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Europe's Automotive Crossroads: Geopolitics, Industrial Policy, Competitiveness and the Industrial Accelerator Act

By

Brunello Rosa and Nato Balavadze

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For information about Rosa&Roubini Associates, please send an email to info@rosa-roubini-associates.com or call +44 (0)20 7101 0718.

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Executive Summary

The State of Europe's Automotive Industry

- Europe's automotive industry remains a cornerstone of the EU economy, accounting for around 7% of GDP and supporting 13.8 million jobs, but its traditional model is increasingly under pressure.
- As global competitors accelerate the transition to electric vehicles, Europe faces growing challenges from fragmented policymaking, industrial rigidities, and intensifying international competition.

Why Europe is Responding

- Europe's automotive sector illustrates the continent's broader competitiveness challenges, with slow adaptation to the EV transition allowing Chinese firms to gain ground through integrated advantages in batteries, supply chains, and vehicle manufacturing despite Europe's substantial R&D investment.
- Long-term structural shifts have reshaped Europe's automotive geography, with declines in France and Italy giving way to a Germany-CEE production hub that is now facing growing pressures from electrification, rising costs, and intensifying global competition.

China's Integrated EV Ecosystem

- China's EV success is rooted in a decades-long strategy that integrated electricity generation, batteries, critical minerals, renewable energy, infrastructure, and vehicle manufacturing into a single industrial ecosystem, creating advantages in scale, innovation, and supply-chain security.
- Chinese automakers are increasingly localizing production in Europe through investments and partnerships, shifting the challenge for Europe from managing imports to competing with Chinese firms that are becoming embedded within European industrial value chains.

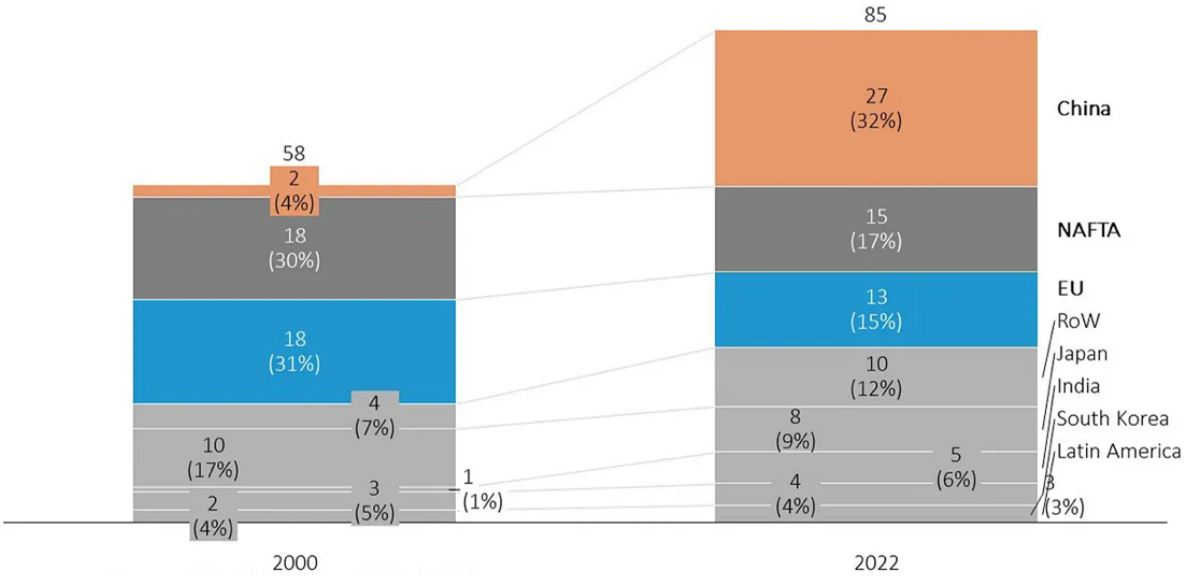
The Debate Around the Industrial Accelerator Act

- The Industrial Accelerator Act is a cornerstone of the EU's Clean Industrial Deal, designed to strengthen industrial competitiveness while supporting decarbonization amid growing pressure from China, high energy costs, and weak investment.
- The proposal promotes domestic manufacturing in strategic sectors through "Made in Europe" procurement rules, local-content requirements, investment conditions, and faster permitting.
- Supporters view the IAA as a necessary response to China's industrial dominance and a tool to enhance strategic autonomy, rebuild manufacturing capacity, and secure critical supply chains.
- Critics argue that the Act risks prioritizing protectionism over competitiveness, warning that local-content rules and investment restrictions could raise costs, slow the green transition, and weaken integration with global value chains.

