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LUHNIP Monthly Brief on EU Industrial Policy

June 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.

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Last Month in Brief

- **10 June:** The European Commission opens an in-depth investigation under the Foreign Subsidies Regulation into the proposed acquisition by Emirates Telecommunications Group of PPF Telecom Group (**see Deep Dive 1**).
- **12 June:** The European Commission provisionally concludes that China's electric vehicle value chain benefits from unfair subsidies and announces the imposition of provisional countervailing duties on imports of battery vehicles from China (**see Deep Dive 2**).
- **13-14 June:** Ursula Von Der Leyen and Charles Michel participate in the G7 meeting in Apulia (Italy) to discuss cooperation in the use of Artificial Intelligence and the fight against non-market national policies and practices.
- **18 June:** The Council of the EU adopts its negotiating position on a new regulation on the use of railway infrastructure capacity as part of the Commission's 'greening freight' package.
- **19 June:** The European Commission identifies 115 Regional Innovation Valleys which can benefit from EU funding to strengthen regional innovation ecosystems and the EU's innovation performance.
- **20 June:** The European Commission launches the European Solar Academy to train workers in the solar photovoltaic sector under the Net-Zero Industry Act.
- **24 June:** Under the Digital Markets Act the European Commission sends its preliminary findings to Apple concerning its App Store rules and opens an additional non-compliance investigation against the company concerning new contractual requirements for third-party app developers and app stores.
- **25 June:** The European Commission opens a formal investigation to assess whether Microsoft breached EU antitrust rules with anti-competitive practices concerning its Teams application.
- **27 June:** EU leaders meet for a European Council meeting to appoint the officials for the three top jobs for the next institutional cycle, to adopt the Strategic agenda 2024-2029, to discuss initiatives to strengthen security and defence policies and to strengthen the competitiveness of European industry (**see Deep Dive 3**).

[1] We would like to thank Stefano Chiappo, Romain Cohen, Francesco Montaña Paladini, Giulio Petrillo and Francesco Rosazza Boneitin for their research assistance.

LUHNIP's Deep Dives

1) The European Commission opens its first in-depth investigation under the FSR regulation

On 10 June, the European Commission opened its first in-depth investigation concerning an acquisition under the Foreign Subsidies Regulation (FSR). The objective is to determine whether telecommunications operator Emirates Telecommunication Group Company PJSC (also known as "e&") granted foreign subsidies as part of the acquisition of PPF Telecom Group B.V. (excluding the company's activities in the Czech telecommunications market), thus distorting the EU single market.

The European Commission's preliminary investigation indicated that there had been sufficient indications that e& received foreign subsidies, thus distorting the EU single market. According to the institution, being a UAE state-controlled company allowed e& to receive an unlimited guarantee from the UAE and a loan from UAE-controlled banks. The Commission is concerned that such subsidies improved e&'s capacity to perform the acquisition and strengthened the merged entity's future competitive position.

Under the rules of the Foreign Subsidies Regulation, the Commission has until 15 October 2024 (the text provides an in-depth 90-working-day review period) to take a decision following the opening of the in-depth investigation. The Commission has three options: to accept the company's remedies to prevent distortion, to prohibit the acquisition or issue a non-objection decision.

LUHNIP's take

The opening of this in-depth investigation under the FSR is an important signal of the European Commission's determination to protect the EU's telecommunications sector. After two investigations concerning tenders from Chinese companies in procurement procedures (see Monthly Briefs for February and April 2024), this is the first investigation under the FSR which relates to an acquisition, and the first one involving a non-Chinese firm. The state-owned company e& is a global player in the telecommunications sector. It operates in 16 countries in the Middle East, Africa and Asia. The acquisition of PPF Telecom Group B.V.'s Bulgarian, Hungarian, Serbian and Slovakian operations is part of e&'s strategy to expand its activities in Europe. It follows the group's acquisition of 9,8% of Vodafone's issued share capital in May 2022 and the signature of a strategic partnership between the two companies in May 2023.

