



New challenges for trade and competition

DIHK impulse paper on local content requirements



German Chamber of
Commerce and Industry

Imprint

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Cover: Getty Image

As of: February 2026

Introduction

At European level, legal requirements to favour local production are currently being considered in various areas. Local content requirements are seen by proponents as an instrument to secure production and employment in Germany in certain sectors or technologies or to react to protectionist, subsidy-oriented behaviour in other countries.

Current European initiatives such as the Industrial Accelerator Act, the European Competitiveness Fund and the revision of EU procurement directives are increasingly focussing on favouring local production. In addition, considerations are also being made to favour a domestic production share in European product regulations. This directly restricts entrepreneurial freedom in many areas. At the same time, it is not clear what further (opportunity) costs these requirements entail. Local content requirements are therefore not a panacea, but at best an emergency solution which, if introduced, must include noticeable relief elsewhere, such as accelerated procedures for the extraction of domestic raw materials.

Key points

In principle, the business community takes a critical view of state intervention in private sector decisions. It is up to companies to diversify their procurement and sales markets from local to global level. At the same time, in view of the changing geopolitical situation, there is also growing agreement in the business community to favour EU companies and/or EU content in order to reduce existing dependencies and avoid new dependencies.

However, competitive disadvantages, which are now to be eliminated via local content requirements, are primarily caused not only by the protectionist, subsidy-oriented behaviour of other countries, but also by EU decisions. If distortions of competition exist due to EU regulations, then these must also be eliminated by the EU. Otherwise, the result will be excessive costs, e.g. for energy, labour and compliance, as well as generally excessive bureaucracy. These domestic factors must now be prioritised - together with a technology-open strengthening of research and development in order to develop competitive technologies in Europe. It is also important to simplify public procurement law instead of making it more complicated through strategic guidelines on local content and burdening it with bureaucracy, e.g. through corresponding obligations to provide evidence.

By improving the framework conditions in the European Single Market, which strengthen the breadth of the economy, migration of industry and industry-related services as well as new dependencies can be avoided. At the same time, this will increase the attractiveness of the location for foreign investment.

In Detail:

Security, industrial and trade policy arguments in favour of more domestic value-added quotas play a role in the debate on local content.

- Political decision-makers must set the direction for **security policy issues**. These include, for example, the exclusion of individual third countries from military procurement, aspects of digital resilience or energy supply, critical components in infrastructures or EU server location requirements for sensitive information. Technologies from companies that are under the control of foreign state actors could harbour significant security risks. Such cases can justify the need for state intervention to create more domestic added value. However, this should be clearly and narrowly defined. In addition to traditional security policy considerations, systemic supply risks could also play a role, for example in strategic key technologies, value chains relevant to energy and climate policy or in the case of high import concentrations; however, local content measures are not the first means of choice here, but other instruments such as state funding and transfer programmes or so-called Important Projects of Common European Interest (IPCEI) are available.
- **From an industrial policy perspective**, local content requirements are fundamentally an instrument for strengthening the domestic economy. However, they should be seen as a "last resort". The aim must be to intervene in markets as little as possible. This is because local content requirements have disadvantages. Apart from the considerable difficulties in assessing what and how much local content means, such specifications harbour risks of undesirable developments such as higher costs or supply bottlenecks if local producers are unable to meet demand. Distortions of competition are also to be expected due to the favouring of certain manufacturers or restrictions in existing sales markets if third countries react with their own restrictions. Finally, local content requirements often reduce the incentive for innovation because there is less competition. They are therefore only suitable and recommended as an industrial policy instrument in exceptional cases.
- The German economy relies on rules-based **international competition** that opens up markets, limits costs and promotes innovation. However, not all countries adhere to the agreed rules of the World Trade Organisation - and sometimes pursue aggressive national promotion policies. In this respect, existing WTO mechanisms and unilateral EU trade defence measures are sometimes too slow and sometimes not sufficient to protect Germany as an industrial location. It is therefore important to quickly implement EU trade defence measures more effectively, to extend the WTO dispute settlement mechanism MPIA to important trading partners and to close the loopholes in the WTO subsidy regulations. Global alliances of like-minded partners are of great importance here.

Europe's competitiveness is based on open markets – restricting markets causes costs

When applying local content, there should always be a balance between the fairest possible competitive conditions for domestic industry and the most open markets possible. The following macroeconomic effects of local content requirements must be taken into account:¹

- **Rising prices:** Europe, which is open and dependent on imports and exports, has a lot to lose. International markets enable innovative and favourably priced offers of (preliminary) products. If foreign (cheaper) raw materials and primary products are excluded by local content requirements, European products can become more expensive. As a result, the competitiveness of European products on third markets also decreases. In addition, production will be cancelled in some areas because the corresponding EU resources for primary products do not exist. The terms-of-trade effects and the loss of purchasing power must also be taken into account if cheaper (preliminary) products from abroad are squeezed out by the protection of more expensive domestic production and thus also (end) products.
- **Additional bureaucracy:** This raises the question of the feasibility of local content requirements, particularly in public procurement. This is because it can be difficult for both companies and contracting authorities to assess when the requirements for categorisation as an EU bidder or "local content compliant" are met and how this is to be proven. Local content requirements can therefore lead to enormous bureaucratic verification obligations for European companies. With regard to "local content", SMEs – even as suppliers in multi-stage supply chains and companies not directly involved in the tender – will also be affected.
- **International credibility decreases and the risk of isolation increases:** The introduction of local content requirements can undermine the EU's credibility as a reliable partner that is committed to open and global trade worldwide, plurilaterally and bilaterally. As a rules-based community of states, the EU must defend the rule of the law, on which the European single market is also based, and should therefore not violate WTO rules and bilateral trade agreements under any circumstances. Excessive restrictions on market access in the EU could prompt third countries to also restrict their markets and thus lead to further trade fragmentation or conflicts. This would have a particularly negative impact on the export-orientated German economy.

