

Policy Brief

Selective Conditionality

The EU's Emerging Approach to Foreign Investment

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The Industrial Accelerator Act (IAA) introduces a logic of selective conditionality into EU foreign direct investment (FDI) policy, tying investment in strategic sectors to requirements on local employment, supplier integration, R&D, ownership, and technology transfer. Rather than constituting a broad protectionist turn, the shift is narrowly targeted and, in practice, primarily affects large-scale Chinese investments in the electric vehicle and battery value chain. Evidence from the battery sector illustrates the rationale behind this approach: while foreign investment has helped close urgent supply gaps, it has generated only modest spillovers in technological capabilities for European firms. As currently designed, however, the mechanism is likely to exert only limited leverage over foreign investors. Making selective conditionality effective will require tighter and more enforceable conditions, targeted trade policy to reduce outside options, and a coherent industrial policy framework capable of supporting domestic actors.

For decades, the EU has maintained a broadly open investment regime, becoming one of the [world's largest recipients and sources of foreign direct investment \(FDI\)](#). That openness was long seen as an economic good in itself. It embedded European firms in global value chains, generated productivity spillovers, and supported industrial growth, while creating [hundreds of thousands of jobs](#) annually. It also drew on a legacy in which US investment underpinned Europe's post-war reconstruction and [industrial catch-up](#).

The [Industrial Accelerator Act \(IAA\)](#) breaks with this tradition. The European Commission proposes to impose conditions on large inward FDI in selected strategic sectors. These conditions would apply to local employment, supplier linkages, R&D, ownership, and technology transfer – to ensure that foreign capital actively contributes to industrial capability. This approach reflects a growing concern that not all inward investment has reliably translated into technology transfer, domestic supplier involvement, or the industrial know-how on which long-term competitiveness depends.

At first glance, this appears to be a paradigm shift away from open-market orthodoxy towards a more interventionist, state-guided approach. [Beijing has been quick](#) to seize on this reading, branding the IAA as a fundamental retreat from social market economy principles and WTO commitments. Yet this misreads the character of the proposal. The IAA does not amount to a general regime for conditioning FDI. Rather, it introduces a narrow, targeted, and politically selective instrument – best understood as a form of selective conditionality. In practice, it will apply almost exclusively to Chinese investment in the electric vehicle (EV) and battery value chain.

This selectivity is rooted in a logic of reciprocity. The IAA echoes, in a more limited form, the FDI conditions that formed part of China's industrial upgrading strategy. It draws lessons from that experience to rebalance structural asymmetries in key sectors where Europe's capability gaps are most acute, and where China's state-backed industrial strategy created both technological eminence and structural dependencies. Done well, this approach could reduce strategic vulnerabilities and extract greater value from foreign investment. But, the framework, as currently designed, is unlikely to deliver on this.

To make selective conditionality work, the EU needs to act on three fronts:

1. Tighten the conditions themselves, replacing soft commitments with binding requirements and ensuring that compliance cannot be reduced to a menu of options.
2. Close outside options that allow foreign firms to bypass FDI conditionality through imports and third-country production.
3. Embed FDI policy within a coherent industrial strategy linking targeted trade defence instruments, supply-side support and demand-side measures.

Importantly, the aim is not to shut out Chinese investment altogether, but to reset the terms on which it takes place. Selective conditionality, properly applied, will allow Europe to more forcefully utilise its central strategic lever: access to its large common market. Pulled credibly, this will give the EU a stronger hand for more cooperative negotiations on rebalancing wider economic relations with China – not as a zero-sum confrontation but as a structured recalibration.

Scrutiny over FDI is not new, but has remained fragmented and unevenly enforced

The EU has progressively strengthened its framework for scrutinising foreign acquisitions in strategic sectors on national security grounds. Its 2019 [FDI Screening Regulation](#), [expanded](#) in late 2025, established mandatory national screening mechanisms for strategic sectors, including advanced technologies such as semiconductors, AI, quantum technologies, digital and physical infrastructure, and critical raw materials. It also strengthened coordination among member states.

Conditioning FDI on economic grounds is not new. As early as the 1980s, under pressure from Japan's rise in the automotive sector, several European governments used [negotiated voluntary export restraints](#) to reduce import pressures while incentivising Japanese firms to invest within Europe, often under conditions related to local content, employment, and supplier integration.

Today, similar practices persist at the national level. Italy's "[Golden Power](#)" regime has increasingly been used to approve investments subject to conditions, while Spain has sought to ensure technology transfer, local employment, and supplier integration through a proposed "[High-Quality Investment Agreement](#)" with China. However, practices across the EU remain fragmented and uneven. For instance, in [several high-profile battery investments](#) across Europe, substantial public subsidies have been granted under Commission-approved state aid frameworks without stringent conditions.

The IAA's FDI conditionality: A paradigm shift in appearance, a narrow instrument in practice

The Commission now seeks to elevate these practices to the European level. As part of the broader IAA aimed at strengthening industrial resilience, competitiveness, and decarbonisation, it is now proposing a standardised framework to condition large foreign investments on their contribution to domestic value creation.

Investments exceeding €100 million would be subject to review, where foreign control or ownership is at least 30% and global production is highly concentrated ($\geq 40\%$ in a single third country). Once these thresholds are met, national authorities assess the investment and retain final decision-making and monitoring, while the Commission issues an opinion and exercises supervisory oversight. At the same time, the proposal allows for selective centralisation. The Commission may take over the assessment in cases of particular economic significance especially for large-scale ($>€1$ billion) or strategically relevant investments.

Approval is tied to a set of "value-added" conditions designed to ensure that foreign investment contributes to industrial capabilities within the EU. Foreign investments may be approved only if they meet at least four out of six criteria, including one mandatory requirement:

- at least 50% of the workforce must consist of EU-based employees across all employment categories and throughout the lifetime of the investment, combined with compulsory commitments to training and capacity-building.