The UK Question: Industrial Policy Versus Integrated Supply Chains

- The Industrial Accelerator Act has sparked debate over who qualifies as "Made in Europe," with uncertainty over whether UK-made vehicles and components will be eligible for EU procurement programmes and subsidy schemes despite deeply integrated UK-EU supply chains.
- The dispute highlights a broader tension between industrial sovereignty and economic integration, as the EU seeks to strengthen domestic manufacturing while avoiding disruptions to cross-border value chains that underpin Europe's automotive industry.

Key Figure: The Shift in Vehicle Production (Million Units, %)

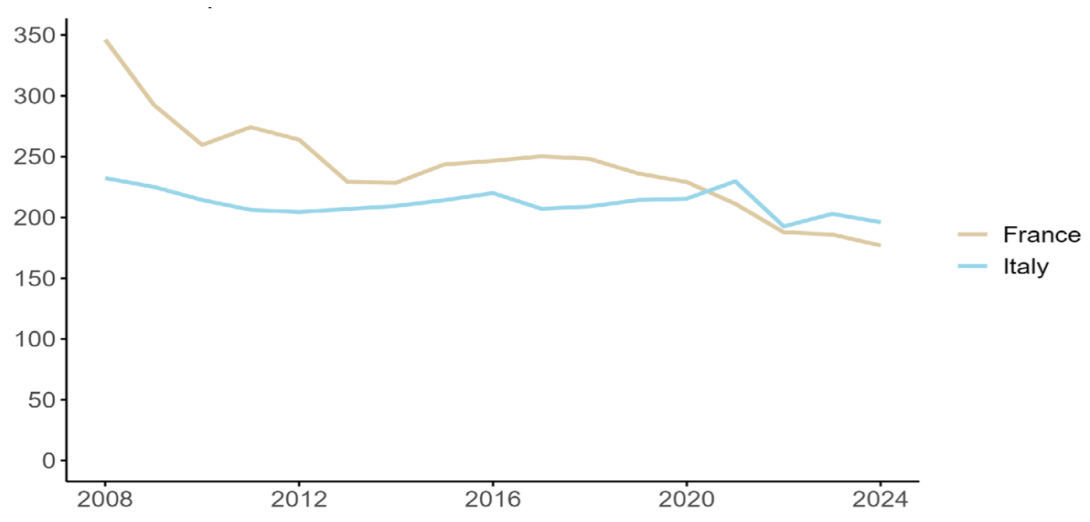


Source: Draghi Report

The State of Europe's Automotive Industry

Europe's automotive industry is entering a decisive decade but lacks a clear strategy for navigating it. While global competitors accelerate the shift to electric vehicles (EVs), Europe remains constrained by fragmented interests, industrial path dependencies, and short-term political pressures. The automotive sector remains one of Europe's most important industries, accounting for around 7% of EU GDP and supporting approximately 13.8 million direct and indirect jobs. For decades, Europe's leading manufacturers benefited from strong engineering capabilities, integrated cross-border supply chains, and dominant positions in global export markets. Today, however, this model is under increasing strain.

Figure 1: Employment in Motor-Vehicle Manufacturing: Italy & France (thousand persons)



