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In recent years, the European Union has embraced a [more active industrial policy](#) to boost its global competitiveness and strategic autonomy. The poster child of this shift are the Important Projects of Common European Interest ([IPCEIs](#)), which allow member states to subsidize projects in key sectors like microelectronics, batteries, or hydrogen. Since the first microelectronics IPCEI kicked off in 2018, a total of 10 IPCEIs worth a combined €37.2 in state aid and an expected €66bn in private investment have been approved by the European Commission, with more to come.

In the [global industrial policy turn](#), IPCEIs stand out with their [stringent requirements](#) for cross-border collaboration and a strong focus on innovativeness. At first sight, they conform to the idea that ‘good’ industrial policy depends on clear conditionalities. Academics and practitioners have widely hailed [conditionality](#) as [key](#) to aligning company-level choices to broader public policy goals. In its [absence](#), as Dani Rodrik notes, state-business relations risk becoming ‘parasitic’, because ‘businesses simply get handouts and subsidies from lobbying’.

Conditionalities can come in many forms, from [performance targets](#) to [limits](#) on stock buybacks and requirements to use renewable energy. In the EU, conditionalities are designed in line with the efficiency-oriented principles of its state aid regime. Politically and ideologically, the [primary impetus](#) is to shield the European single market from distortions that jeopardize its ability to allocate resources efficiently. Only in areas with identifiable market failures are subsidies admissible, with strong ex-ante criteria to guarantee the necessity, importance, and proportionality of the subsidies.

¹ This policy brief is based on a working paper with further details, accessible via <https://osf.io/preprints/osf/f63gd>.

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While conditionalities are rightfully considered a key factor for good industrial policy, our [research](#) shows that there is a price attached to getting things right. The stringent conditions attached to IPCEI funding - while well-intentioned - create unexpected costs that limit the instrument's effectiveness. These costs manifest in three ways: perverse outcomes, adverse selection, and workarounds. After outlining these costs, we propose four fixes to navigate these cost-conditionality trade-offs.

Perverse outcomes

IPCEIs aim to fund cutting-edge innovation by subsidizing research and development and first industrial deployment (FID). Crucially, this means that mass production cannot be supported through IPCEIs. Furthermore, the innovativeness criterion limits funding to projects which innovate at the 'global state-of-the-art'. One interviewee effectively sketches out the implications: "If TSMC were to be part of an IPCEI, its project in Europe would have to be innovative beyond what it is doing in Taiwan to be eligible for funding. This would mean, in this case, that it would have to do a project making chips at less than 2nm, say at 1nm." As such, the stringent interpretation of innovation requirements can repel the very companies Europe aims to attract or retain. Tesla, for instance, dropped out of a battery-IPCEI for similar reasons.

Adverse selection

The stringent requirements for innovativeness and cross-border spillovers inherent to IPCEIs introduce myriad complexities to the application process. Member states have to agree on a market failure that is to be addressed through an IPCEI, they have to draft an application, open calls for firms and research institutes to participate, and submit their requests to the European Commission. The Commission, meanwhile, sends lengthy and detailed requests for information (RFIs) to inquire about the funding gap and the necessity for subsidies.