In addition, foreign investors must comply with at least three of the following conditions:

- a cap of 49% on foreign ownership or control of the Union target or asset;
- the investment is conducted via a joint venture with Union entities, in which the foreign investor holds no more than 49% of ownership and voting rights, and which ensures effective participation of Union partners in management, technology transfer, and capacity-building;
- agreements to license intellectual property and know-how to the Union entity, alongside provisions for joint ownership of technologies developed through collaboration;
- a commitment to dedicate at least 1% of gross annual revenue to research and development in the EU; and
- requirements to encourage firms to prioritise EU-based suppliers, including publishing a sourcing strategy and aiming for at least 30% of inputs to be sourced from within the Union.

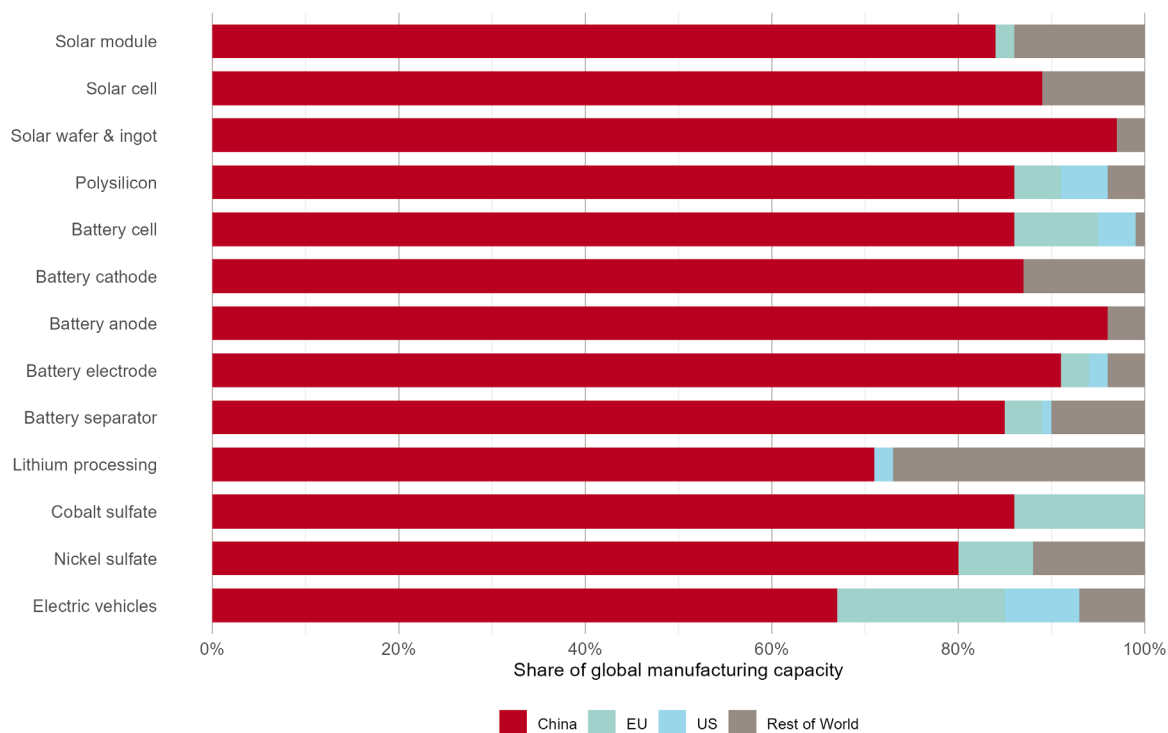
Together, these criteria address different dimensions of economic value capture. Requirements on local workforce and input sourcing aim to support job creation and supplier networks within the EU, while R&D commitments are intended to strengthen local innovation ecosystems and foster knowledge spillovers. Ownership limits and joint venture requirements seek to embed foreign

investment within the European industrial base by ensuring shared control and participation in value creation, with IP licensing offering more direct channels for technological transfer and co-development. In this sense, the FDI framework combines incentives for local value creation with more ambitious objectives of capability-building and technological catch-up.

In practice, two factors limit the reach of the new instruments. First, while the regulation formally targets a set of “emerging strategic sectors”, its actual application is limited to four areas: batteries, electric vehicles, solar, and critical raw materials. Although the Commission retains the ability to expand the scope to other net-zero technologies, such as wind, heat pumps or hydrogen electrolyzers, through [delegated acts](#), they are for now not included.

Second, while formally country-neutral, the design of the instrument embeds clear geographic selectivity. The 40% global production threshold, combined with exemptions for countries with free trade and economic agreements, means in practice that Chinese investment is the primary target (see Figure 1). In fact, it is very unlikely that the new regime would apply to any non-Chinese investment in the near future.

Figure 1. China dominates global manufacturing capacity across the covered sectors



Source: [IEA](#), [Bloomberg](#), [Apollo](#)

