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LUHNIP Monthly brief on EU Industrial Policy

January 2024

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Every month, our Monthly Brief on EU industrial policy provides a bullet-point recap of the month's main events, followed by three reasoned deep dives into significant developments of EU industrial policy. Our analysis is complemented by a monthly guest contribution from renowned experts or practitioners in the field.

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Last Month in Brief

- **1 January:** beginning of the Belgian Presidency of the Council of the EU (**see below the Monthly Guest Contribution by Belgian Secretary of State Thomas Dermine**)
- **8 January:** the European Commission approves Germany's State aid in favour of Swedish battery maker Northvolt. This is the first case of "matching aid" (**see deep dive 3**)
- **15-16 January:** European ministers responsible for the environment meet in Brussels for an informal meeting
- **15-18 January:** the European Parliament meets in Strasbourg for a plenary session **16 January:** the European ministers of Economic and Financial affairs meet in Brussels for an Economic and Financial Affairs Council meeting to discuss, among others, the financing of EU industrial policies (**see deep dive 1**)
- **22-23 January:** European ministers for Trade meet in Brussels for an informal meeting to discuss European strategic autonomy and the preparation of the next WTO conference
- **24 January:** the European Commission adopts 5 legislative proposals to strengthen the EU's economic security (**see deep dive 2**)
- **26 January:** the Council of the EU adopts its position (negotiating mandate) on the regulation prohibiting products made with forced labour on the EU market
- **30-31 January:** European Commissioners Margrethe Vestager (Competition), Valdis Dombrovskis (Trade) and Thierry Breton (Internal Market) participate in the 5th EU-US Trade & Technology Council meeting in Washington
- **30-31 January:** the European Defence ministers meet in Brussels for an informal meeting to discuss how to strengthen the European defence, technological and industrial base (EDTIB) and the upcoming European Defence Industrial Strategy (EDIS)

LUHNIP's Deep Dives

1) The ECOFIN's work on the financing of EU industrial policy

On 16 January 2024, during the first ECOFIN (Economic and Financial Affairs Council) of the Belgian Presidency of the Council, Belgium's Minister of Finance Vincent van Peteghem outlined the Presidency's three main priorities for the semester:

1. *The economic governance review and the trialogue negotiations with the European Parliament;*
2. *Strengthening the European Banking Union and further deepening the Capital Markets Union;*
3. *Ukraine's future financial support.*

Deepening the Capital Markets Union (CMU) has become key in discussions about how to finance EU industrial policy. According to some calculations, the EU needs around €600bn additional yearly net investments from now to 2050 to achieve the goals of the twin transition. Given the mounting "green backlash" across the EU, the hope is that private investors will chip in with the funds necessary for the bloc to achieve its climate and digital objectives. Various politicians and experts have argued in favour of a full-fledged CMU to boost investment across the EU. Over the past years, various Council meetings and two action plans on the completion of the CMU (2015 and 2020) by the Commission have taken place. Yet, the project remains far from being concluded due to difficulties in harmonising laws and opposing interests across Member States: financially and economically weaker Member States fear capital will flow toward stronger EU states.

The introduction of new own EU resources to enable the dual transition of European industry is another major priority of the Belgian Presidency of the Council. In this regard, discussions within the Council have stalled despite the European Parliament's favourable position and despite the proposals set forth by the Commission in December 2022. These include greater revenues from an extended Emissions Trading Scheme (ETS), a border carbon adjustment mechanism (BCA) and payments by the Member States of a national contribution based on a share of the residual profits of the large multinational companies on the basis of pillar 1 of the 2021 OECD/G20 agreement.

LUHNIP's take

Following last December's European Council proposal to substantially reduce the new budgetary resources devoted to the twin transition, during the first ECOFIN meeting of the year the new Belgian Presidency of the Council raised the issue of EU industrial policy financing. Belgian authorities have made strengthening the EU industrial policy one of their Council presidency's key priorities. Historically, Belgium has been deeply concerned about large EU economies' spending for state aid. The President of the Flemish Region, Jan Jambon, has recently called for the end of temporary flexibilities in the EU state aid framework.

The Belgian presidency's ambition to find new solutions for EU-level funding of the bloc's new industrial policy ambitions dovetails with both the Commission's positions and France's ambitions. Addressing the European Parliament, Thierry Breton, Commissioner for Internal Market, has recently called for the creation of a €100 billion defence fund. French President Emmanuel Macron has proposed the creation of EU defence bonds at the last meeting of the World Economic Forum in Davos.