The FSR investigation is taking place in the context of the development of new initiatives by EU institutions to strengthen the competitiveness of the telecommunications sector. In February 2024, the European Commission presented a white paper for strengthening European digital infrastructure. The Letta report released in April 2024, for its part, proposed measures to increase investment and reduce fragmentation of the EU telecommunications market (for an analysis of those initiatives see our Monthly Brief for April 2024). The launch of this new investigation would enable the EU to protect the industry against competition from the Emirati telecommunications giant. It is therefore another important example of the use by the European Commission of the FSR for industrial policy purposes.

2) The European Commission announces the provisional results of its anti-subsidy investigation into the Chinese Battery Electric Vehicle (BEV) value chain

On 12 June, the European Commission announced the provisional results of its anti-subsidy investigation into the Chinese Battery Electric Vehicle (BEV) value chain, initiated in October 2023 (see our Monthly Brief for October 2023). The investigation concluded that the entire value chain, including sectors like mining, refined metals, lithium, and shipping, had benefited from unfair subsidisation by the Chinese government, and thus injuring or posing a threat to the EU's BEV industry. The European Commission assessed the impact of these subsidies on importers, users and consumers, delved into company records and consulted with their stakeholders. In the wake of this probe, it informed the Chinese authorities of the findings, stating that if no resolution is found, provisional countervailing duties would be imposed on 5 July, in addition to the existing 10% tariffs on BEVs. The new tariffs will remain provisional until the end of the investigation on 2 November 2024 after which they will become definitive. They are tailored to the level of subsidies granted to the companies and the cooperation between them. The duties will first apply to the three firms sampled during the EC's investigation: Build Your Dreams (BYD), Geely, and Shanghai Automotive Industry Corporation (SAIC). BYD will face a tariff of 17.4%, Geely 20%, while SAIC will face a tariff of 38.1%.

Regarding the firms not sampled by the European Commission, they will face a 38,1% tariff if they do not cooperate, while compliant companies including Tesla will face a lower tariff of 21%. The US company is seeking a lower tariff by requesting a tailored duty rate which can also be applied to other companies not chosen in the selected sample. In this case, the European Commission would lead an accelerated review within the nine months following the definitive duties.

Although informed by the European Commission, the Chinese authorities, including the Chinese Ministry of Commerce, rebuked the investigation's conclusions, viewing them as protectionist. They also criticized the European Commission's methodology, which relied on available information due to a lack of data from the companies sampled during its probe. During the investigation, the European Commission sent letters to the three sampled companies, particularly to SAIC, informing them that they had not provided sufficient information on their subsidies, sales projections, operations, and supplies. Chinese officials thereupon stated that the subsidies had been artificially created or exaggerated. EU-China consultations over the EU's anti-subsidy investigation against Chinese electric vehicles started on 22 June to avoid the application of definitive duties in November.