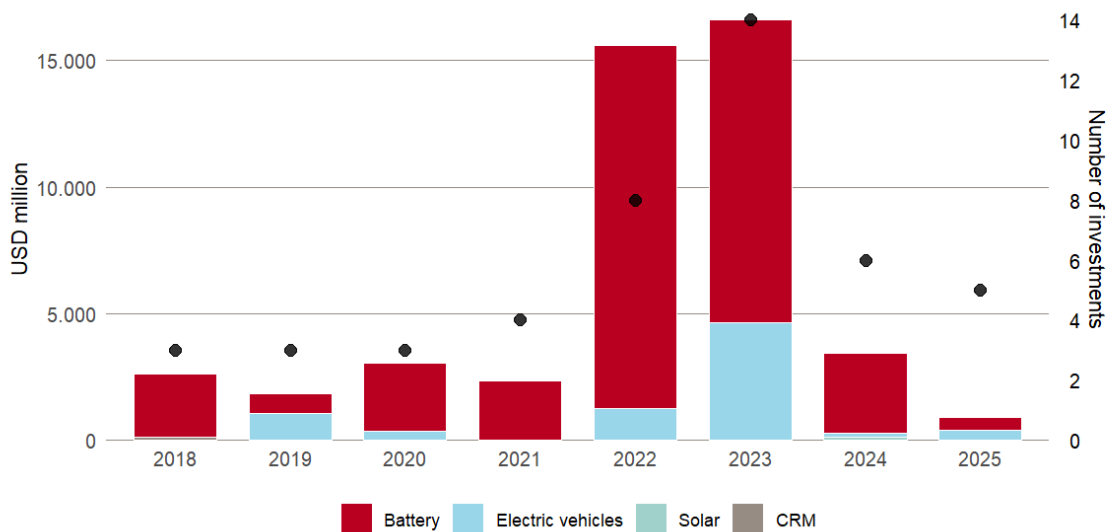
There is a clear rationale for the IAA to focus on Chinese investment. First, China’s dominant position across the covered sectors in technology, supply chains, and market scale, is the product of a sustained, state-backed industrial strategy that has [combined](#) demand- and supply-side support, as also highlighted by the [EU’s EV anti-subsidy investigation](#). This has enabled firms to heavily invest in [R&D](#) and scale rapidly even under loss-making conditions, creating [overcapacities](#) that cannot be absorbed domestically. The result is fierce domestic competition, pushing firms to seek new markets through exports and FDI. For Europe, this means Chinese investment arrives with structural cost advantages, especially when drawing heavily on foreign supply chains. This undermines fair competition for Europe’s homegrown industry.

Second, it is a move driven by the logic of reciprocity. China has long used market access as leverage to shape foreign investment, most notably in the automotive sector, where entry was tied to joint ventures under strict conditions. These included ownership caps at 50%, mandatory establishment of local R&D centres and training programs, incentives for supplier integration, and restrictions on imported knockdown kits. European carmakers readily accepted these terms to access the growing Chinese market. [Evidence](#) suggests that such arrangements contributed to knowledge spillovers through worker mobility and supplier networks in the context of China’s broader industrialisation strategy.

Third, Beijing has repeatedly used its dominance across technologies and inputs as a geopolitical lever. Following the EU’s imposition of anti-subsidy tariffs on Chinese-made EVs in October 2024, [Chinese authorities reportedly pressured](#) carmakers to pause investment plans in member states backing the measure. Corporate decisions appear to reflect this, as illustrated by [Leapmotor’s shift of planned EV production](#) from Poland to Spain. In parallel, China has [progressively tightened export controls](#) over critical raw materials, expanding from licensing requirements to outright bans on selected minerals against the backdrop of US trade and technology restrictions. The recent case of Netherlands-based, Chinese-owned semiconductor firm [Nexperia](#) highlights how such tools extend to corporate operations. When the Dutch government temporarily took effective control of Nexperia in 2025 over economic security concerns, Beijing restricted exports from its Chinese facilities, disrupting supply chains and demonstrating its willingness to use export controls in response to political decisions affecting strategic assets.

Despite the limited sectoral scope, the IAA’s proposed conditionality would cover a large proportion of Chinese FDI. While Chinese investment represents only a small share of total inward investment – at [€9.4 billion](#) in 2024 compared with over [€203.6 billion overall](#) – it is highly concentrated in battery and EV projects, which accounted [for more than half of Chinese FDI in 2024](#) (see Figure 2). These investments are also disproportionately large. Around \$46.4 billion out of \$49.3 billion invested in the covered sectors over the past decade stems from projects exceeding \$100 million, which broadly corresponds to the €100 million threshold. At the same time, the number of annual cases likely to fall under the mechanism remains limited, given that in the past decade an average of around six investments would have been above the new thresholds.

Figure 2. Large announced Chinese FDI projects (exceeding \$100 million) in the EU are concentrated in batteries and EVs



Source: [Rhodium Group China Cross-Border Monitor](#)

Taken together, the IAA does not establish a general regime for conditioning FDI but in practice applies primarily to a few large Chinese investments in the EV battery value chain. This reflects both the concentration of Chinese FDI and the strategic importance of this segment at the intersection of key EU objectives: decarbonisation, industrial renewal, and the reduction of concentrated dependencies.