The quest for new solutions to jointly fund EU-wide industrial policy comes against the backdrop of experts' continuing warnings about the risk of Europe's fast de-industrialisation, waning US support for military aid to Ukraine, and fears that Donald Trump's return to the White House may jeopardise Europe's defence and security objectives.

2) The European Commission adopts a new EU economic security package (24 January 2024)

On 24 January 2024, the European Commission adopted an "economic security package" that included five initiatives:

1) *a new regulation on the screening of foreign direct investments;*
2) *a White Paper on Export Controls;*
3) *a White Paper on Outbound Investment;*
4) *a Proposal for a Council Recommendation on Research Security;*
5) *a White Paper on research and development involving technologies with dual-use potential.*

The adoption of this package had already been announced in the Joint Communication by the European Commission and the High Representative for Foreign and Security Policy on a European Economic Security Strategy last 20 June 2023.

In revising the 2019 FDI Screening Regulation, the aims of the **Proposal for a new regulation on the screening of foreign investments** are threefold. First, Member States are being asked to establish mandatory screening mechanisms for both extra-EU and intra-EU investments that may pose a risk to security and public order in the EU. Between April 2019 and June 2023, around 23% of foreign acquisitions and 20% of greenfield projects occurred in Member States without full-fledged screening mechanisms. Second, the proposal aims to harmonise rules for FDI screening and strengthen cooperation between the Member States and the Commission. Third, it proposes to enhance cooperation mechanisms to screen investments across EU Member States in cases where the investor is in/directly controlled by a foreign entity.

The White Paper on Export Controls aims to improve coordination between the Member States and the Commission concerning the control of technology exports sensitive to EU security. In this realm, divergent approaches across Member States undermine the effectiveness of controls and weaken EU security as a whole. The Commission advocates for greater political cooperation, uniform export controls across the EU and greater coordination and coherence in the new National Control Lists introduced by the different Member States.

The White Paper on Outbound Investment aims to assess the potential risks of outbound European investments – particularly concerning dual-use technologies – for international peace and security. According to the Commission, there is significant risk that investments could be hijacked by third countries to develop their military capabilities. The Commission proposes to review outbound investments in specific technologies and carry out a security risk assessment with the Member States, followed by ad hoc policy proposals.

The proposal for a Council Recommendation on Research Security sets forth a European approach to the issue of critical technology and knowledge transfer to third countries. The fear is that third countries may capitalise on EU know-how and technologies to develop military capabilities that pose a threat to the EU's security and the EU's fundamental values. The Commission aims to curb the proliferation of a plethora of uncoordinated national measures which would eventually lead to the fragmentation of the European Research Area (ERA). The proposal envisages the creation of a platform to support researchers and technologists involved in international cooperations dealing with these risks and the creation by research institutions of platforms to exchange critical information among the various EU research stakeholders.

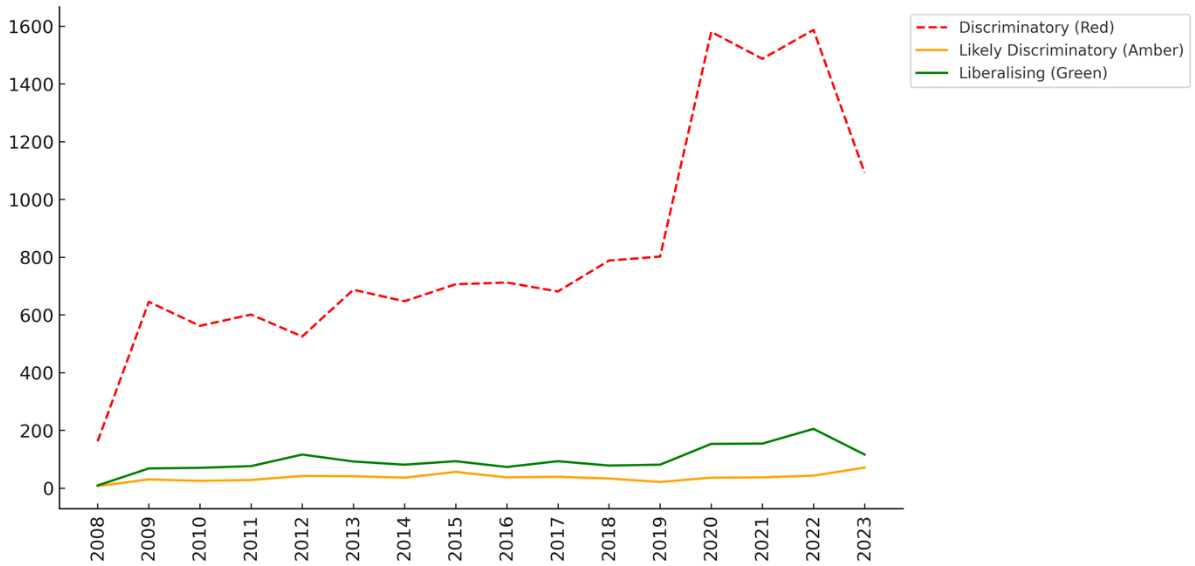
The White Paper for enhancing support for research and development involving technologies with dual-use potential proposes various options for Member States to strengthen cross-fertilisation in the R&D of technologies with dual-use potential considered essential for modern defence capabilities in the EU. This document follows several related initiatives which, since 2021, have aimed at improving synergies between the various research programmes with civilian applications (Horizon Europe) and those with military applications (under the European Defence Fund (EDF)). To strengthen the development of dual-use technologies, the Commission proposes to remove the exclusive focus on civil applications in parts of the next multiannual framework's programme for research and innovation as well as the creation of a new instrument focusing specifically on R&D with dual-use potential.