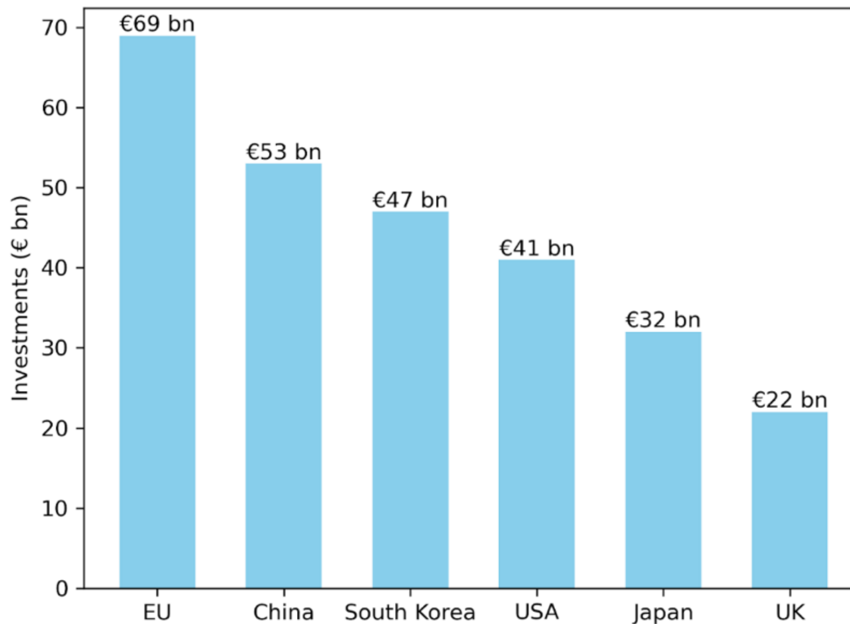
LUHNIP's take

The countervailing duties proposed by the EU Commission of up to 38,1% exceed the expected 25-30% duties. These tariffs, based on firms' subsidization, EU production sites, and cooperation, aim to create a fairer playing field, unlike the US's 100% tariff on Chinese BEVs without prior investigation, which potentially breaches WTO rules. However, experts have warned that a 20% tariff could harm the EU, leading to higher consumer prices, production shifts, reduced EU exports to China, and market uncertainty. Others suggest that tariffs should reach 50% to be effective, as China's BEV producers benefit from cost advantages due to cheaper labour, energy, and more developed electronic modules.

With these tailored tariffs, Chinese producers BYD and Geely, the owner of Volvo, will remain competitive as their vehicles will stay cheaper than their EU counterparts. Additionally, these companies and other Chinese producers could circumvent tariffs by expanding their production in Europe through joint ventures with EU firms, or through licensing agreements. While increased Chinese Foreign Direct Investment (FDI) in the EU's BEV sector, especially in Eastern Europe, poses a threat to EU sovereignty in this industry, it could also bring benefits like job creation and technology transfer. This would mirror the 1980s competition between European and Japanese automakers. It is worth noting that besides Eastern Europe, China's producers are likely to use Morocco or Turkey, who have privileged trade relationships with the EU, to produce their BEV and gain market shares in the sector.

This situation explains China's anticipated retaliation and the mixed reactions within the EU, particularly in Germany. EU automakers, notably German ones such as Volkswagen, involved in joint ventures with Chinese companies will be impacted by the tariffs as that would increase their production costs and push them to reassess their value chain. Additionally, German carmakers are also concerned about China's potential retaliatory tariffs on the luxury models imported from Germany. Amid the tariff announcement, Germany's exports to China have already fallen. Despite the EU tariffs, Germany seeks to maintain its relationship with China, with officials like Vice Chancellor Robert Habeck making frequent visits to Beijing. The Olaf Scholz administration's strong push for EU-China negotiations to resolve the issue raised concerns among other EU states that Germany's stance could weaken the EU's unified position. Other EU sectors, like pork and dairy, also fear China's retaliation with anti-dumping investigations already launched into EU pork products. Pressure from representatives of economic sectors and some Member States could lead to a qualified majority of Member States rejecting the measures proposed by the European Commission at the next October Trade Council.

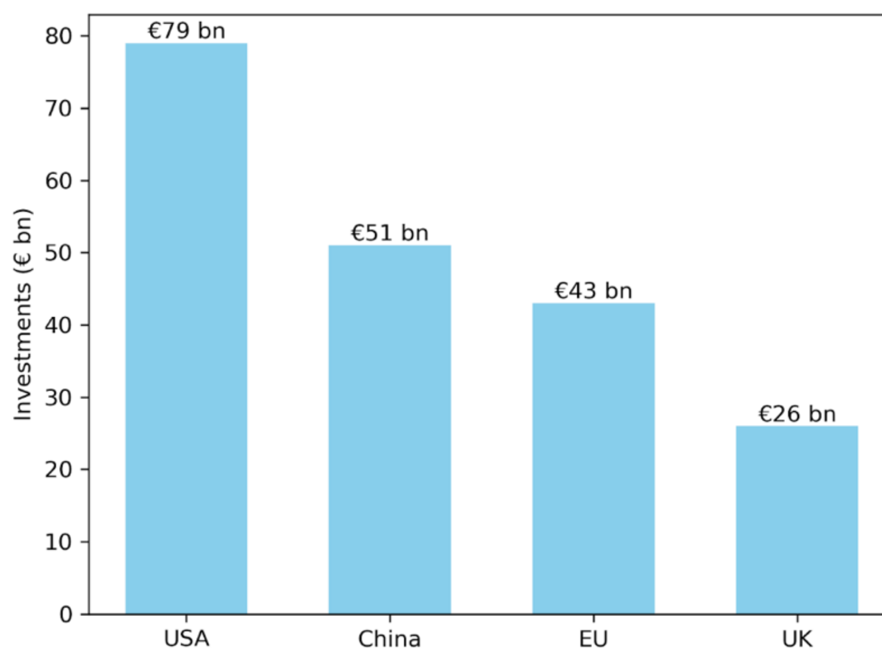
Graph 1: Investments Announced in the BEV between 2021-2023 in the EU, China, South Korea, USA, Japan and the UK (in €bn)