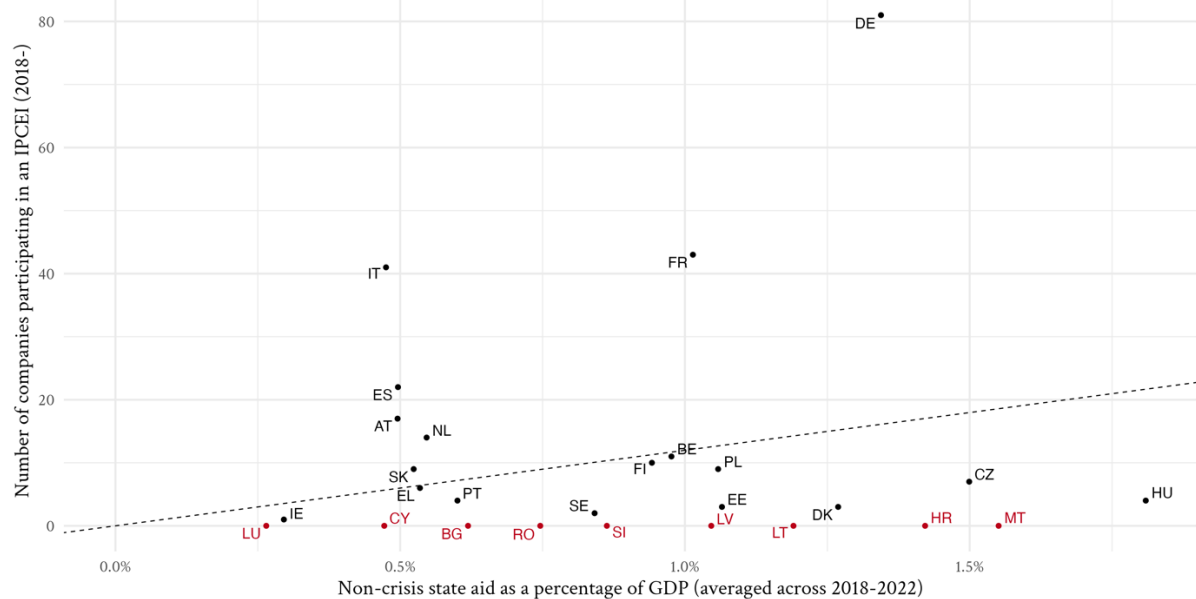
While such a process weeds out frivolous requests, the complex application and review processes for IPCEIs create a significant administrative burden. We document cases where companies dropped out altogether because of this and the lengthy duration of the process, even though they were perfectly

suitable to be part of an IPCEI. The process from the emergence of an IPCEI to the final disbursement of funds can take up to 4-5 years. The administrative burden disproportionately affects smaller companies and member states with less experience navigating EU funding mechanisms. The Head of Strategy at a semiconductor company quantified this burden: “From the firm's point of view an IPCEI costs €700,000 to €800,000. The administration is crazy, horrible. We had one person fully working on it for one and a half years. We also hired a consultancy.” And it is not just firms offering typical complaints about administrative red tape. A policy officer told us that “the companies have a point. The IPCEI notification process is insane. Those who have gone through it are damaged for life”.

This complexity leads to adverse selection, where only larger companies or those from member states with more administrative capacity and experience can effectively participate (see Figure 1). It is no coincidence that Germany coordinates most IPCEIs and has companies participating in all but one of the 10 approved projects.

Figure 1: IPCEI and State Aid Spending

Dashed line represents the expected value based on proportional relationship. Countries in red have no companies participating in IPCEIs.



Source: State Aid Scoreboard, Commission Website on IPCEIs

Workarounds

Faced with these challenges, many companies seek alternatives to IPCEI funding. Some look to other EU instruments with less stringent requirements. The Temporary Crisis and Transition Framework ([TCTF](#)), for instance, allows member states to subsidize mass production for green technologies while also removing requirements for cross-country collaboration found in IPCEIs. Increased expediency comes at the high price of [distortion](#), where only a few member states allocate almost all the subsidies.

Other companies have effectively leveraged the threat of [exit](#) in favor of more straightforward subsidies offered by non-EU countries. As one semiconductor executive put it: “In the US, the support works via a simple tax refund. This is much less complicated than the IPCEI procedure.” While such threats are par for the course in a world of subsidy races, there is ample evidence that overly complex funding mechanisms may drive investment away from Europe, undermining the very goals IPCEIs aim to achieve.

Improving IPCEIs: A Way Forward

The central message is that just like the Commission balances the benefits and costs of state aid, it should also balance the costs and benefits of conditionalities more explicitly. We make four key suggestions, starting with one general suggestion and then moving to three specific suggestions. Crucially, these suggestions do not require a fundamental break with the efficiency-oriented principles of the EU state aid regime, but are, in our view, entirely compatible with these principles.