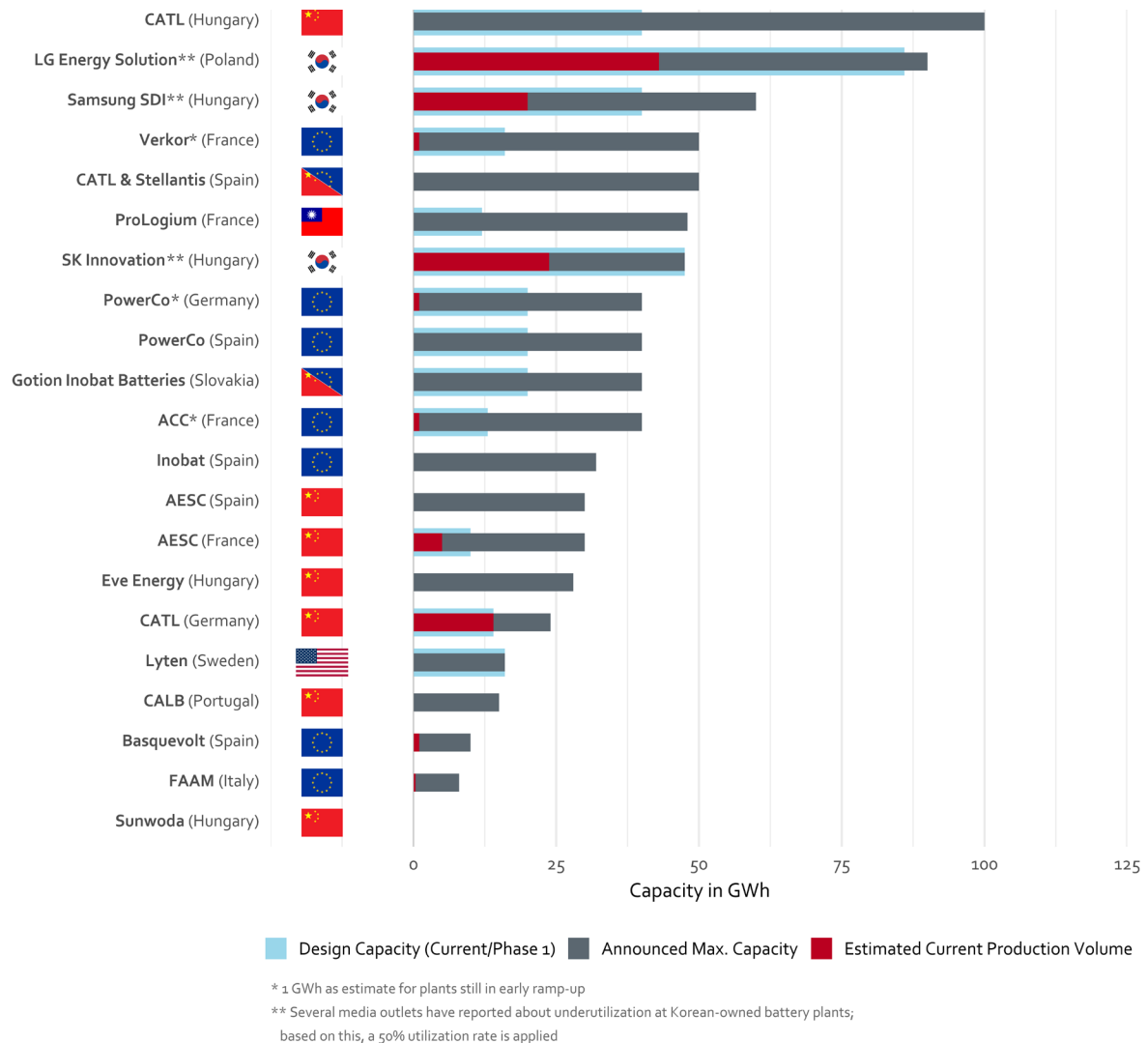
What can the IAA's FDI conditions realistically change in Europe's EV battery build-out?

The European Commission made the creation of a domestic EV battery value chain [a strategic priority](#) for its industrial transformation. FDI plays a key role in this endeavour. The question is whether the IAA's proposed conditions for FDI can anchor production more firmly within the EU's regulatory and industrial framework, reduce external leverage, and secure greater economic value in the form of jobs, local sourcing, R&D, and technological capabilities.

European battery firms have struggled to move from pilot production to mass manufacturing. Batteries constitute [around one-third](#) of an electric vehicle's value and European carmakers are in urgent need of high-quality inputs in this rapidly evolving sector. Yet Europe's most prominent attempt to build a homegrown battery champion, Swedish start-up [Northvolt](#), ultimately failed to navigate its ramp-up phase, despite considerable public and private investment. Firms like [ACC](#) or [PowerCo](#) have scaled back ambitious expansion plans in order to stabilise initial operations, while others have [exited](#) mass-market battery cell production altogether.

Korean and Chinese manufacturers have stepped in to fill this gap, meeting immediate industrial needs while benefitting from strong political support. For governments, the short-term incentives are clear. Projects established by Asian battery makers deliver output, domestic jobs, and visible industrial progress. This has led many member states to [actively court](#) foreign investors with generous subsidies and lax regulatory conditions, and the European Commission has largely given them the leeway to do so. As a result, Asian firms today control the vast majority of operational battery cell production capacity on EU soil, with the share of Chinese-backed projects projected to exceed 39% if all announced maximal capacity is realised (see Figure 3).

Figure 3. Capacity of EV battery cell gigafactories in Europe: Estimated current production volume, design capacity, and maximum announced capacity per site



Source: Official press releases & media reports. List may not be exhaustive.

