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LUHNIP Monthly Brief on EU Industrial Policy

May 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 in EU Industrial Policy. Our analysis is complemented by a monthly guest contribution from renowned experts or practitioners in the field.

Last Month in Brief

- **6 May:** French President Emmanuel Macron and President of the European Commission Ursula Von der Leyen [meet](#) with Chinese President Xi Jinping for a trilateral exchange on EU-China trade and economic relations ([see Deep Dive 1](#)).
- **8 May:** The European Investment Bank (EIB) [adopts](#) its Security and Defence Industry Action plan.
- **11 May:** Finance ministers of the eurozone countries [meet](#) to discuss the state of implementation of the Recovery and Resilience Facility (RRF), the Value Added Tax (VAT) package for the digital age and the completion of the Capital Markets Union.
- **16 May:** The European Commission [opens](#) formal proceedings against Meta under the Digital Services Act (DSA).
- **21 May:** EU ministers for Digitalisation and Telecommunications [meet](#) to discuss the implementation of the adopted legislation in the digital and cybersecurity fields and the future of EU policies in these sectors.
- **23 May:** EU ministers for Innovation and Science [meet](#) to discuss the future EU space law, the strengthening of the European space sector and the recent EU initiatives in research policy ([see Deep Dive 2](#)).
- **24 May:** EU ministers for Economy and Industry [meet](#) to discuss the future of EU industrial policy, the internal market and the public procurement policy ([see Deep Dive 3](#)).
- **27 May:** The Council of the EU [adopts](#) the Net-Zero Emissions Industry Act (NZIA).
- **28 May:** EU Defence ministers [meet](#) to discuss EU military support to Ukraine and the strengthening of the EU's Defence Technological and Industrial Base (EDTIB).
- **30 May:** EU ministers for Foreign Affairs and Trade [meet](#) in Brussels to discuss the contribution of EU trade policy to strengthening the competitiveness of European industry and the export controls and Dual Use regulations.

¹ We would like to thank Romain Cohen, Francesco Montaña, Giulio Petrillo, Giovanni Pacchiardi and Francesco Rosazza Boneitin for their excellent research assistance.

LUHNIP's Deep Dives

1) The results of the trilateral summit between China, France and the European Commission

On 6 May, France's President Emmanuel Macron and the President of the European Commission Ursula von der Leyen met China's President Xi Jinping for a trilateral summit in Paris. The meeting was organised prior to Xi Jinping's State [visit](#) to France, marking the 60th anniversary of Franco-Chinese relations. It [aimed](#) to address the growing tensions between the EU and China over trade, Chinese market access and fair competition.

The President of the European Commission [confronted](#) Xi Jinping about the Chinese subsidised products flooding the EU market, such as electric vehicles and steel. At the same time, it encouraged the Chinese President to address the country's structural domestic industrial overcapacities. Chinese authorities have always denied these allegations, emphasising the necessity of dialogue amidst ongoing EU investigations of imports of Chinese electric [vehicles](#)² and of subsidies for the Chinese solar [photovoltaic](#) and wind [turbines](#) sectors.

Subsequently, the EU and Chinese leaders exchanged opinions on market access and trade fairness. Emmanuel Macron and Ursula Von der Leyen [emphasised](#) the need for reciprocal access to markets to avoid distortions that could lead to European deindustrialisation. They also [underlined](#) the EU's determination to use its trade defence tools to counter market distortion should dialogues fail. This attitude is exemplified by the European Commission's launch last April of the first [investigation](#) under the EU International Procurement Instrument ([IPI](#)) into the measures and practices in China's procurement market for medical devices. Ursula Von der Leyen also [affirmed](#) the EU's willingness to continue addressing excessive dependence on key suppliers of critical raw materials, like China, by diversifying sources of supply.