Source: Delors Center

Structural Decline and Competitiveness Challenges

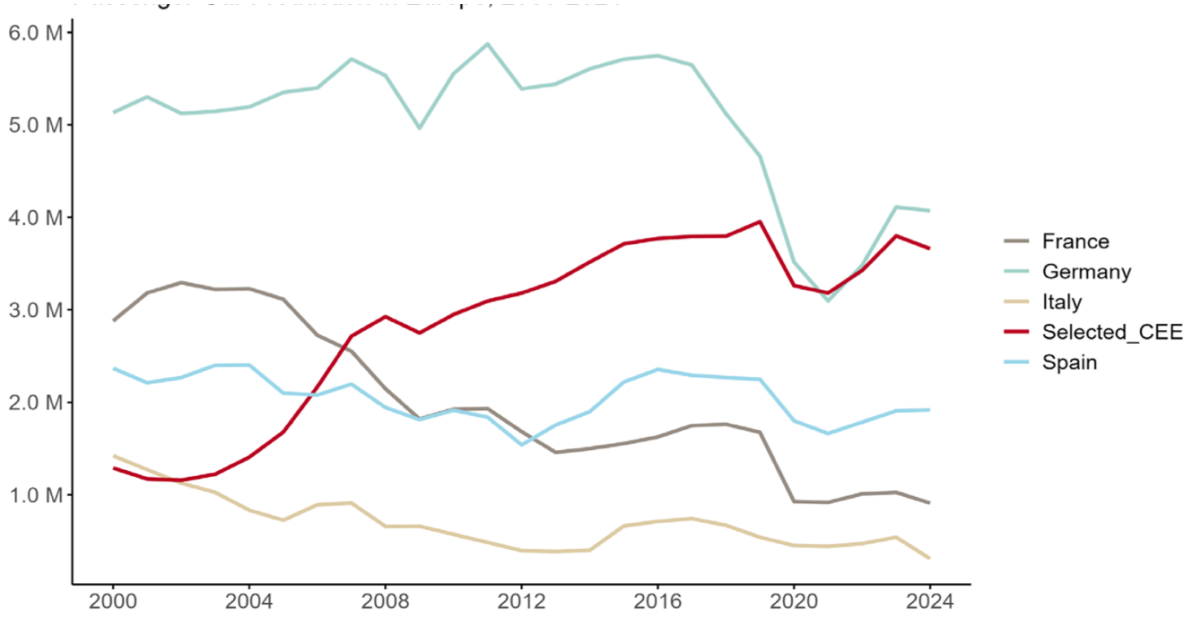
Europe's automotive weakness reflects a broader problem in the continent's political economy: low investment, weak innovation dynamics, and an inability to turn scientific capacity into industrial leadership. As the Draghi report argues, Europe's competitiveness gap is not only a macroeconomic problem but also a sectoral one.

The automotive industry illustrates this clearly. While US corporate R&D leadership has shifted from traditional industries toward technology, Europe's R&D base remains heavily concentrated in the German automotive sector. The industry accounts for around one-third of European corporate R&D investment, yet this spending has not prevented Europe's position from eroding.

Since 2000, EU vehicle production has fallen sharply, while Chinese car imports have surged. Europe is also losing ground in electric vehicles: European brands hold a small share of China's BEV market, while Chinese EV makers are rapidly expanding in Europe. The result is a striking mismatch: Europe continues to invest heavily in an industry where it is no longer setting the technological pace.

Thus, the challenges facing the sector extend beyond the transition to electric mobility. Structural pressures have been reshaping Europe's automotive geography for decades. Long before electrification emerged as a policy priority, France and Italy experienced sustained declines in vehicle production and employment as manufacturing shifted to lower-cost locations. At the same time, the centre of gravity of European automotive production moved eastward, giving rise to a highly integrated Germany-Central and Eastern Europe (CEE) manufacturing cluster that became the backbone of the continent's automotive industry.

Figure 2: Vehicle Production (Passenger-car production, million)



Source: Delors Center

Yet this model is also showing signs of strain. European manufacturers were slow to embrace battery electric vehicles (BEVs), while competitors, particularly in China, used sustained industrial policy support to build scale across batteries, supply chains, and vehicle production. As a result, European automakers are increasingly playing catch-up in a market they once helped shape.

The transition has also proven more difficult than anticipated. EV sales growth has been uneven, several high-profile battery projects have faced delays or setbacks, and a growing number of factory closures and job-cut announcements have fuelled concerns about Europe's industrial future. External pressures are adding to the challenge. US tariffs have increased costs for European exporters, while European manufacturers are steadily losing market share in China, a market that previously generated a significant share of industry profits.