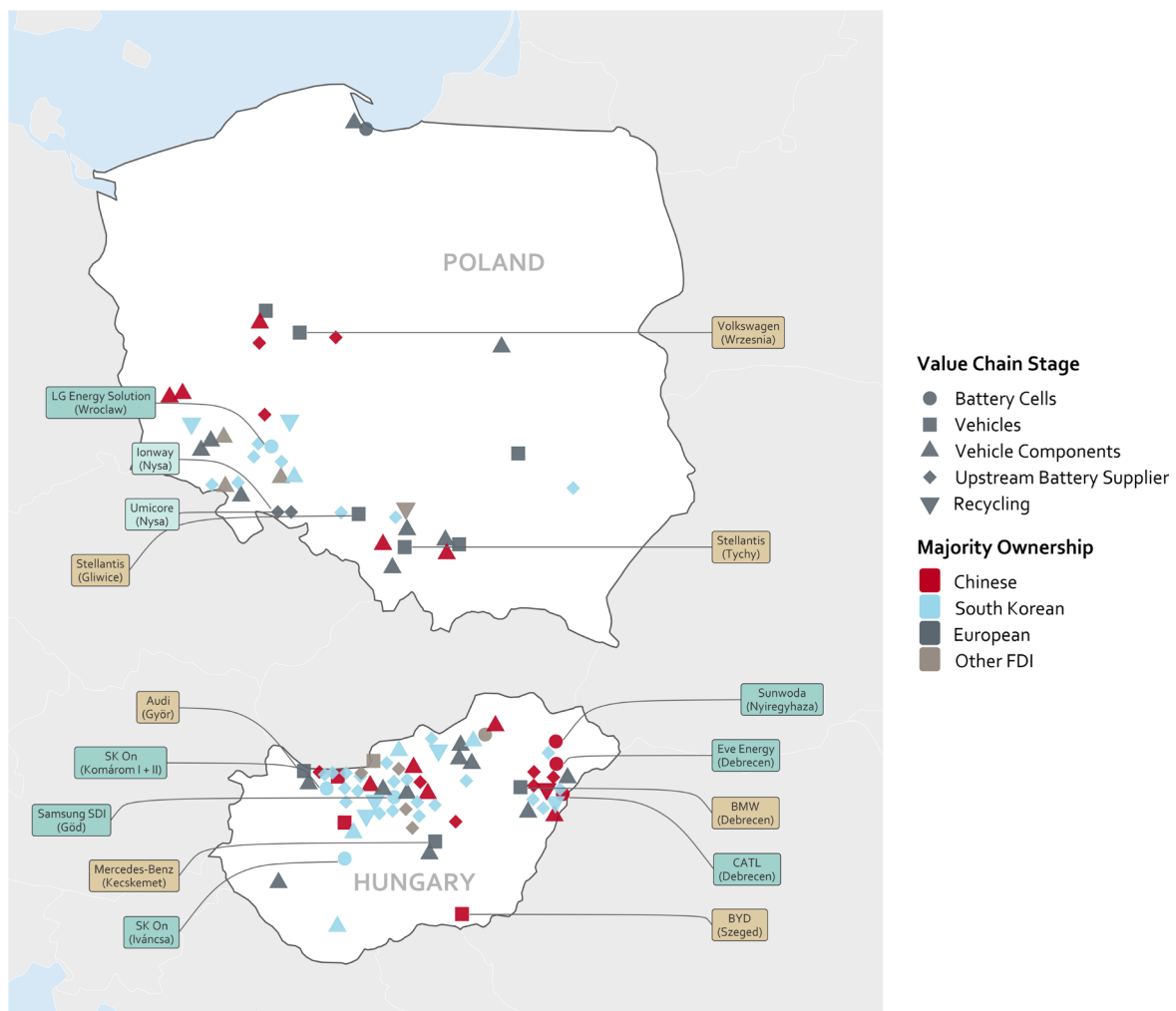
a) Value chain integration

The IAA aims to anchor foreign investment in European value chains by promoting local sourcing. It requires investors to publish a strategy for strengthening EU value chains and to aim for at least 30% local input sourcing to avoid “screwdriver factories” that circumvent trade barriers while relying predominantly on imported inputs and offering little domestic value-add.

These concerns are grounded in recent experiences of Chinese EV assembly projects. BYD’s new EV plant in Hungary, for instance, will initially import battery cells rather than localise production, while Stellantis’ short-lived assembly of Leapmotor EVs in Poland relied entirely on Chinese-made components. In Spain, Chery’s joint venture with Ebro has operated initially on a completely knocked-down (CKD) basis, assembling cars that arrive from China in parts – a model closely mirrored by Magna Steyr’s production for Xpeng and GAC in Austria. These examples appear consistent with a broader policy approach, as in July 2024, China’s Ministry of Commerce reportedly advised its domestic automakers to retain advanced electric vehicle technology at home while encouraging them to build up knock-down kit assembly plants abroad.

For FDI in battery cell production, however, the picture is more complex. In Poland and Hungary, for instance, dense regional ecosystems have formed around anchoring gigafactory projects operated by Chinese and Korean firms (see Figure 4). These plants feed battery cells into a wide range of EU carmaker assembly plants across the continent, and European Original Equipment Manufacturers (OEMs) and suppliers – including [BMW](#), [Mercedes-Benz](#), [Audi](#), [ZF](#) or [Bosch](#) – are expanding production close to Hungarian battery hubs. Yet within these ecosystems, there is a clear split between European and non-European firms along value chains segments. High-value upstream activities, producing the inputs that go into battery cells – such as cathode active materials, electrolytes, separators, and cell housings – are dominated by Asian suppliers. European participation remains limited, with [Umicore](#) and its Volkswagen joint venture [IONWAY](#) in Poland among the few notable exceptions.

Figure 4. Dense regional EV and battery ecosystems in Hungary and Poland: Distribution of announced and materialised production sites by ownership and stage of automotive value chain



Source: Official press releases, Hungarian Investment Promotion Agency (HIPA), Polish Investment and Trade Agency (PAIH) and media reports. List may not be exhaustive. Note: Coordinates are approximate; points spread to avoid overlap.

This hybrid pattern is visible across the EU. Beyond Central and Eastern Europe, Chinese battery cell investments have spread across countries such as [Spain](#), [Portugal](#), [France](#), [Germany](#), and [Slovakia](#). Typically, these investments co-locate with established automotive clusters and support the electrification of European OEM plants. Unlike in Poland and Hungary, however, supplier ecosystems around them remain comparatively thin so far. CATL, for example, has a [framework agreement](#) with BASF for cathode active materials but is otherwise embedded in supply chains that remain dominated by Chinese suppliers. Meanwhile, AESC's battery gigafactory in northern France [integrates](#) the entire production chain in-house.

The IAA's sourcing condition can only partially change this. Because it targets local sourcing within the EU rather than sourcing from EU-owned suppliers, it remains compatible with foreign-led upstream clusters located within the single market. As a result, the provision may promote localisation, but not necessarily Europeanization of EV battery value chains. At best, it will act as a minimum safeguard against the shallowest forms of “screwdriver” assembly – but only if the 30% input threshold is binding. Otherwise, the condition will remain a soft steering tool.

b) Local job creation and skills transfer

The IAA places particular emphasis on local employment and skills development. It stipulates that at least 50% of employees across all categories - from operational to managerial roles – must be EU workers from the outset and throughout the lifetime of the investment, combined with training and capacity-building obligations. Importantly, these workforce requirements are the only mandatory condition attached to any foreign investment targeted by the IAA.