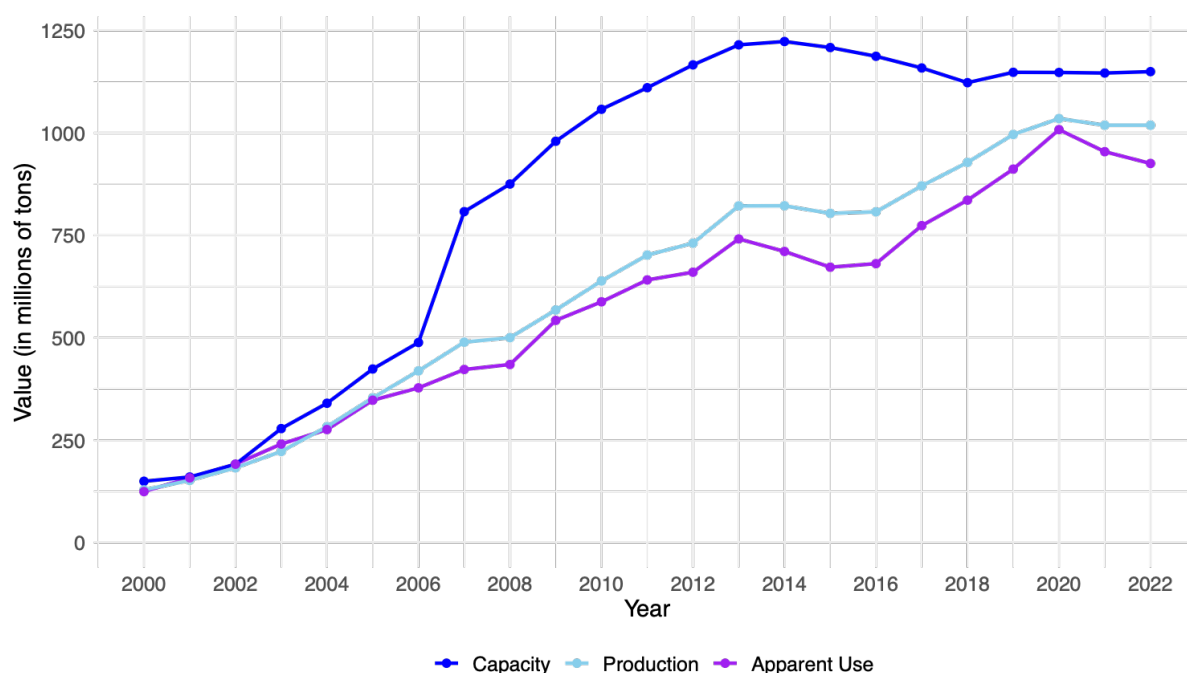
LUHNIP's take

Similarly to the 24th EU-China summit in [December 2023](#), the trilateral meeting between Emmanuel Macron, Ursula von der Leyen and Xi Jinping did not lead to any concrete agreements to resolve the current problems in economic and trade relations between the EU and China. However, it did show that dialogue continues between the two economic powers, despite current trade disputes and the EU's [criticism](#) of China over its close relationship with Russia. At the same time, President Macron's invitation to Ursula Von der Leyen to attend a meeting with Xi Jinping ahead of his state visit to France demonstrated a united EU front against China. It [contrasted](#) with Chancellor Scholz's bilateral meeting in Beijing last April, during which he [defended](#) only the interests of German industry.

² The Commission's recent announcement of the provisional conclusion of its anti-subsidy investigation into imports of Chinese electric vehicles will be analysed in our June monthly brief.

While the three leaders emphasised the need to pursue dialogue, the forthcoming [publication](#) of the results of the EU's anti-subsidy investigation into Chinese [BEV](#) imports could lead to an escalation of tensions between the EU and China. In a [letter](#) to the European Commission, China warned that if tariffs were to be imposed, retaliatory measures on EU agricultural and aviation sectors could be adopted. At the same time, China's mounting overcapacity in strategic sectors, like the [shipbuilding](#) and [steel](#) industries, may cause difficulties in resolving trade disputes between China and the European Union. In the latter sector, despite the decline in total crude steel production and apparent steel consumption, mainly due to the crisis in China's real estate market, industrial capacities have continually increased in recent years. The steel industry has maintained its investments in expanding facilities, leading to increased production capacities (**See Graph 1**).