LUHNIP's take

The adoption of the European Economic Security Package represents an important step in the European Union's quest for economic security in times of geo-economic competition between China, the EU and the US. By proposing to adopt a pan-European approach to economic security measures, the Commission wishes to prevent the proliferation of national discriminatory trade measures based on Member States' narrow interests. As shown in Figure 1 below, these have been on the rise over the last years. Such developments risk fragmenting the single market and weakening the European Union's strategy of building strategic autonomy.

However, obstacles persist. It will be difficult to nudge Member States into adopting an EU-wide approach to policies that have historically been dictated by the strategic interests of each European nation and its companies. For FDI screening, the Commission may force participation by Member States, but Member States ultimately retain the power to decide whether to set up a national screening mechanism or not and how to deal with each specific case. Another difficulty lies in defining the EU's interests in economic security. The Von der Leyen Commission has made advancements in this sense - for example by defining a list of strategic technologies – but it remains difficult for Member States to agree on a common approach to economic security. Hungary's opposition to a common approach to the screening of Chinese foreign investment at the last informal meeting of European trade ministers epitomises this problem.

Figure 1: The evolution of discriminatory and liberalising trade measures in OECD countries (2008-2023)



Source: Our elaboration based on Global Trade Alert data.

3) The European Commission's approval of the first matching aid and the European parliament resolution on the 2023 report on competition policy

On 8 January 2024, the European Commission approved Germany's State aid in favour of Swedish battery maker Northvolt. This subsidy of €902mn includes €700 direct grants provided by the German federal government (€564mn) and the regional government of Schleswig-Holstein (€136mn), but also a state guarantee of €202mn. The measure provides public financial support for the construction of an electric vehicle battery production plant in Heide (Germany) by 2026. **This is the first case of "matching aid" in the EU,** namely State aid which can be approved by the Commission under the Temporary Crisis and Transition Framework (TCTF) to prevent investments from being "unfairly diverted to the highest bidder outside Europe."