At the same time, the competitive challenge from China is evolving. Chinese automakers initially entered Europe through exports, but increasingly they are pursuing localization strategies through investments, partnerships, and production facilities within Europe itself. Rather than remaining external competitors, Chinese firms are becoming embedded participants in Europe's automotive ecosystem. This shift may support investment and employment in some regions, but it also underscores the growing technological and industrial capabilities of China's automotive sector.

Despite mounting pressures, Europe still lacks a shared diagnosis of the problem. Debates continue over trade protection, industrial subsidies, public procurement, and the 2035 phase-out of internal combustion engine vehicles. While the EU's Automotive Action Plan identifies many of the sector's key challenges, it stops short of articulating a comprehensive industrial strategy capable of restoring Europe's long-term competitiveness.The result is a growing disconnect between the scale of the transformation underway and the policy response designed to manage it.

China's Integrated EV Ecosystem

As discussed in our column, China's growing competitiveness in electric vehicles reflects more than successful industrial policy in the automotive sector. Building on our earlier research on China's emergence as an "electrostate," Beijing has spent decades building an integrated industrial ecosystem centred on electricity generation, batteries, critical minerals, renewable energy, grid infrastructure, and electric mobility. This approach treats electrification not as a single industry but as a system in which energy production, manufacturing, transport, and digital infrastructure reinforce one another. Chinese automakers therefore compete with advantages derived not only from vehicle production, but from access to a broader ecosystem that supports scale, cost reductions, technological learning, and supply-chain security.

This integrated model is increasingly visible in Europe. Chinese-made vehicles accounted for around 22% of EV sales in Europe in 2026, while Chinese brands continue to expand their market share across key European markets. Despite EU tariffs on Chinese-made EVs, sales have grown rapidly, prompting Chinese manufacturers to establish a more permanent presence through local manufacturing and supply chains.

Driven by both commercial incentives and emerging EU industrial policies, incuding the proposed Industrial Accelerator Act, Chinese firms are pursuing investments in European production. While some, such as BYD, are building new facilities, many are opting to utilize underused capacity at existing European plants through partnerships with local manufacturers.

This trend presents both opportunities and risks for Europe. Chinese investment can help preserve jobs and support EV value chains, but it also highlights the growing competitiveness of Chinese automakers. As production becomes increasingly localized, the challenge for Europe shifts from managing imports to competing. As a result, European automakers are increasingly competing not simply against individual Chinese manufacturers, but against a broader industrial ecosystem that supports rapid innovation, lower costs, and global market expansion.

Europe's New Industrial Policy Response

The Industrial Accelerator Act (IAA), proposed by the European Commission in March 2026, is one of the flagship initiatives of the EU's Clean Industrial Deal. It seeks to address a growing concern at the heart of European policymaking: how to decarbonize industry while preserving competitiveness in an era of intensifying global competition.

The proposal emerged against a backdrop of rising pressure on European industry. High energy costs following the energy crisis, growing Chinese dominance across clean-technology value chains, weak investment, and concerns over deindustrialization have raised questions about Europe's ability to maintain its industrial base while pursuing ambitious climate targets. At the same time, the EU faces increasing competition from more interventionist industrial strategies, including China's state-led industrial policies and the United States' Inflation Reduction Act.

Key Provisions of the Industrial Accelerator Act

The IAA aims to strengthen domestic manufacturing capacity in strategic sectors, including electric vehicles, batteries, solar panels, wind equipment, critical raw materials, and energy-intensive industries such as steel, cement, and aluminium. The legislation combines industrial, climate, and economic security objectives. Its key measures include "Made in Europe" preferences in public procurement and support schemes, incentives for low-carbon products, conditions on certain foreign investments, and measures to accelerate permitting for industrial projects.

The Debate Over Industrial Sovereignty

Supporters view the IAA as a necessary response to growing global competition and China's dominance in key clean-technology sectors. They argue that Europe can no longer rely solely on market forces and must adopt a more proactive industrial policy to rebuild manufacturing capacity, strengthen strategic autonomy, and secure critical supply chains.

Critics, however, argue that the legislation risks prioritizing industrial protection over competitiveness. They warn that local-content requirements, procurement preferences, and restrictions on foreign investment could raise costs, slow decarbonization, and undermine integration with global value chains. From this perspective, Europe's challenge is not simply foreign competition but its ability to remain innovative and globally competitive.

The UK Question: How European Is "Made in Europe"?

