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LUHNIP Monthly Brief on EU Industrial Policy

October 2024

Dimitri Zurstrassen and Donato di Carlo

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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

- **2 October:** The European Commission adopts a Communication on building sustainable international partnerships as "Team Europe".
- **4 October:** EU Member States adopt the European Commission's proposal to impose definitive countervailing duties on imports of Chinese battery electric vehicles. (**See Deep Dive 1**)
- **7 October:** The Commission, via its Health Emergency Preparedness and Response Authority (HERA) and the European Investment Bank, signs a €20 million agreement with French biopharma company Fabentech to develop broad-spectrum therapeutics against biological threats.
- **9 October:** The European Commission adopts the second Work Programme for the digital part of the Connecting Europe Facility (CEF) Digital, allocating around €865 million for improving Europe's digital connectivity infrastructures from 2024 to 2027.
- **10 October:** The European Commission updates product liability rules to align with the digital age and the circular economy.
- **10 October:** The Council adopts the Cyber Resilience Act, setting cybersecurity requirements for products with digital elements to ensure they are safe before being placed on the market.
- **17 October:** The European Commission adopts the first implementing rules on cybersecurity for critical entities and networks under the NIS2 Directive, aiming to establish a high common level of cybersecurity across the Union.
- **17-18 October:** EU trade ministers gather for an informal meeting to engage in high-level discussions on critical issues, including the European Union's trade relations with ASEAN countries and EU-China trade relations.
- **22 October**: The European Commission adopts a communication on the implementation of the European Research Area (ERA) (**See Deep Dive 2**).
- **29 October**: The European Commission adopts the 2025 work programme of the European Innovation Council, opening funding opportunities worth €1.4 billion for strategic technologies and scaling up companies.
- **31 October:** Former Finnish President Sauli Niinistö presents his report on strengthening Europe's civilian and military preparedness, addressing strategies to enhance resilience against climate change, security threats, and other geopolitical challenges.

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

LUHNIP's Deep Dives

1) Adoption of tariffs on Chinese battery electric vehicles and the future of EU trade policy

On 4 October, EU Member States convened during an informal Council meeting to adopt the European Commission's proposed tariffs on battery electric vehicles (BEVs) from China. This decision concludes the anti-subsidy investigation initiated in October 2023, which revealed evidence that Chinese EV exports benefit from countervailable subsidies. Notably, there was a substantial increase in imports, estimated at 11%, from October 2023 to January 2024. To address this, the Commission proposed additional import duties ranging from 7.8% for Tesla to 35.3% for SAIC's MG, on top of the existing 10% tariff on electric vehicles (EVs) manufactured in China. This move aims to counteract the significant subsidies provided to Chinese EV manufacturers and to level the playing field as European carmakers expand their EV offerings. Preliminary tariffs have been in effect for two months.

While ten Member States, including France, Italy, and Poland, supported the tariffs, twelve countries, including Spain (which had initially favoured them), abstained. Five countries - Germany, Hungary, Slovakia, and Slovenia - expressed opposition. Since the EU countries still need to reach a qualified majority to approve or reject the proposed additional tariffs, procedural rules allow the EU executive to implement them.

During a subsequent Informal Foreign Affairs Council (Trade) meeting on 17-18 October 2024, EU ministers discussed relations with the Association and Southeast Asian Nations (ASEAN) and China, and European investment policy. Member States agreed on the need for the European Commission to continue discussions with China to find a solution to the current EU-China trade disputes.