Source: our elaboration from Transport & Environment

It is too early to assess the tariffs' impact on EU manufacturers. While tariffs should help EU BEV manufacturers compete with Chinese prices, they remain dependent on the Chinese market. Tariffs alone are insufficient; EU automakers, including German ones, have been surpassed by their Chinese counterparts in car software and digital equipment. This explains Volkswagen's recent €5 billion investment in US startup Rivian. The EU lags in attracting BEV sector investments compared to the US and China. While European carmakers announced substantial investments (**see Graph 1**) between 2021 and 2023, the EU has struggled to attract investments in the BEV sector compared to the US and China (**see Graph 2**). The EU needs a robust industrial policy and increased investments to enhance its global competitiveness and support the dual transition of the automotive sector (see on this topic our Monthly Brief for May 2024).

Graph 2: Investments in BEV by destination region between 2021 and 2023 (in € bn)



Source: our elaboration from Transport & Environment

3) The last European Council meeting and the future of EU industrial policies

On 27-28 June, the first formal European Council since the European elections took place. The meeting's agenda included the appointment of officials for the EU's top jobs, the adoption of the strategic agenda 2024-2029, the future of EU support for Ukraine, and EU initiatives for strengthening the EU's defence technological and industrial base (EDTIB) and enhancing competitiveness of EU industry.

Concerning the choice of officials for the EU's top jobs, the European Council officially adopted an agreement foreseeing the election of António Costa as President of the European Council, the nomination of Ursula von der Leyen as candidate for President of the European Commission and the nomination of Kaja Kallas as candidate for the post of High Representative of the Union for Foreign Affairs and Security Policy.

Next, the European Council approved the Strategic agenda for 2024-2029, which establishes the EU leaders' priorities for the coming institutional cycle. It is composed of three pillars: "a free and democratic Europe", "a strong and secure Europe", and a "prosperous and competitive Europe". For the final pillar, the European Council emphasises the need to reinforce the EU's sovereignty in strategic sectors and makes it a technological and industrial powerhouse, while maintaining an open economy.

To achieve this objective, EU leaders are arguing that greater efforts need to be made in terms of innovation and the mobilisation of private and public funds. The European Council believes that the main instruments for this are the deepening of the Single market, the financial integration of the EU and the pursuit of a trade policy based on sustainable goals, economic security and the opening of external markets. Also, EU leaders reconfirm the objective of achieving climate neutrality by 2050. To achieve this goal, they emphasise the need to create a stable and predictable framework, and a more supportive environment for scaling up Europe's clean manufacturing and technology and pursuing a just and fair climate transition. Finally, the European Council underlined the importance of exploiting the potential of data, promoting its interoperability and encouraging investment in digital technologies.

Concerning the future of defence and security initiatives, the EU leaders reaffirmed their commitment to support Ukraine militarily and strengthen the EU's Defence Technological and Industrial Base (EDTIB). They invited the other EU institutions to proceed with the various European Commission initiatives in this area, such as the European Defence Industry Strategy (EDIS) and the European Defence Industry Programme (EDIP). Finally, they discussed the future funding of EU defence and security policies and invited the Commission and the High Representative to present developed options for public and private funding to strengthen the EDTIB and address the capability gaps.

Finally, the European Council reviewed the progress made on enhancing the EU's competitiveness. It called on the Council and the Commission to accelerate work on the Capital Markets Union, given its importance in mobilising private investment for the EU's goals. Also, it recommended that the new European competitiveness deal be completed by the end of the year.