This targets a politically sensitive concern: Foreign investors, particularly from China, often rely heavily on imported labour, limiting local job creation and reducing broader knowledge spillovers. [Recent media coverage](#) around projects such as CATL's joint venture with Stellantis in Spain, where plans to bring in 2,000 skilled Chinese workers during ramp-up, illustrate the problem.

Empirical evidence, however, points to a strongly time-dependent pattern. Across both Korean and Chinese battery investments, reliance on home-country staff is [typically](#) highest during the ramp-up phase, when production lines are installed, calibrated and brought to stable operation. This stage is highly knowledge-intensive, requiring experience in achieving commercially viable yields, reducing scrap rates and ensuring consistent quality at scale. Firms therefore have strong incentives to deploy engineers and technicians from established production sites abroad. As production matures, however, the workforce composition typically shifts towards increased local hiring.

Importantly, this shift is neither automatic nor uniform but shaped by local labour market conditions and policy choices. In Hungary, rapid battery industry expansion has outpaced domestic labor supply, leading to a more sustained reliance on foreign labour, [often recruited](#) under so-called “guest-worker” schemes that tie work permits to employers and weaken labor protections. More broadly, [precarious safety and working conditions](#) have become a [recurring concern](#) across the Hungarian EV battery ecosystem. In contrast, Chinese and Korean battery gigafactories in [Germany](#) or [France](#) suggest stronger local employment over time and greater emphasis on working conditions and training. Nevertheless, managerial and technical roles [frequently](#) remain dominated by expatriate staff, limiting the diffusion of high-value skills and know-how.

The central challenge the IAA condition seeks to address is therefore not simply the number of local jobs created, but the timing and quality of workforce integration. The ramp-up phase – when production sites rely more heavily on foreign expertise – is also when the [transfer](#) of critical knowledge about large-scale battery manufacturing takes place. This is precisely the capability European battery start-ups have struggled to develop.

In this sense, the workforce condition is well targeted and potentially impactful. If enforced rigorously across all categories of employment and from the earliest stages of implementation, it could accelerate the transfer of operational know-how and strengthen Europe's industrial capabilities. However, this is also where practical constraints are most acute. Foreign investors have strong incentives to rely on experienced in-house staff during ramp-up to minimise technical and financial risks. Ensuring meaningful local participation at this stage will therefore require effective monitoring and enforcement.

c) R&D and technology transfer

Accelerating technological catch-up is arguably the most ambitious objective of the IAA's FDI conditions. Four of its six conditions – limits on foreign control, joint venture requirements, licensing of intellectual property, and minimum R&D spending – seek to ensure that foreign investment does not merely localise production but contributes to building European capabilities in battery technologies and large-scale manufacturing.

This addresses a real problem: Existing investment patterns have delivered little on this front. Partnerships and joint ventures between EU and Chinese companies – such as CATL-Stellantis and Gotion-Volkswagen – have primarily focused on securing high-quality battery supply, with [little evidence](#) of meaningful technology transfer. This reflects not only firm-level incentives but also policy choices. Most foreign battery investments in Europe have received public support yet this has been granted without binding requirements on IP sharing, R&D spillovers, or the transfer of skills and know-how. The only major exception is France's conditioned support for Taiwanese battery maker ProLogium, which includes [commitments](#) on local R&D diffusion and ecosystem development.

As a result, European firms remain dependent on foreign technology, expertise, and equipment to scale up. No European manufacturer has so far managed to run a gigafactory without some form of external support. PowerCo, for instance, draws on China's [Wuxi Lead](#) for manufacturing equipment and collaborates with Gotion as a [technology partner](#); Slovakia's InoBat has entered a joint venture with Gotion to build a gigafactory; and France's battery ventures [Verkor](#) and [ACC](#) have relied on Asian experts to train their workforce and stabilise production. Partnerships may enable production scale-up, but they are structured on terms set by foreign firms, which retain control over core technologies and processes.

Even where foreign firms establish R&D and training activities in Europe, their contribution to technological upgrading remains limited. Existing initiatives, such as [CATL's cooperation](#) with German research institutes or Samsung SDI's R&D presence in Hungary, tend to focus on testing, adaptation, and incremental innovation rather than the [transfer](#) of frontier technologies.

The challenge of technological catch-up is further compounded by the direction of innovation and political constraints. The EV battery market is increasingly shifting towards lithium iron phosphate (LFP) batteries, where Chinese firms [hold](#) a near monopolistic market position and tight grip on global supply chains. Korean and European producers, meanwhile, have focused on nickel-manganese-cobalt (NMC) batteries. As LFP gains ground, particularly in mass-market EV segments, Korean manufacturers are already seeing their European market share [decline](#). At the same time, Chinese battery makers are advancing into next-generation technologies such as sodium-ion and solid-state batteries, reinforcing their lead through heavy R&D investments. CATL, for instance, [announced](#) mass delivery of sodium-ion batteries from late 2026.

Beijing is reinforcing this lead politically. In July 2025, China tightened export controls on technologies used to process critical minerals and manufacture battery components, introducing [new licensing requirements](#) for the overseas transfer of key lithium iron phosphate battery technologies and lithium processing techniques. As a result, access to frontier technologies is being constrained not only by firm-level incentives but by deliberate state policy, narrowing the scope for technological leapfrogging.

