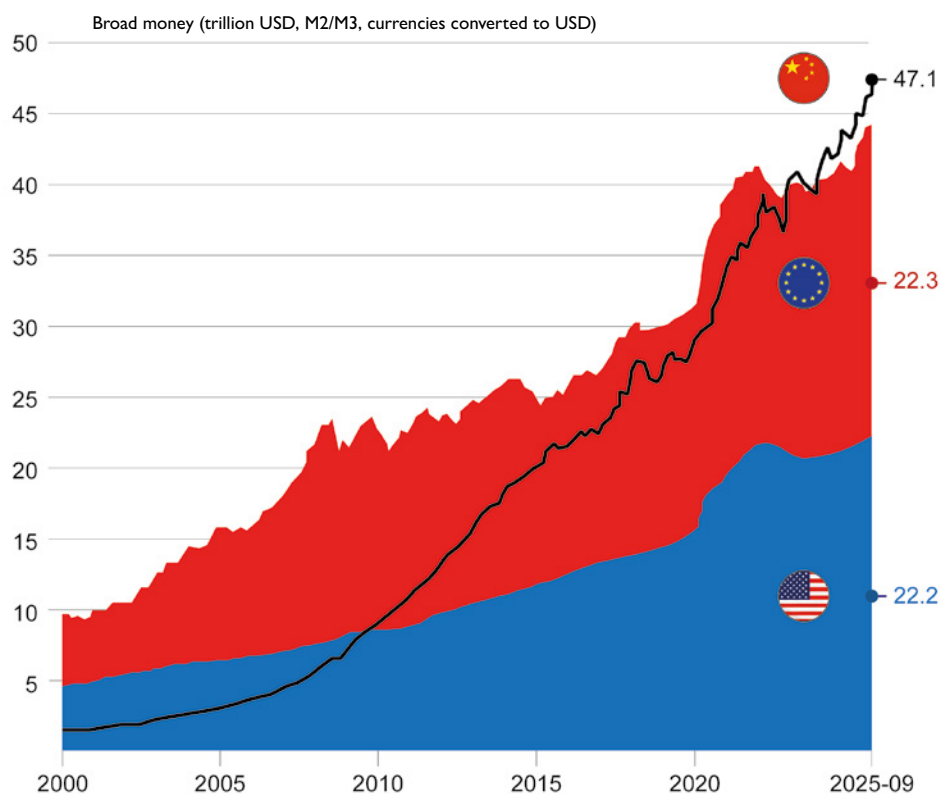


Figure 1.3: China's broad money supply (M2) has surpassed the combined US and EU amount since 2023

Sources: Econovis visuals based on Fed, ECB, PBoC.

M&A and R&D opportunities

The process of consolidation implies that foreign firms can acquire Chinese companies or their products for relatively attractive prices.

For instance, in the machine equipment sector, Buehler has a long record of acquiring local companies in China to enter new market segments or consolidate its position against very cost-effective local competitors (see, for instance, Casas-Klett & Hilb, 2014). This strategic approach is no longer exceptional. Big pharma (Roche, Novartis, AstraZeneca, Pfizer, Sanofi and so on) “increasingly licenses Chinese assets for global pipelines, with China contributing significantly to innovation inflows despite tensions” (Gautam, 2025). Pharma companies clearly see opportunities in acquiring the novel products of emerging Chinese biotech companies. In this regard, Roche’s partnership and licensing deal with the Chinese company MediLink, worth over USD 1 billion, (Davis Plüss, 2024) is illustrative. Moreover, in order to build a pipeline for future acquisitions, the Swiss giant built its own accelerator in Shanghai in 2023 to support promising Chinese start-ups.

Chinese technology-related competencies like the fast and cost-effective development of new products are also available to international companies. Chinese localities strongly encourage the development of foreign R&D centers, and may also offer financial incentives. They hope to enrich their entrepreneurial ecosystems through the contributions of international firms. At the same time, the pain and job losses linked to the forces of involution and consolidation is making the prospect of working for stable global companies attractive to Chinese talent such as researchers, engineers, and R&D managers.

A development center in China can be a very good complement to global R&D initiatives; to localize existing products and develop new ones for the Chinese market, as well as to support the intensive and fast development of products for international markets. Therefore, it is not surprising that Roche has recently made investment announcements worth hundreds of millions of USD to expand production in China and reinforce its R&D-linked manufacturing base (Manalac, 2025).

Conclusion

In summary, involution lowers the prices of highly competitive acquisition targets for Western companies in China and provides opportunities to build very cost-effective basic research and product development capabilities. The successful integration of such assets into the overall organization enables foreign firms to combine the strengths of both Western and Chinese business practices to boost their international competitiveness. Many of the challenges facing foreign companies such as slow responsiveness to market changes and detachment from evolving client needs, limited product portfolios, minimal partnership networks, aging business models, or weak innovation capabilities can be mitigated through the injection of Chinese engineering and managerial talent. Chinese managers also excel at leveraging new technologies, especially AI.

The coming consolidation—the “cycle of competition so fierce” that will prove difficult at both the firm and macro levels—does have a silver lining in that it opens a unique window of opportunity for Western firms. If these opportunities are properly analyzed and seized, foreign interests in China will not merely gain market share, but through their Chinese partners and employees will also grow and become increasingly innovative, efficient, and ultimately more formidable global players.

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