Graph 1: Trends in Chinese steel production overcapacity (2000-2022)

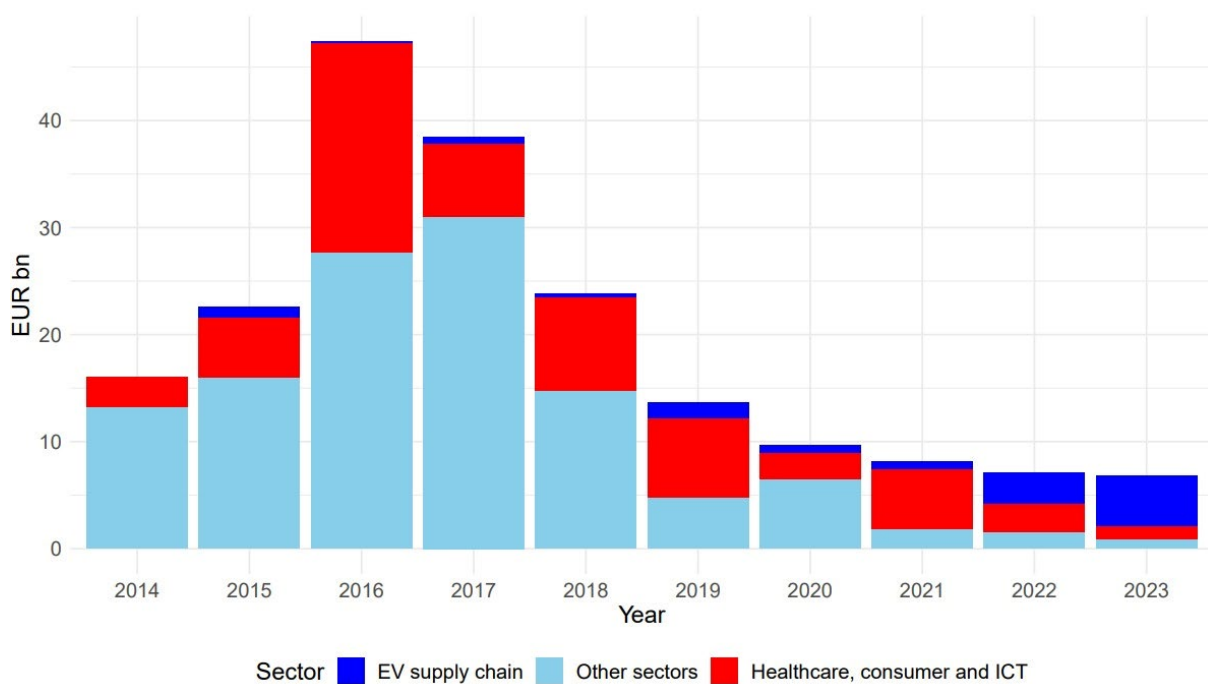


Sources: our own elaboration from [OECD Statistics](#) and [World Steel Association](#). Capacity and production refer to crude steel. Apparent steel use is an estimation of domestic demand and is measured in terms of finished steel products. Exports refer to semi-finished and finished steel products.

The Biden administration's recent [decision](#) to increase tariffs on imports of Chinese electric cars, solar panels and steel may also lead to an acceleration of current trade tensions between China and the EU. It can [redirect](#) China's excess industrial production to the EU, where these products have lower customs duties. In the electric vehicles sector, there has already been a notable increase in Chinese foreign direct investment in recent years (**see Graph 2**). This trend is exemplified by Hungary's future [hosting](#) of BYD's

BEV plant and the recent [announcement](#) by the Chinese company Chery of the building of its first European electric vehicle plant in Barcelona.

Graph 2: China’s foreign direct investment in Europe by industrial sector (2014-2023)



Source: [MERICS](#), 2023.

2) The future of EU research and space policies

On 23 May, the EU ministers for research and space policies convened in Brussels for a Competitiveness Council (Space, Research and Innovation). The Council meeting was devoted to space policy, with an exchange of views on the future EU Space Law ([EUSL](#)), the preparation of the next EU-ESA Space Council meeting and the contribution of the space sector to the competitiveness of European industry. It also covered EU research and innovation policies, including the EuroHPC joint initiative, research security, R&I on advanced materials, the ex-post evaluation of Horizon 2020 and knowledge valorisation.