This highlights the substantial challenges to facilitate technology transfer. In principle, the proposed conditions target complementary channels of knowledge diffusion. Ownership caps and joint-venture requirements embed foreign investors into the European industrial base and open channels for spillovers through shared governance and production processes. The condition on localising R&D valued at 1% of annual revenue in a sector projected to reach a market volume

of [€130-€150 billion by 2035](#), could significantly boost innovation activity and develop research capabilities in the EU. Provisions on intellectual property offer a direct route to accessing advanced technologies of next-generation batteries and embedding them in the European market. Yet each condition addresses only one dimension of the problem. Only when applied in combination can they credibly shift the terms on which foreign firms transfer technology and know-how to European companies.

How to make selective FDI conditionality work

The EV battery sector illustrates both the rationale for FDI conditionality and its current limits.

As the preceding analysis shows, foreign direct investment has been pivotal in closing Europe's short-term supply gaps during the industrial transformation. Yet across core channels of domestic capability building – technology transfer, value chain integration, workforce development, and local R&D – FDI's contribution has remained limited, even where projects benefited from substantial public support.

The IAA represents a first targeted attempt to rebalance the status quo. By attaching minimum conditions to foreign investment, it seeks to move beyond an approach merely focused on attracting capital towards one that aims to actively shape FDI's contribution to Europe's industrial base. However, to achieve this the EU now needs to act on three fronts:

1. Tightening FDI conditionality on design, enforcement, and scope

The effectiveness of an investment framework hinges on the stringency, implementation, and, crucially, the combination of its conditions. In its current form, however, its impact is constrained by three key limitations.

First, the IAA needs enforcement. For conditionality to shape outcomes, criteria need to be specific, binding, and clearly defined. The battery sector analysis highlights that the proposed FDI conditions target real shortcomings. At the same time, several provisions remain too weak or ambiguous to guarantee meaningful impact. The sourcing condition amounts to a statement of intent rather than an enforceable commitment, while requirements on local R&D and intellectual property licensing leave considerable room for interpretation as to what constitutes meaningful compliance. In strategic sectors, where firms have strong incentives to protect core technologies and rely on established supplier networks and home-country workers, such ambiguity matters. It creates scope for formal fulfilment without substantive capability-building. This risk is compounded by the fact that compliance is assessed primarily at the member-state level, where varying political and economic incentives have led to divergent implementation in the past. While the Commission retains the option to step in and take over assessments in strategically relevant cases, the political bar for interfering at the EU level is likely to be high and the extent it will exercise this selective discretion remains uncertain.

Second, the conditions set out in the IAA must be applied jointly. The battery analysis shows that no single condition is sufficient on its own. Supplier localisation does not necessarily ensure the presence of European companies in strategic upstream segments. R&D spending and IP-related requirements remain limited in their effectiveness where firms retain full control over the scope and diffusion of knowledge. Similarly, ownership-sharing or joint-venture arrangements alone leave foreign investors room to minimise technology transfer. Earlier [drafts](#) recognised this and reportedly required compliance with all six conditions, removing the possibility for selective application. The shift to a “four out of six” formulation reflects a political compromise shaped by the tension between attracting large-scale foreign investment and imposing more demanding conditions. This tension is real, but the proposed framework – particularly if further diluted during negotiations – risks reducing conditionality to a menu of options, encouraging strategic

compliance whereby firms meet formal requirements while minimising their substantive impact.

A third constraint concerns timing and scope. By the time the FDI framework becomes operational, many major investments will already have been committed. FDI conditionality is expected to take effect only 12 months after the IAA enters into force, placing its effective start no earlier than 2028. Foreign investments undertaken before this date fall outside the scope. In the battery sector, this would exclude 7 out of the 9 currently announced, Chinese-backed battery gigafactory projects, substantially limiting the framework's reach (see Figure 3). Without retroactive coverage of recent foreign investments or accelerated entry into force, the IAA risks arriving too late to support Europe's homegrown battery makers as they undergo the capital-intensive scale-up phase.

If the EU is serious about using FDI as a tool for industrial upgrading, it must tighten the framework across all three dimensions. This means making key conditions binding and clearly defining them to ensure enforceability, requiring compliance across a clear set of complementary criteria to prevent selective application, and accelerating implementation or extending coverage to capture a meaningful share of investments. It also requires establishing common practices and clearly defined, consistently applied guidelines across member states' assessments, alongside a strong supervisory role for the Commission. Without such adjustments, and especially if provisions are further diluted, the IAA's practical impact on technology transfer and industrial upgrading is likely to remain limited.

2. Limiting outside options

FDI conditionality only works if firms cannot easily serve the EU market from the outside. As long as imports from third-country production remain viable alternatives, incentives to localise production within the EU remain weak.

The IAA attempts to address this through local content requirements, tying eligibility for public support schemes to production within the EU. In the EV value chain, this includes linking corporate car tax advantages to EU-based assembly, and conditioning public procurement and purchase subsidies for private consumer on vehicle assembly either within the EU or in countries that have a customs union or free trade agreement with the EU. The framework sets further minimum local content thresholds for components, initially covering several key battery inputs and a substantial share of non-battery components, with provisions to tighten these requirements over time. Notably, important upstream inputs such as precursor cathode materials and anode active materials are not covered.

Crucially, the capacity of these provisions to alter firms' production decisions remains limited. Although a substantial share of EVs sold in the EU [benefits](#) directly or indirectly from public support, especially if the provisions were to cover corporate cars, coverage would still be partial. At the same time, Chinese producers retain substantial cost advantages that allow them to compete even when excluded from such schemes. More fundamentally, they do not remove firms' ability to serve the EU market through imports or alternative production locations.

Imports from China remain a highly effective channel. In Q1 of 2026, China's exports to the [EU rose by 18% year-on-year](#), posting its largest first-quarter surplus at around €72 billion. This expansion is increasingly driven by precisely the sectors at the heart of Europe's industry: Mechanical and electrical products account for over 60% of China's global exports, with [particularly strong growth](#) in the first months of 2026 seen in EVs (+77.5%) and lithium batteries (+50.4%). For Europe this translates into a [near doubling](#) of electric and hybrid vehicles to approximately €19 billion imported from China, accounting for roughly one-third of China's total exports of these vehicle categories.