The proposed Industrial Accelerator Act has exposed tensions over how far "Made in Europe" requirements should extend. Under current proposals, certain subsidies and procurement incentives for electric vehicles would be limited to vehicles produced within the EU. However, the definition of what qualifies as "European" remains contested.

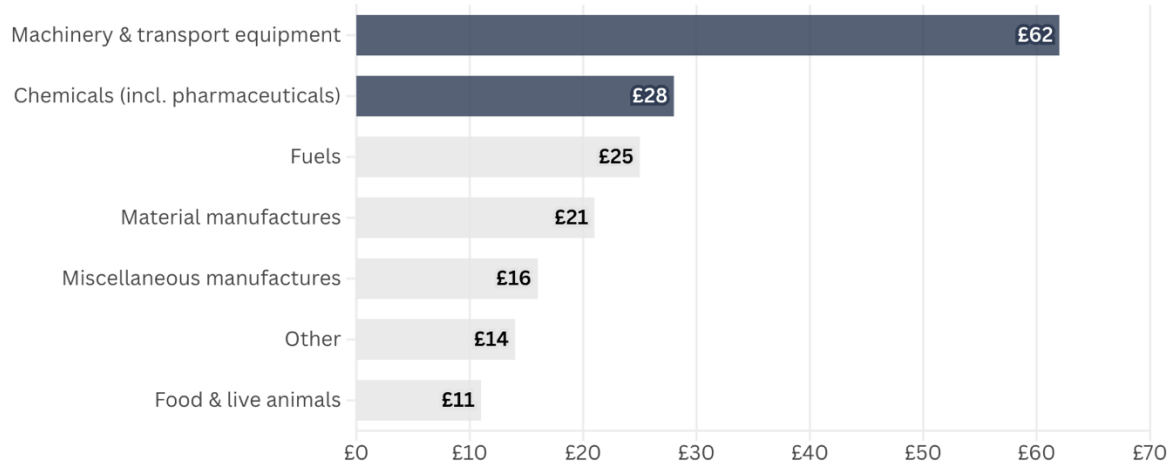
While the initiative is primarily designed to strengthen EU industry, eligibility is not restricted to EU member states. The current framework allows participation by certain "trusted partners" through existing free trade agreements (FTAs) and membership of the WTO Government Procurement Agreement (GPA), provided reciprocal access to public procurement markets exists. Although the UK qualifies under both the UK-EU Trade and Cooperation Agreement and GPA membership, inclusion is not automatic. The European Commission retains significant discretion in determining whether UK procurement rules provide sufficient reciprocity, making access as much a political question as a legal one.

This uncertainty has raised concerns in the UK, whose automotive sector remains deeply integrated with European supply chains and relies heavily on exports to the EU (**Figure 3**). Cars and automotive components are Britain's largest export category to the bloc, while manufacturers including Nissan, BMW, Ford, Volkswagen, and Stellantis operate production networks spanning both sides of the Channel.

British officials have lobbied Brussels to ensure that UK firms are not excluded from procurement programmes, subsidy schemes, and industrial partnerships linked to the bloc's emerging "Made in Europe" agenda. The automotive sector is particularly exposed. Manufacturers including BMW, Volkswagen, Ford, and Stellantis operate production networks spanning both the UK and the EU, making them vulnerable to stricter local-content requirements. While the EU views such measures as a tool to strengthen domestic manufacturing and reduce strategic dependencies, critics argue that they risk increasing costs and fragmenting existing industrial ecosystems.

Several member states, including France and the Netherlands, have signaled support for greater UK inclusion, reflecting concerns that overly restrictive rules could disrupt existing production networks and undermine investment. The debate illustrates a broader challenge facing European industrial policy: balancing the goal of strengthening domestic manufacturing with the realities of highly integrated cross-border supply chains. While local-content requirements may encourage investment within the EU, excessively narrow definitions of "European" production risk fragmenting existing industrial ecosystems and increasing costs for manufacturers operating across the region. As negotiations continue, the treatment of UK-made vehicles has become a test case for how far the EU is willing to balance industrial sovereignty against economic integration.

Figure 3: UK Goods Exports To The EU In 2024, £Bn



Source: ONS UK Trade Bulletins 2024