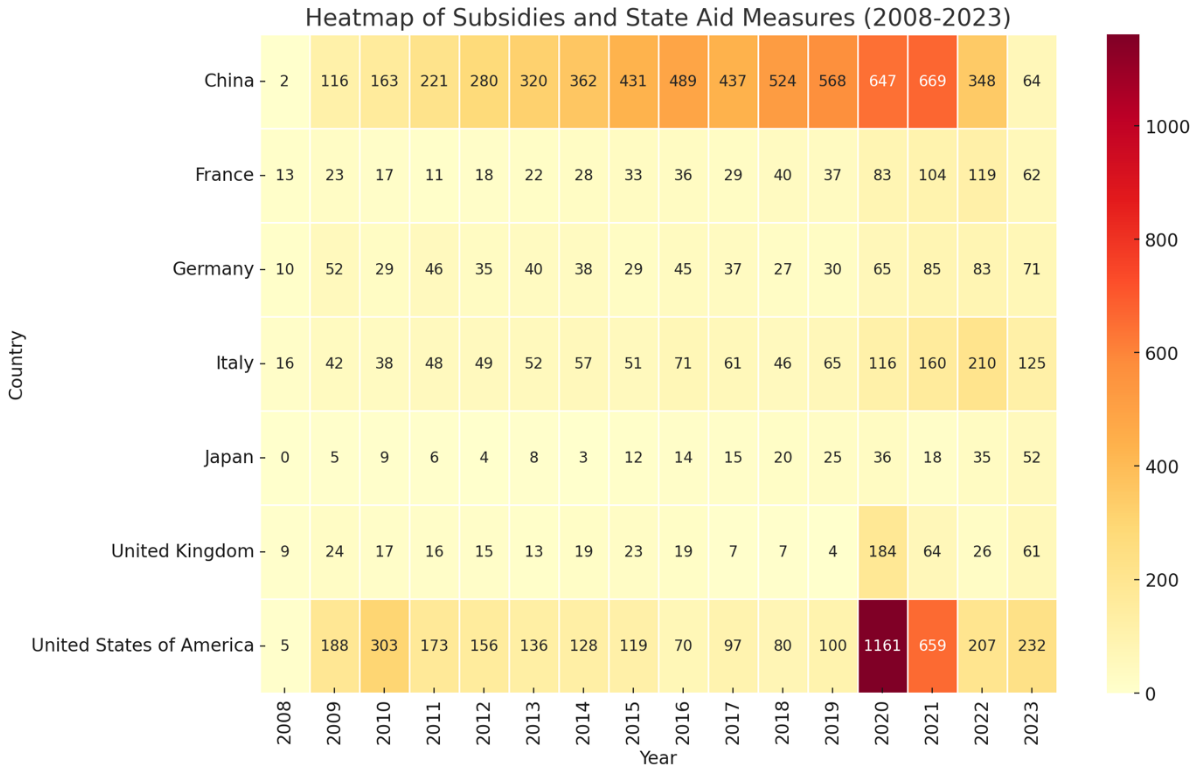
Indeed, the decision was motivated by the fact that, absent the German subsidy, Northvolt would have built its facility in the US state of Nebraska thanks to $850mn subsidies. At the same time, the Commission considered that State aid was of strategic importance for the European industry's environmental transition. Battery production in the EU is both vital for the gradual electrification of the European car fleet and to reduce the EU's dependence on China, the world's leading manufacturer of batteries.

On 16 January, the European Parliament approved its resolution on the 2022 Commission annual report on competition policy, calling on the Commission to ensure that the EU response to the US Inflation Reduction Act (IRA) does not result in a subsidy race between Member States. As Figure 2 below shows, subsidies and state aid measures have been on the rise over the last decade. The provision of state aid measures has accelerated especially since the COVID-19 pandemic, in China and the US, but also across Member States.

On the one hand, the European Parliament calls for temporary and well-targeted state aid to support the EU's industrial, environmental, and social policy objectives. On the other hand, it is calling for EU competition law and policy to be strengthened in specific areas, for example:

- *Concerning the rules on public procurement to be modernised to help the environmental transition of industry;*
- *The creation of European standards;*
- *The simplification of the notification procedures for the different Important Projects of Common European Interest (IPCEIs) and antitrust procedures.*

Figure 2: Heatmap of the evolution of Subsidies and State Aid Measures in the major world economic powers from 2008 to 2023



Source: our elaboration based on data from the Global Trade Alert database.

LUHNIP's take

The European Commission's approval on 8 January 2024 of the first "matching aid" is a significant event because it demonstrates the Commission's determination to use competition law to achieve industrial policy objectives, even if this may result in the fragmentation of the single market. This latter problem is a major source of concern for the European Parliament, as the content of its resolution on the Commission's latest report on competition policy shows. The European Parliament favours strengthening EU-level competition policy and horizontal industrial policy instruments rather than giving Member States too much leeway to pursue national competition or industrial policies. Over the coming months, a major concern will be how to solve the difficult equation between the need to compete with China and the United States in industrial terms and the preservation of the single market. Particular attention to these issues will be paid in the publication of Enrico Letta's report on the future of the single market, now scheduled for April.