Concerning space policy, the debate on the future EU space law was based on a [note](#) from the Belgian presidency. The latter identified the challenges to which future regulation must respond and underlined the need to reinforce the competitiveness and resilience of the industry, to apply the proportionality principle and to limit new regulation. These proposals were well [received](#) by the other Member States, who called for a speedy adoption of the EU space law. Finally, Member States adopted [conclusions](#) on “Strengthening Europe’s competitiveness through space”, which underline the importance of space contribution to European competitiveness and environmental transition, the urgency of enhancing EU autonomy in the sector and the importance of reinforcing the EU-ESA partnership.

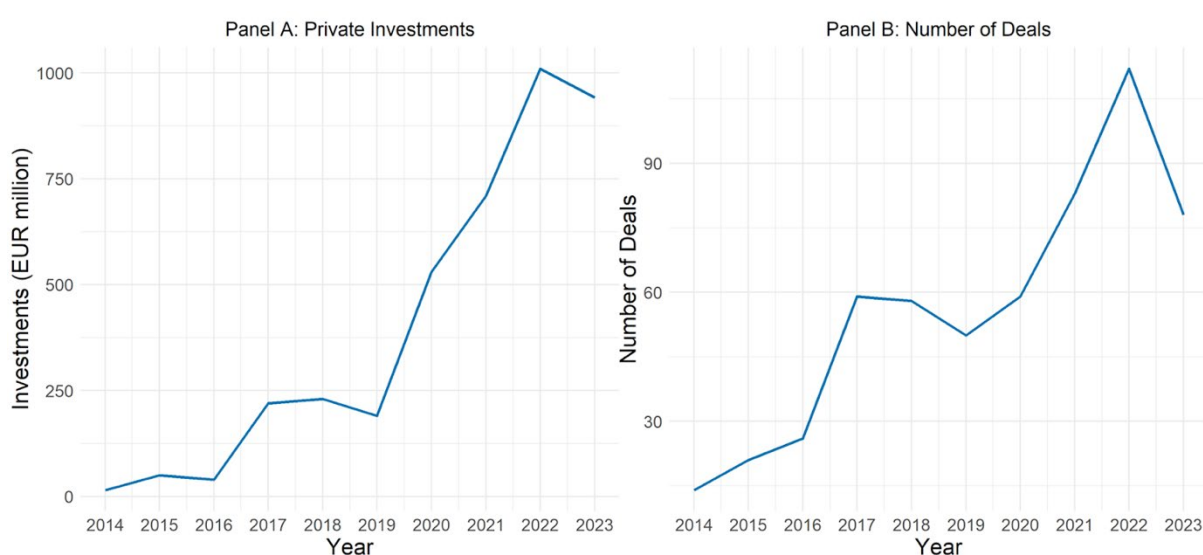
Concerning EU research policy, first, the Council reached a political agreement on the regulation establishing the European High-Performance Computing Joint Undertaking ([Euro HPC JU](#)), known as the “AI Factories Act”. Then, the ministers adopted a [recommendation](#) on enhancing research security to fight undesirable transfer of knowledge, malign influence and ethical or integrity violations. Next, the ministers adopted [guidelines](#) for strengthening knowledge valorisation and [proposals](#) to strengthen the European innovation landscape. Also, the Council approved an [evaluation](#) of the Horizon 2020 framework programme to provide guidance in view of the preparation of the 10th framework programme (2028-2034). Finally, the ministers held a debate on the improvement of joint coordination in research and innovation of advanced materials, prioritisation of sectoral application areas and the sharing of successful national practices in the field.

LUHNIP’s take

The last Competitiveness Council (Space, Research, Innovation) of the Belgian presidency enabled the representatives of national governments to formulate their position on several important legislative initiatives in the field of EU research and space policies. It also made it possible for them to propose strategic guidelines for the next European Commission in these fields. Concerning the EU space law, the adoption by the Council of its recommendations will enable the Commission to quickly adopt an essential regulation to strengthen EU strategic autonomy in the sector. An EU space law is urgently needed to address market fragmentation (given the [growing](#) number of national initiatives in this area) and the [increase](#) in debris and activity in space in recent years, as well as develop European capacities in the sector. On this last point, the EU must reduce its dependencies on foreign actors for the use of

launching capabilities and satellite technologies. The EU's recent [decision](#) to launch Galileo satellites for the US territory and the increasing presence of foreign actors in space, in particular from the US private [sector](#) and from [China](#), demonstrate the need for a change in approach to EU space policy. It should include increasing the EU's funding capacity and investments for the industry, a European preference for space-related public contracts and increased support for disruptive innovation and the SMEs in the sector. Although investment by EU space startups and the number of their deals rose sharply from 2014 to 2022, since then they have been decreasing (**see Graph 3**). New space investments and ventures in the EU startup industry are still far from the US level, and lower than the Chinese ones, with the risk of the gap between the EU and these two superpowers widening (**see Graph 4**).

