EU Elections Series

April 16, 2024 | Paper No. 8

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Geostrategy

What’s at Stake in the EU Elections: Industrial Policy

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By Julia Trehu | April 16, 2024

The European Parliament elections in 2024 will shape the EU's political direction over the next five years and, therefore, constitute a defining moment. In this series, GMF experts discuss the impact the elections will have on EU policy in key areas, consider what can—and should—be done before the elections, and outline potential post-election scenarios. This piece looks at industrial policy and the challenges of the green and digital transition.

The EU is dusting off its industrial policy toolkit, a wide-ranging set of policies to respond to the challenges of the green and digital transitions, the dangers of concentrated supply chains, and the risks of dependencies amid rising geopolitical tensions. Industrial policy may be "back", with prominent economists rethinking the role of the state in economic development and innovation (through subsidies, tax incentives, targeted investment, and research and development (R&D)), but it is nothing new. The EU's origin as a coal and steel community was an effort to mutualize industrial production to stimulate post-war economic recovery and bind together previously warring states in areas crucial for defense.

The need for an EU industrial strategy will be a central theme in European election campaigns. But the relative slipperiness of the term implies starkly different outcomes that vary according to the place on the political spectrum from which policy proposals come.

Before June 2024: Stumbling Blocks and Lowered Expectations

The return to industrial policy has been evident over recent years. It was seen in the European Commission's 2020 industrial strategy, and, more recently, in the European Chips Act, the Net-Zero Industry Act, and the relaxation of state aid rules to allow subsidies of national industries by governments or groups of member states through Important Projects of Common European Interest. The EU feels threatened by industrial policies deployed by the People's Republic of China (PRC), especially in green technologies such as solar panels or electric vehicles, and the United States, through its Inflation Reduction Act. While Brussels was pleased to see Washington's belated adoption of climate policies, the act's subsidies were seen as enticing EU businesses to relocate abroad. The risks of dependencies—whether on Russia for energy, or on geopolitical hotspots such as Taiwan for semiconductors—and worries about strengthening EU competitiveness, and access to and sovereignty over key critical technologies, mean the bloc is also turning to industrial policy.

This new approach poses several challenges. The EU sees itself as setting rules of the road, from competition policy to artificial intelligence to data protection, that align with its values. To create a single market and level playing field, its rules significantly limit member states' abilities to deploy industrial policy on a national basis. Creating carve-outs to these standards, whether by weakening competition rules to allow European national champions, for example, or through state aid exceptions, risks setting off a race to the bottom on subsidies. Instead of strengthening EU competitiveness, it could widen the gaps among member states, allow firms to play countries against each other for support, increase market concentration in certain sectors, and, ultimately, undermine efforts toward accelerating the green

green transition or increasing economic security and resilience. At the same time, reluctance to adapt to the new realities of the global return to industrial policy also poses risks to European competitiveness and security, with attendant downstream social consequences.

The EU, however, does not have a federal budget able to subsidize specific sectors, and industrial policy largely remains under national control. There is also the question of the extent to which industrial policies can be deployed within World Trade Organization rules. EU instruments focus on carbon pricing (via the Carbon Border Adjustment Mechanism) rather than on subsidies for green technologies. Measures to match US tax credits would require unanimity among member states, which is unlikely. And while member states recognize the risks of loosening state aid restrictions to allow national subsidies, the alternative, pooling resources via a proposed Sovereignty Fund, continues to be watered down and lacks the necessary political will. The €10 billion Strategic Technologies for Europe Platform (STEP), proposed in 2022, for investment in cleantech and R&D was whittled down by January 2024 to €1.5 billion specifically earmarked for defense.

Scenarios and Risks: What Happens After the Elections?

There is support across the political spectrum for some kind of increased industrial policy, and it is visible in campaigns from labor groups and through business support for a proposed EU Industrial Deal alongside the bloc's existing Green Deal. An ideological realignment in the upcoming elections, however, will have significant impact on the objectives or policy prescriptions regarding industrial policy. Left-leaning and Green parties emphasize the necessary green dimension of an EU industrial strategy. The conservative European People's Party has called for state aid for specific sectors, but the emphasis is often on traditional industries, while the perceived costs of environmental policies, one factor behind recent protests by farmers across Europe, is a cause of concern. While funding for industrial policy should be pooled and coordinated as much as possible at the EU level to avoid a race to the bottom among member states and to maintain bloc cohesion, this is easier said than done.

Member states are already skeptical of the EU Sovereignty Fund. Why should they pay out to support development elsewhere? A power shift toward far-right parties at the EU level would essentially close the door on any such possibility and divert efforts from combatting climate change through investment in green technology. The far-right Identity and Democracy Party grouping is already highly critical of the current Commission's green policies. Those on this part of the political spectrum frame the Green Deal as too onerous for industry and workers. They see climate policy as undermining the existing industrial base and fueling unemployment and inflation. Were they to gain power in the next European Parliament, a new EU anti-climate coalition would arise. This would also herald a brake on efforts to ramp up cleantech industries. Without the green transition at the heart of new EU industrial policies, the bloc's environmental trajectory would be toward fracture rather than resilience.

The goal for European industrial policy should be to pursue targeted deployment of technologies needed for the green transition. The effort, however, must ensure that distortions to the single market do not have uneven effects and do not widen the gap between member states with the fiscal capacity to subsidize (namely Germany and France) and the rest. This will help create a level playing field, avoid a subsidy race, and prevent the PRC from benefiting from existing subsidies in the absence of local-content rules. The challenge for the next Commission, likely still under President Ursula von der Leyen, will be implementing current industrial policies and strategies, not creating new ones. National cleantech investment will also continue and possibly diverge among member states as national politics dictate.

An EU industrial strategy should, therefore, include:

- bloc-level investment incentives to prevent firms from moving abroad, including R&D investments to create the necessary conditions to attract high-tech industry
- a focus on exporting EU standards, for example for batteries and cleantech
- setting clear objectives beyond increased competitiveness or resilience: What are the EU's specific needs in, for example, semiconductors, and what market share would signify an acceptable level of risk versus resilience? In what sectors should promoting domestic production take precedence over importing green technologies from the PRC, even at the risk of slowing deployment and missing carbon-reduction targets?
- skills-training, workforce and social investment, and workforce participation
- creation of a European Sovereignty Fund beyond the reallocation of resources from existing programs to help finance deployment of green technology and renewable energy, and ensure balance among member states
- coordination with allies and partners through bodies such as the Trade and Technology Council, whose continuation depends on the US presidential election result

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