LUHNIP's take

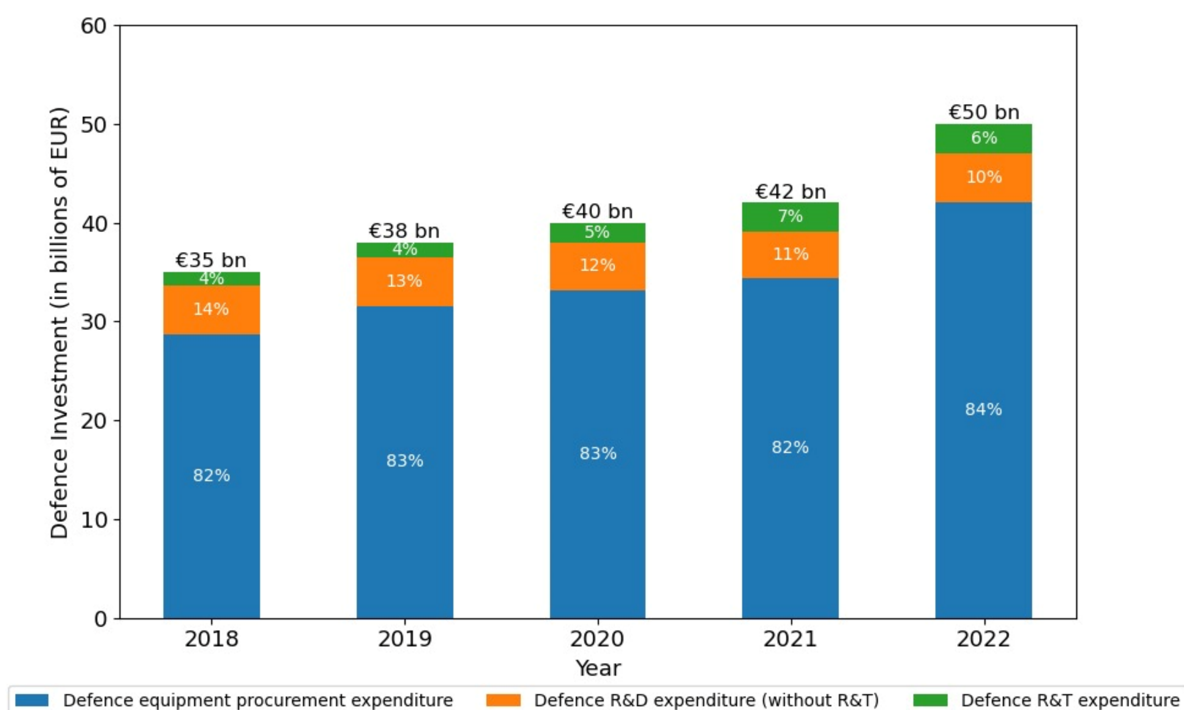
The first European Council meeting after the European elections in early June enabled the EU leaders to nominate the candidates for the top jobs for the next institutional cycle (2024-2029) and to adopt their Strategic Agenda for 2024-2029. Its adoption is a significant event, as it contains the EU leaders' main priorities for the next five years. The fact that the third pillar is dedicated to strengthening the competitiveness of the European economy demonstrates the importance of this objective for EU leaders. The EU industry's strong support for this objective, and from the new Hungarian Presidency of the Council, which has made it one of its priorities, will mean that the design of policies to reach this objective will be a major focus of the European institutions in the coming months. The key issue was the balance between the pursuit of this objective and the legal obligation to reduce the EU's greenhouse gas emissions by at least 55% by 2030 in the current "green backlash" context.

The content of the EU Strategic Agenda and the conclusions of the last Environment Council seem to answer this question. The reduction of greenhouse gas emissions will remain a priority for the European institutions during the next institutional cycle, but the measures for the green transition of the industry should also serve the objective of strengthening its competitiveness. This approach is supported by a large number of actors, as shown by the letter published by more than 400 companies, public associations, local entities, and non-governmental associations on 17 June. At the same time, increasing

consultation with industry will be promoted to provide stability for businesses. Finally, the European institutions are planning to significantly reduce the bureaucratic and regulatory burdens for industry and simplify and accelerate procedures.