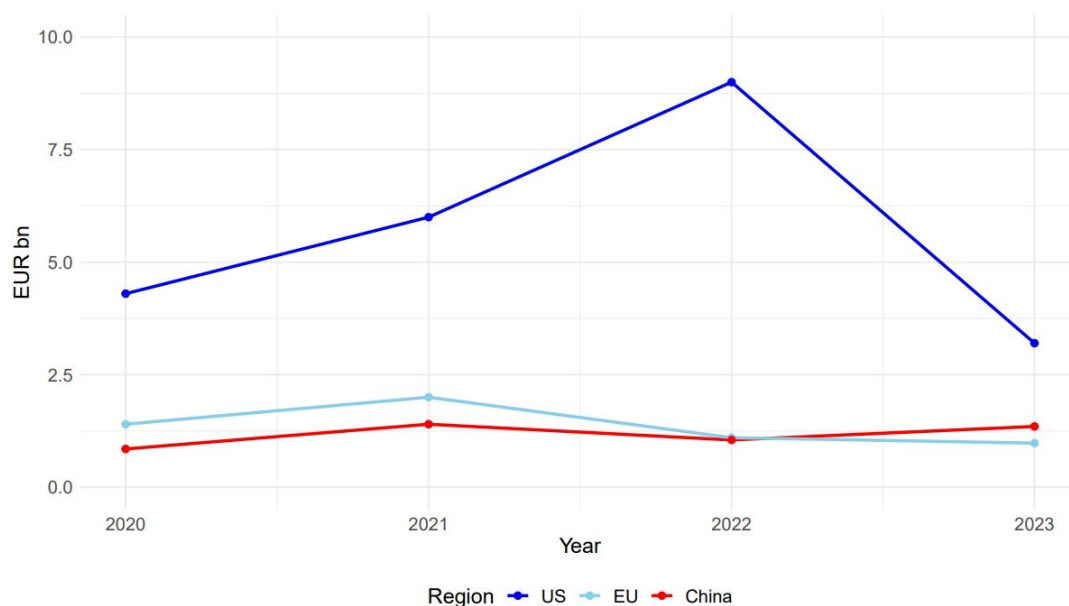
Graph 3: The evolution of investment and number of deals of EU space startups (2014-2023)



Sources: our own elaboration from ESPI, [2023](#) and [2024](#).

Regarding research policy, the adoption by the Council of a political agreement on the modification of the EuroHPC regulation, which includes the creation of “IA factories”, is an important event. It will allow the EU to upgrade its General-purpose AI (GPAI) models, supercomputers and programming facilities and increase its autonomy in the chips sectors by developing new graphics processing units (GPUs). The adoption of the Council recommendation on research security, one of the [pillars](#) of the last EU economic security package, is also a significant event, even if it [remains](#) a non-legally binding document. The new initiatives to strengthen the EU's innovation policies, for their part, are very welcome in the context of the increasing gap between the EU and other global actors, such as the US, China and Japan, in this area. There are currently important [discrepancies](#) in investment levels (see our [Monthly Brief](#) for April 2024), but also in the [support](#) of disruptive innovation and high-tech. The work on defining the priorities of the next framework research programme (2025-2027) in the coming months represents an opportunity for the EU to fill these gaps.

Graph 4: New space investments and ventures in the startup industry in the US, EU and China (2020-2023)



Sources: our own elaboration from ESPI, [2023](#) and [2024](#).

3) The results of the last Competitiveness Council (Internal Market and Industry)

On 24 May, the Member States' ministers responsible for internal market and industry [convened](#) in Brussels for a Competitiveness Council (Internal Market and Industry) session. The meeting agenda included the adoption of legislative proposals to strengthen the Single Market, a discussion on the future of EU industrial policy and on the Commission's recent [communication](#) on "boosting biotechnology and biomanufacturing in the EU".