*** Guest contribution of the Month ***

Thomas Dermine

Belgian Secretary of State for Recovery and Strategic Investment

EU Strategic Investments and Industrial Policy in a New World Disorder

Industrial policy in Europe has historically oscillated between interventionist strategies, notably prevalent during post-war reconstruction, and market-oriented approaches, highlighted by the development of the internal market and competition policy, including state aid regulations. Two key policy instruments often underscored in industrial policy are investment in infrastructure and the promotion of industrial clusters. The EU must commit to strengthening these two pillars, adhering to the Jacques Delors' mantra: "*On doit pouvoir concilier planification et liberté*" ("One should be able to reconcile central planning and freedom").

Since the Treaty of Rome, Europe has supported major cross-border infrastructure projects in the areas of transport, energy, and telecommunications, both in terms of strategic planning and financial support, whether through budgetary funds or via the European Investment Bank (EIB). It was felt that such Trans-European Networks (TENs) would reinforce the internal market and the economic cohesion among regions. In addition, such projects were found to boost economic growth and employment. In the aftermath of the 2007-2008 economic and financial crisis, the « Investment Plan for Europe - IPE » (also called «Juncker Plan») reinforced the role of the EU in coordinating and financing key infrastructure projects. This initiative extended beyond TENs, encompassing the "twin transition" (climate action and digitalization/AI) and other EU priorities such as health, education, and the environment. The subsequent COVID-19 pandemic confirmed the urgency for an ambitious drive at European level to rescue national economies from recession. The creation of the "Resilience and Recovery Facility" (RRF), with a substantial envelope of EUR 800 billion raised on the bond markets under the EU's signature, marked a historic step. These funds, allocated as grants or loans to Member States, are earmarked for policy-oriented projects, primarily in the infrastructure sector, including renewables, fibre optics, energy efficiency, and sustainable transport.

On behalf of the Belgian government, I submitted a National Recovery and Resilience Plan to the European Commission in April 2021. Such plans, taken collectively, provide for the first time ever a comprehensive mapping of the strategic infrastructure investments across the EU, which is an invaluable insight for the economy to adapt itself to such orientations. In Belgium, for example, with 51% allocated to green initiatives and 27% to digital investments, we are paving the way for the twin transition. From transforming the North Sea into a major energy hub to expanding fibre optics infrastructure and 5G capabilities in industrial parks, and streamlining administrative processes through digitalization, we are charting a course towards a more sustainable future in collaboration with the private sector.

In the framework of the current Belgian Presidency of the Council of the EU, expectations are high for the mid-term review of the RRF instrument. The Presidency will ensure that the ECOFIN Council will carefully observe the recommendations to optimise the RRF, a new instrument that should in one form or another become a permanent feature of the EU, also taking stock of some teething problems that need to be fixed. At our request, a policy paper has been published in January this year about « Accelerating strategic investment in the European Union beyond 2026 », with policy recommendations that should be part of the strategic agenda for the next legislature.

Furthermore, the geopolitical reshuffling has reshaped the traditional EU approach towards industrial policy, hitherto based on a « laissez-faire » approach disciplined by a comprehensive State Aid framework. Times have changed. If the EU is to maintain its standards of living and strategic autonomy, it needs to retake control not only of its energy, but also of its technological and industrial leadership, especially for critical value chains and raw materials. The IPCEI framework emerges as a pivotal tool for advancing the EU's industrial objectives, particularly in sectors like semiconductor manufacturing and hydrogen infrastructure. Facilitating extensive cross-border collaboration, IPCEI fosters ecosystems for critical innovation and infrastructure projects within the European Union. For instance, Belgium has participated in IPCEI initiatives focusing on hydrogen, battery technologies or the biotech sector. To leverage this instrument effectively, it is crucial to ensure that it does not distort the internal market and allows the participation of all Member States. To be effective, the IPCEI instrument needs to be streamlined and ensure that it does not create unfair competition practices amongst Member States. Moreover, it should be accompanied by genuine EU-level coordination to enhance collective efforts and a robust European financing strategy, drawing inspiration from the NextGenerationEU funding model.

A "New EU Industrial Strategy" is emerging. I am convinced that the EU needs to connect all the dots and develop a global vision that spans the need for strategic investments and the demands of a newly found industrial policy. Political leaders will have to articulate EU and national resources smartly and efficiently to address the twin transition and consolidate the bloc's internal market and competitiveness (two topics to be addressed by upcoming reports commissioned by the European Commission to Enrico Letta and Mario Draghi), this without resorting to neo-protectionism and market distortions, which often work against the smaller Member States and the interest of the citizens in general. Time for strategic government, time for action!