¹ These estimates may differ for critical economic sectors such as the medical or pharmaceutical industry. In highly regulated markets such as pharmaceuticals, where the entire supply chain must be legally recorded, the bureaucratic effort is likely to be less, as all the information is already available – from the regulatory authorities as well as from the companies.

Prerequisites for local content requirements

If local content requirements are unavoidable, they should fulfil the following requirements:

1. **Ultima ratio principle:** Local content requirements should be introduced as little as possible, i.e. only in areas that are essential for the security of Europe and/or Germany and that cannot be protected from unfair third-country measures by other means - such as the Foreign Subsidy Regulation (FSR) or the International Procurement Instrument (IPI). If industries are to be protected, then only in a WTO-compliant manner.
2. **Limited in time:** In the case of local content requirements, it should be clearly defined that these are limited in time until the justification for the respective measure ceases to apply in order to emphasise the exceptional nature of such regulations. This also includes continuous monitoring.
3. **Clearly defined and targeted:** It is imperative that local content requirements are clearly defined. This must be practicable, easily verifiable and consistent with other definitions of rules of origin in the broader sense. Both companies and contracting authorities must be able to handle them. If the state classifies entire areas and sectors as strategic and wishes to protect them, these often comprise very complex and global value chains. In these sectors, legislators should only focus on specific, sensitive components². Business-related experts from the relevant sectors should be consulted together with security experts in order to identify the relevant components. If necessary, this can also include needs analyses for crisis situations in cases of national security. This must not result in competitive disadvantages for upstream and downstream production stages.
4. **Comprehensive impact assessment:** Before new protective measures are introduced, a comprehensive impact assessment involving those affected is necessary, with explicit consideration of SMEs, which takes into account both the costs associated with the measures (e.g. possible price increases, additional bureaucracy or a lack of skilled workers in the development of domestic production) and trade policy effects (e.g. countermeasures by third countries and possible conflicts between localisation definitions and preferential rules of origin in trade agreements). In addition, the secure supply of necessary products and components, e.g. for the expansion of the energy infrastructure, should be taken into account both in the short and long term.
5. **Lean-bureaucracy implementation:** Implementation of the local content requirements should take into account the "think-small-first" principle and avoid additional bureaucracy for both companies and contracting authorities. In particular, European companies should not be burdened so much with obligations to provide evidence of local content or multi-tier ownership structures that they ultimately refrain from submitting bids in response to public tenders due to the effort involved.

² such as inverters in solar modules that are to be manufactured in Europe. Relevant areas are: digital resilience/security in critical infrastructure/utilities such as energy supply, water supply, ICT, transport and traffic, healthcare, government and administration, defence.

6. **Provide for opening options:** If it should be de facto impossible to comply with the local content requirements designed on this aforementioned basis, it is necessary to provide for opening options. Otherwise, an existing procurement requirement cannot be met because, for example, an EU product with the required local content does not even exist or because no corresponding bids are submitted in response to invitations to tender. It should also be possible to determine this at the market exploration stage, as otherwise procurement procedures would obviously come to nothing and be delayed.
7. **WTO-compliant design:** A WTO-compliant design of all localisation efforts should be sought, which enables the safeguarding of critical production and innovation capabilities without unnecessarily distorting markets. Escalating trade conflicts should be avoided. Similarly, the EU should not take measures that violate bilateral trade agreements.

Currently relevant discussion in the area of trade defence

- The planned EU steel defence measures, which will come into force when the EU Safeguards expire in mid-2026, are systemic in nature and affect many German companies both directly and indirectly. The aim of the measures is to protect the European steel industry from rising global overcapacity. Parts of the German economy take a critical view of these measures, as they make the cost structure of steel users, where a large part of German value creation takes place, less competitive worldwide.³ The EU Commission speaks of limited price increases, but has not published a comprehensive impact assessment focussing on SMEs. Even if, according to the EU Commission, the measures are to be implemented in a WTO-compliant manner with compensation negotiations with relevant third countries, there is also the threat of countermeasures. In addition, the EU is losing its credibility as a partner that honours its obligations under bilateral and international agreements.
- Affected stakeholders along the steel value chain, on the other hand, are expressly in favour of the protective measures in order to secure Germany's future as a steel location. There are also questions about the extent to which the EU can rely on steel imports from third countries in defence situations. Comprehensive impact assessments with a focus on SMEs and an intensive dialogue with third countries are now important. The aim should be the broadest possible coalition of countries that coordinate their trade defence and subsidy measures and thus keep trade in the metal sector open among themselves. This is all the more urgent as both the negotiations in the OECD Steel Committee and at G20 level within the framework of the Global Forum on Steel Excess Capacity have so far failed to make substantial progress.

³ From the perspective of individual companies, trade defence measures should be extended to preliminary products (derivatives) in the steel and metal sector.