Concerning the internal market, the Council gave its final [approval](#) to the Corporate sustainability diligence (CSDDD), the last step in the decision-making procedure. The text introduces obligations for large companies (with more than 1000 employees and a turnover of more than EUR 450 million) to monitor, prevent or remedy human rights violations or environmental damages. It also provides the possibility to sanction those actors if they violate their obligations. Also, based on Letta's report [presented](#) last March, the Council adopted [conclusions](#) on the future of the Single Market. They highlight the need to simplify the EU's regulatory framework, ensure a business-friendly environment, foster investments, competition and research and innovation, whilst enhancing the EU's environmental and social standards.

The discussion on EU industrial policy aimed to provide proposals for the new European competitiveness deal that will be formulated by the next European Commission. The adopted

[conclusions](#) called first for giving priority to the areas of technology that are critical for the EU's economic security and the identification of a limited number of strategic priorities in the EU's industrial research and innovation policies. Next, they underline the need to bridge "the innovation [paradox](#)" and to boost private and public finance instruments, while preserving the EU's competition policies. Finally, the Council called for establishing an appropriate regulatory framework at the EU level to enhance the competitiveness of the European industry, and a strategy in line with the green and digital priorities of the Union.

Finally, concerning actions in the biotechnology sector, the Council welcomed the [communication](#) adopted by the European Commission on 20 March 2024. The latter aims to identify the challenges of and barriers to biotechnology and biomanufacturing in the EU, and to propose target actions to tackle them. Priority areas include the streamlining of regulation, the fostering of private and public investment, and the strengthening of international cooperation. At the same time, it [urged](#) the Commission to recognise biotechnology as an elementary part of EU industrial policy and to reduce its dependencies in the sector.

LUHNIP's take

The final approval of the CSDDD by the Council is a significant event, as it ends a legislative process fraught with obstacles. [Proposed](#) in February 2022 by the European Commission, the directive was met with continuous opposition, especially from German industry groups (e.g., BDI, VDMA and VCI) and the German Free Democratic [Party](#). Their concerns included the directive's effects on the competitiveness, supply security and diversification of industry. As a result, it was [amended](#) by the Council in February 2024 to increase the threshold and limit the Directive's applicability to companies with more than 1,000 employees and a minimum turnover of €450 million. At the same time, under [pressure](#) from the French government, and against the [opinion](#) of the European Parliament, banks and other financial institutions were excluded from the application of the CSDDD, except for the application of environmental measures. Although the final text approved by the Council falls short of what the European Parliament had called for, it nevertheless represents an important step towards ensuring that many European companies respect human rights and the environment.

The discussion within the Council about the EU actions in the biotech and biomanufacturing sectors has made it possible to quickly implement new policies in favour of essential industries for EU competitiveness and population, especially since the COVID-19 pandemic. They will enable to simplify processes, shorten the time for biotech innovations to reach the market and reduce fragmentation of measures taken in favour of the sector. Also, they will identify obstacles impeding both public and private investments in the industry. This will help the EU to overcome the widening R&D investment [gap](#) with the US and China. Finally, the strengthening of international cooperation and the reduction of dependence on other countries in critical sectors like pharmaceuticals and food production are crucial for the EU to play an essential role in the [global health agenda](#) and to avoid new health crises.

Furthermore, the last Competitiveness Council (Internal Market and Industry) meeting enabled the Member States to give a clear mandate to the next Commission on industrial policy strategy. It includes the actions advocated by the Commission and the European Council during the last two years: a focus on the twin transition of the European industry, the enhancement of EU economic security, but also support measures to increase investment in research and innovation. Also, it includes the need to simplify the EU's regulatory framework, a key [demand](#) from European industry. Finally, the request to promote new financial instruments at the EU level is a key action for enabling competition with the US and China, which grant large subsidies to their industries, and to avoid the fragmentation of the single market. However, this issue is likely to lead to major debates in the coming months. Spain, Greece and Portugal, [supported](#) by Italy, France, Cyprus and Poland, recently [called](#) for a new financial instrument to mobilise public resources at the EU level. On the contrary, Sweden, Finland, the Netherlands and Denmark were more [cautious](#) on this issue. The proposal to complete the Capital Markets Union to foster private investment in European industry is still facing, for its part, significant [opposition](#) from the majority of EU countries.