- 1) **Increase tolerance for failure:** The EU is making a mistake by trying not to make mistakes. Currently, the IPCEI instrument prioritizes the elimination of false positives (allocating subsidies to projects that would occur anyway) over eliminating false negatives (projects that do not occur at all, or occur elsewhere). However, this creates both high administrative costs for everyone and high opportunity costs for companies as they spend years in a state aid limbo, not knowing whether they will receive subsidies or not. This makes little sense given the fundamentally uncertain nature of innovation and the fast-moving character of the technological landscape. Funding innovation is inherently risky, and the risk of failure increases

the longer one waits. Just like climbers paradoxically put themselves in greater danger by overly prioritizing safety (as this often means extending their time on the mountain), perfection can be the enemy of the good in state aid as well. Minimizing the risks of distortion and waste for individual projects while sidelining the costs this produces for the EU's overall innovation and industrial ecosystem is mistaking the forest for the trees. This does not mean throwing all caution away. Rather, it means developing a more holistic understanding of the costs of minimizing risks. As Dani Rodrik [points out](#): “The objective should be not to minimize the chances that mistakes will occur (...) but to minimize the costs of the mistakes when they do occur. If governments make no mistakes, it only means that they are not trying hard enough.”

- 2) **Broaden the innovativeness criterion:** The IPCEIs' innovativeness criterion has been interpreted too restrictively by the Commission. While the IPCEI communication itself merely states that R&D&I projects need to be of “major innovative nature *or* constitute an important added value (...) in the light of the state of the art in the sector concerned,” the [IPCEI Project Portfolio](#) Template, for example, asks for R&D&I activities to go “beyond the global state-of-the-art”. As we have seen, this produces effects that run counter to the EU's overall industrial policy goals. This is also noted by both the [Letta](#) and [Draghi](#) Reports, which argue that aid in the context of IPCEIs should “be allowed beyond 'world-class' innovation” and finance a “broader class of innovations (as opposed to breakthrough innovations), provided that they offer the potential for Europe to jump to the technological frontier in strategic areas where it is lagging behind and where State aid framework for research and development and innovation (RDI framework) is not sufficient.”
- 3) **Shift from *ex-ante* to *ex-post* conditionality:** In practice, the key to making IPCEIs faster and nimbler is to shift its conditionality regime from ex-ante to ex-post conditionalities, even if this may increase the risks of distortion and waste for individual projects. On the one hand, the burdensome and time-consuming IPCEI assessment process should be simplified. For example, the length and complexity of RFIs could be reduced or capped, simplified cost options currently used in cohesion policy could significantly reduce administrative overhead, and risk-based assessments and audits could be used to focus resources on projects most likely to lead to significant distortions or waste. On the other hand, a greater willingness to disburse money early should go hand in hand with a clear signaling of the intent to recover excess subsidies.

For example, the EU should put greater emphasis on the already-existing “[clawback](#)” provision which can work as a Sword of Damocles that keeps “companies honest”, as a Commission official noted. Similarly, repayable advances have been shown to have [great promise](#) for industrial policy, and in prior state aid [guidelines](#), the EU Commission itself has already flagged them as “the aid instrument of choice” for “activities that are close to the market.” It may also be worth experimenting with performance-based instruments that disburse funds on the basis of the achievement of milestones and targets, like in the case of the Recovery and Resilience Facility.

- 4) **Integrate IPCEIs and other policy instruments:** Our suggestions thus far aim at reducing the administrative burden while maintaining the integrity of the funding process. They would allow for faster project approvals and encourage more diverse participation from companies and member states. However, IPCEIs may sometimes simply not be the right instrument for some companies even if they would benefit from being part of IPCEIs (e.g., because participating allows them to find potential customers or suppliers). Existing initiatives to more systematically coordinate IPCEIs with other funding instruments such as the General Block Exemption Regulation, TCTF, and the Chips Act, or cohesion funds should therefore be expanded and guidance on different funding options should be provided. This would allow (especially smaller) companies to access the most suitable funding instruments while remaining embedded in larger industrial ecosystems centered around IPCEIs. Aligning and combining multiple (industrial) policy instruments, however, requires more systematic strategic coordination. We thus support the Draghi Report’s suggestions for establishing a ‘Competitiveness Coordination Framework’ to coordinate activities around different politically decided strategic priorities. The [Joint European Forum for IPCEI](#) could serve as a blueprint or organizational nucleus for such a strategic industrial policy body.

Overall, as the EU (re-)discovers the need for and its willingness to conduct industrial policy, it is crucial that it gets the design of its instruments right. What we argue for is that the Commission, just like it weighs the pros and cons of subsidies, should also weigh the pros and cons of the strings it attaches to these subsidies. It is unreasonable to expect the EU to get the new and more interventionist industrial policy right on the first try. But it is reasonable to expect it to continuously monitor its instruments and learn from their shortcomings.