Crucially, the EU's tariff regime does little to constrain these flows. Plug-in hybrid vehicles are subject to the 10% standard import tariff. And the impact of the EU's anti-subsidy duties on EVs has been modest, with recent trade data [showing](#) that BEV imports bounced back to pre-tariff levels after a temporary slowdown, as Chinese firms continue to [enjoy](#) attractive profit margin on their EU exports. Batteries face even more permissive duties of only around 1.3%.

A second outside option lies in geographic arbitrage. Battery and EV makers could relocate production to nearby third countries with preferential access to the EU market. Morocco, for example, benefits from a free trade agreement with the EU and has attracted around [€18.7 billion in pledged green manufacturing projects](#) from China alone. A similar pattern is emerging in Turkey, where Chinese EV maker [BYD is expanding production plans](#), using Turkey's cost advantages and proximity to the EU market to serve European demand. Depending on how the IAA's local content rules are applied, such production may also qualify as "Union Origin" and continue to be eligible for EU public support, further reducing the incentive to locate activities within the EU.

Therefore, the EU must complement any attempt to condition FDI with a more comprehensive and strategically deployed trade policy. While [anti-subsidy investigations](#) can play a role in addressing specific distortions, they are often too slow and resource-intensive to respond to rapidly expanding export surges. Instead, the EU should make greater use of [safeguard instruments](#) where the legal conditions are met. These are faster, product- or sector-wide interventions, typically in the form of quotas or tariff regimes, in response to sudden import surges. They are therefore better suited to addressing the scale and speed of current trade pressures. Crucially, safeguards can consider broader systemic factors, including persistent overcapacity, exchange rate dynamics, and the interaction with third-country trade regimes, making them a more flexible tool to address structural distortions. Where warranted, they can also be applied to rerouted trade flows via third countries, helping to prevent circumvention.

3. Embedding FDI in a coherent industrial policy framework

Selective FDI conditioning will only deliver results if it is integrated in a credible industrial policy framework. Tightening conditions and limiting outside options for foreign firms is necessary, but it is insufficient to close Europe's technological gaps. To translate into industrial upgrading, FDI conditionality must be embedded in a policy mix that creates predictable demand, provides targeted supply-side and infrastructure support, and ties public support to clear value-creation criteria. Otherwise, the EU risks imposing obligations on foreign investors without equipping European firms to turn them into capability and scale.

The EV and battery value chain represents the EU's most developed attempt to build a coherent industrial policy framework. Yet its effectiveness is undermined less by missing instruments than by weak political alignment across them: the core elements exist but they do not operate as a consistent system.

The most significant weaknesses lie on the demand side. Tightening fleet-wide CO2 emission performance standards and carbon pricing are intended to provide a predictable pathway for electrification. Yet repeated political contestation of the pace of the transition and efforts to dilute key measures have weakened credibility, undermining investor certainty and slowing uptake. At the same time, purchase incentives remain nationally determined, [vary widely](#) in design and scale, and are not systematically designed to foster mass-market EV uptake and local production. The IAA's "Made with Europe" provisions seek to address this gap by linking public support and procurement more closely to local value creation, but their impact will ultimately depend on sustained political backing and the final design of the provisions.

On the supply side, EU-level fiscal capacity to mobilise private investment in the industrial transformation of strategic sectors remains structurally limited. While instruments such as [Horizon Europe](#), [EIB financing](#), and [targeted facilities](#) support research, innovation and investment, their scale remains modest relative to the investment needs. Member states have shown limited willingness to equip the EU budget with additional resources to promote industrial scaling. In response, the EU has increasingly relied on national instruments. Loosened state aid rules and Important Projects of Common European Interest ([IPCEIs](#)) have supported battery projects and industrial conversion, complemented by faster permitting under the [Net-Zero Industry Act](#) and [skills initiatives](#). However, reliance on individual national subsidy schemes, rather than coordinated EU-level instruments, comes at the cost of coherence. Support remains uneven across member states and is not consistently tied to conditions that ensure technological catch-up, capability-building, or long-term value creation.

To address this, the EU should strengthen coordination across demand- and supply-side instruments and tie public support more systematically to clear and enforceable conditions on local value creation. This includes maintaining credible and predictable demand signals through tightening CO₂ standards, aligning national subsidy schemes with common European objectives, and conditioning both EU and national support on measurable contributions to technological upgrading, local supply chains, and skills development.

Conclusion

The IAA embodies the EU's emerging logic of selective FDI conditionality, strategically leveraging access to the single market to reshape the terms of foreign investment in sectors where Europe's dependencies are most acute. That selectivity is justified. In the case of EV batteries, FDI has helped close urgent supply gaps, but it has done too little to build European capabilities in technology, upstream inputs, skills, or scale. Selective conditionality can help avoid this outcome, but only if it bites. That means binding criteria, consistent enforcement, fewer loopholes through imports and third-country production, and an industrial policy framework that gives European firms the demand, targeted support, and absorptive capacity to benefit from foreign investment.

Absent such a framework, FDI conditionality may remain largely symbolic. Where it is not embedded in a coherent policy mix, conditioning foreign investment alone is unlikely to generate meaningful industrial capabilities. This becomes particularly relevant as the EU considers extending this approach to other strategic areas under intensifying competitive pressure. China's industrial ascent underscores the point: Conditioning foreign investment was effective not in isolation, but as part of a broader system combining market-access restrictions with sustained support for domestic firms, infrastructure, demand creation, and technological upgrading. The lesson for Europe is not to exclude Chinese investment altogether, but to ensure that access to the European market translates into European value, resilience, and capability-building.

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