In the field of security and defence policies, the European Council's request to make progress on the strengthening of the European Defence Industrial and Technological Base (EDTIB) reflects the strong consensus among Member States to pursue this strategy during the next institutional cycle. To achieve this goal, the EU will have to increase its defence R&D and R&T expenditure. **As Graph 3** shows, while there was an increase in defence investment by EU Member States between 2018 and 2022, a small proportion of this was dedicated to R&D and R&T.

Graph 3: Evolution of Defence Investments in the EU from 2018 to 2022 (in €bn)



Source : our elaboration from the Science, Research and Innovation Performance of the EU report (2024)

While the EU leaders all agree on the need to reinforce the EDTIB, they continue to disagree on how to finance the investments needed to achieve this objective. The statement in the European Council conclusions that "the European Council invites the Commission and the High Representative to present developed options (...) for public and private funding to strengthen the EDTIB and address critical capability gaps" shows that the debate on this issue is still not settled. The proposal to issue defence bonds, promoted in particular by France, is still rejected by frugal countries, who are in favour of a more market-based approach. Another difficulty in this discussion during the European Council meeting was German Chancellor Scholz's desire to avoid making any commitments to providing additional public resources for EU defence objectives in the context of the difficult negotiations for the adoption of the

German federal budget for 2025. It will be urgent for the European institutions to resolve the issue of financing investment in defence and security policy to avoid failure in achieving the objectives set in this area. With the increasing geopolitical challenges, the EU has no choice but to give itself the necessary means to strengthen its military sovereignty.

Guest contribution

The role of institutional investors in financing European start-ups and scale-ups

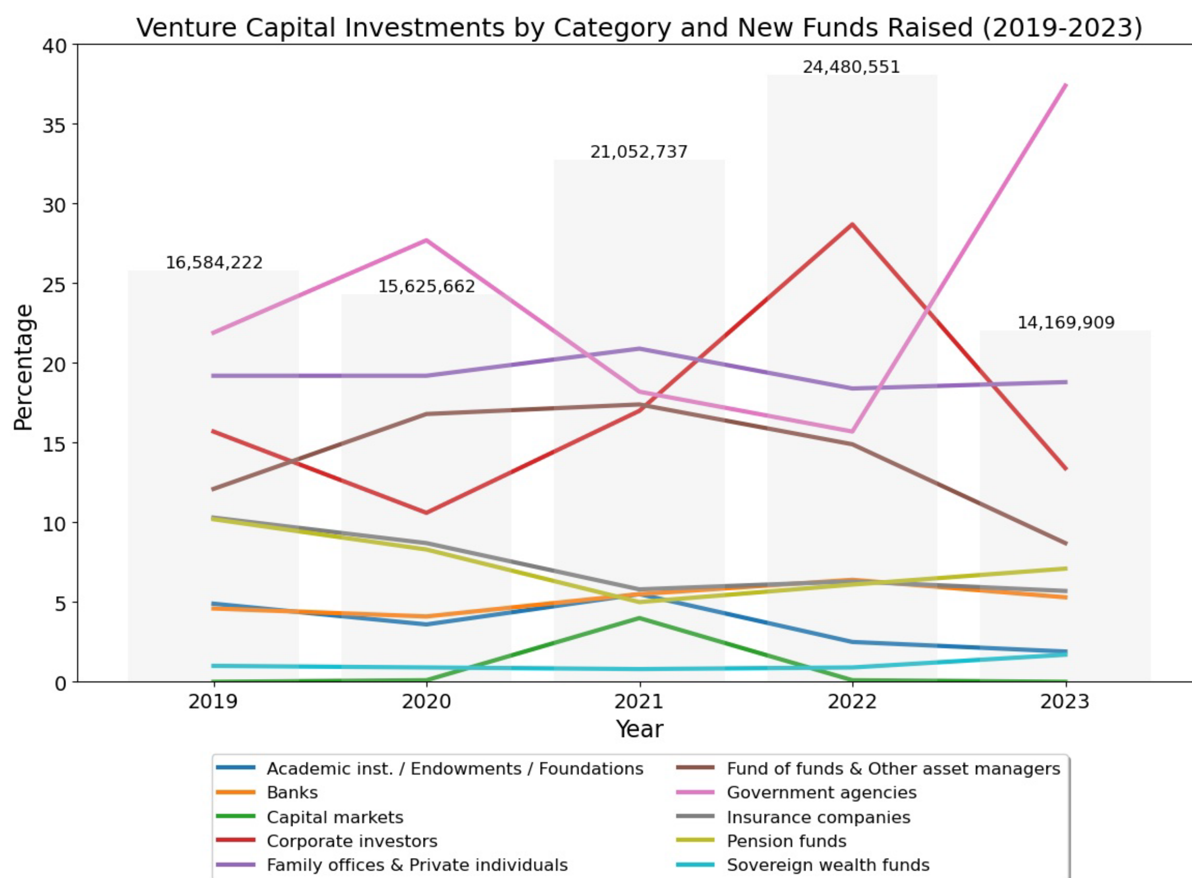
Armando Melone, Policy Officer Access to Finance, DG for Internal Market, Industry, Entrepreneurship and SMEs, European Commission (information and views set out in this article are those of the author and do not necessarily reflect the official opinion of the Institution).