*****Guest contribution*******The European automotive industry, the twin transition and the Chinese challenge**

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The European automotive industry entered the 2020s with three major issues. Following the [Dieselgate scandal](#) in 2015, the sector accepted the road toward electrification. This implied abandoning the European-specific advantage in diesel engine cars and integrating a new value chain around the electric battery and semiconductors. Secondly, European automobile firms continued to deploy resources to accelerate the development of connected, smart cars and, in the long run, autonomous cars. These innovations were not only value-oriented, but also aimed to tackle an increasing demand for safety, either from the consumers or from the regulators. Last but not least, the automotive industry is facing the entry of Chinese competitors in Europe. In the first period, Chinese carmakers, like Geely, took [control](#) of European automakers. Now, they are ready to export cars directly from China, pushed by their own overcapacities.

To tackle the issue of the twin transition of the industry, the EU adopted industrial policy measures and roadmaps. The first instrument has been regulatory policies. By 2035, only zero-emission cars will be [allowed](#) for sale in the Single Market. The [roadmap](#) setting the pathway toward electrification and automation argues in favour of a positive relationship between stringent regulations and international competitiveness. The second instrument is a change in the IPCEI doctrine. Currently, IPCEIs are used to coordinate State aid in support of the development of new value chains. For example, an [IPCEI](#) focuses on the manufacturing of electric batteries with the ambition to produce in Europe enough batteries to satisfy the European demand. This transformation of IPCEIs into an infant-industry instrument implies a radical shift, as it enlarges the scope of authorized State aid in the EU.

However, we can see two shortcomings in these two instruments. Regulations are creating adverse effects in the industry. The sustained rhythm of regulations and the lack of coordination among Directorate Generals are blurring the short and long-term visibility of the industry, which needs time to develop and produce cars. Secondly, this flow of continuous regulations has a direct impact on the new vehicle cost. Coupled with increasing wage moderation, only high-income households can afford to buy new, high-quality cars designed by premium manufacturers, whereas others prefer second-hand cars to new small cars. Therefore, EU [regulations](#) encourage manufacturers to abandon small-car segments. This segment shift towards expensive vehicles makes large room for Chinese importations, as China manufactures small electric vehicles sold at affordable prices, thanks to high economies of scale. We

need new regulations to reverse the trend and to make small cars affordable by giving, for example, fiscal incentives calculated by an eco-score considering the frugality of the cars (both in terms of power and materials).

The IPCEIs, for their part, increase the competition among European regions for foreign direct investment. So far, only France and Germany have been financially able to grant such a high level of [State aid](#). Instead of smart specialization, we observe a great dissemination of investment where substantial State aid is granted. Concerning the IPCEIs, the only goal is to increase the production and research and development capacities. Therefore, the doors are wide open to attract non-EU competitors which are now investing in Europe and will compete with ACC (Automobile Cell Company), the so-called “Airbus of batteries”. More inter-industry and inter-state cooperation instead of competition would bring better strength and resilience to this new sector.

Finally, we must discuss the lack of a proactive EU trade policy. Even if the EU works on critical raw materials to secure its supply, the EU must adopt trade policy measures to [protect](#) its own production and to develop an autonomous value chain. The recent unilateral increase of the US automobile tariff against Chinese electric cars risks bringing all the Chinese surplus production towards the EU market. The EU anti-subsidy [investigation](#) of Chinese electric car imports is not an appropriate measure. Its resolution requires the unlikely collaboration of carmakers and the Chinese government. Moreover, European manufacturers in China, mainly German companies, which import electric cars to the EU from their Chinese subsidiaries can pay a high price also in terms of retaliation against cars imported from China. The European automobile industry rejects any trade war in the sector as it has a lot to lose in terms of volumes and profits generated by the Chinese domestic market. Looking at the current situation characterised by a rise of Chinese [FDI](#) in the EU to counter potential protectionist measures from the bloc, an effective solution might be the negotiation of a voluntary export agreement with China, as was [proposed](#) by the Commission in the beginning of the 1980s to regulate Japanese car imports. It would allow China and the EU to agree on a maximum market share of imports into the EU and to adapt all other industrial policy instruments to the effective monitoring of the agreement.