The European economy is substantially bank-financed, while equity is a suitable source of funding for only a relatively small but important pool of highly innovative companies with a scalable business model. In the EU only 10% of SMEs consider equity as a relevant source of financing, while only 1% of them make use of it. If the equity financing gap in the start-up phase is already quite relevant, the EU has a significant scale-up financing gap which is hampering the growth and expansion of innovative start-up companies. More and more EU companies are acquired by foreign investors and relocate abroad.

EU venture capital markets are still focused on domestic investments, often driven by high government intervention that tends to support national ecosystems. Today, domestic investments account on average for 64% of the total VC activity, while cross-border investments within Europe account on average for only the remainder. Partially related to this feature, the size of European funds is typically very small compared e.g. to the United States. VC funds operating in the US are at least 7 times larger in size (i.e. bigger than EUR 600 million) than European VC funds.

These patterns explain and, at the same time, are influenced by the limited involvement of institutional investments, e.g. insurance companies, pension funds, banks etc., in venture capital. As a consequence, in a period of strained public budgets, national and EU public programmes are increasingly asked to fill this gap. In 2023, public/governmental involvement in VC reached 37%, expanding to peak levels and reversing a declining trajectory (see Graph 4 below).

Graph 4: Venture Capital Investments by Category and New Funds Raised (2019-2023) (in €)



Source: our elaboration from Invest Europe survey on Private Equity Activity 2023.

Institutional investors' limited involvement is explained by various factors, including their retreat from risk-taking. More traditional assets such as government bonds are often considered a safer investment, especially in the current high interest rates scenario. All in all, amidst the current geopolitical tensions, increasing international competition and the higher risk of relocation for our industry and technologies, the contribution of institutional investors is indispensable to achieve the objectives of the Capital Markets Union, as also highlighted in the latest Letta report.

Pension funds' involvement in EU venture capital is a case in point. In 2022, just 0.01% of EU pension funds' assets were invested in European VCs. Anecdotal evidence shows that the current gap in EU pension funds' involvement is filled by international ones. In 2023, US pension funds owned 10% of Germany's tech unicorns, compared with 0.2% for German pension funds. Cultural, historical, and political factors may partially explain this phenomenon. Most EU pension schemes are pay-as-you-go while only a minority of Member States (e.g. Netherlands, Sweden, Denmark) have fully-funded pension schemes where funds are set aside during a worker's active years to accumulate a pool of assets that will finance worker's retirement benefits in the future. These funds could then be invested in financial

instruments, including riskier assets such as private equities and venture capital, to generate returns over time.

In sum, ongoing challenges require the active participation of institutional investors in financing the European industry. Excessive risk aversion could hamper the availability of equity funding needed to fill the current financing gaps and, in turn, heavily impact the creation and development of essential technologies in the EU.