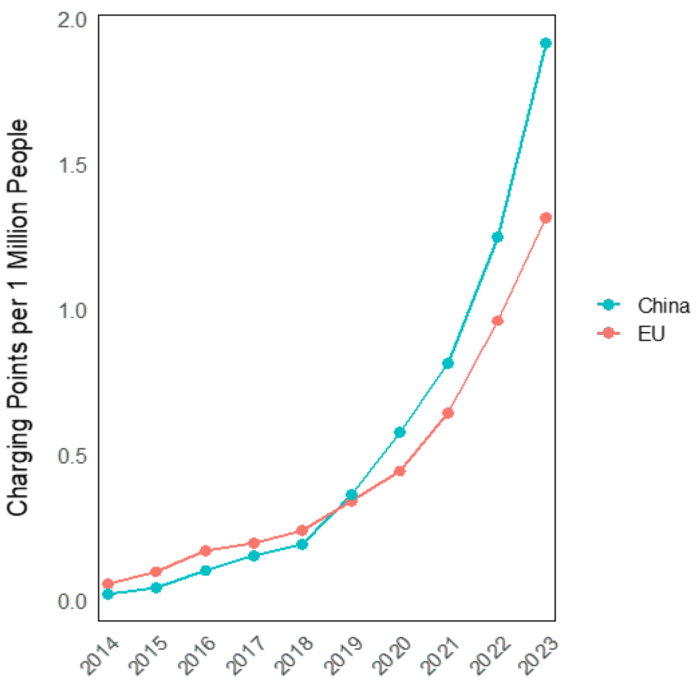
LUHNIP's take

The vote held during the Informal Council meeting of 4 October to adopt the European Commission's proposed tariffs on battery electric vehicles (BEVs) from China highlights the current challenge to develop a common European strategy for managing Chinese industrial competition. Among the Member States, there is a division between those in favour of maintaining strong economic ties with China while seeking alternative partners to reduce dependency, whereas others support protective measures to promote Europe's strategic autonomy. Germany, in particular, strongly opposed the measures due to fears of retaliation that could hurt its automotive sector, especially after China's threat to impose tariffs on EU imports. Also, despite of rising geopolitical tensions between the EU and China, German foreign direct investment in China has grown, leading Germany to promote the opening of the Chinese market.

One effect of the adopted tariffs could be the reduction in the development of integrated value chains between EU and Chinese companies. This shift may hinder innovation and diminish the global competitiveness of EU manufacturers. China has already advised its automakers to pause significant investments in European countries that support new tariffs on Chinese electric vehicles. Moreover, the tariffs could contribute to a broader trend of global trade fragmentation, with the EU and the US working to reduce dependency on China.

It is important to note that tariffs alone will not revitalize the EU automotive industry, as they do not address underlying factors necessary for the growth of the sector. A comprehensive strategy focusing on infrastructure development, regulatory certainty, and strategic partnerships is essential for European EV manufacturers to compete globally (see the Guest Contribution in our Monthly Brief for May 2024). The EU's limited market share in electric vehicles is largely due to internal challenges, such as under-investment in innovation, rather than solely competition from Chinese imports. European manufacturers lag behind their Chinese counterparts in key areas like battery efficiency and technology, with many struggling to adapt due to internal resistance and outdated processes. Meanwhile, the rollout of charging infrastructure in the EU is slower than in China, which hampers the transition to EVs (**see Graph 1**).

Graph 1: Comparison of publicly available EV charging infrastructures in the EU and China per population (2014-2023)



Source: *Our elaboration based on IEA data*

2)The future of EU research policy

The Directorate-General for Research and Innovation of the European Commission recently published an independent expert report to further implement EU RD&I policies in the future entitled "Align, Act and accelerate". It defines a "transformative agenda" for future EU framework programmes for research and innovation, covering the last three years of Horizon Europe, and for the future Multiannual Financial

Framework 2028-2034. The report is based on the analysis of the *interim* evaluation of Horizon Europe and on the *ex-post* assessment of the Horizon 2020 programmes.

In a context of rising disruptive technologies, the worsening of the climate crisis, increasing geoeconomic competition and the war in Ukraine, the experts committee defined four main spheres of action to strengthen EU RD&I policies:

1. The promotion and strengthening of **competitive excellence in science and innovation** by reinforcing the criteria of excelling on RD&I, the fostering of careers of researchers, increasing attraction of private investment and the introduction of disruptive innovation programmes into the European Innovation Council (EIC).
2. The fostering of **industrial competitiveness** through more market integration (the promotion of "the fifth freedom"), the strengthening of the EU RD&I framework, and by providing increased and better focused funding.
3. The promotion of **societal transformations** through research and innovation, by creating a Societal Challenges Council to align better RD&I policies with the broad EU objectives and the link with philanthropy and civil society.
4. The strengthening of the **European RD&I ecosystem** by creating an Industrial Competitiveness and Technology Council to identify and monitor critical technologies and value chains for the EU and supporting open and pan-European collaborative research.

This report has been followed by the adoption of the communication on the implementation of the European Research Area (ERA) on 22 October 2024. The communication aims to take stock of the implementation of the priority actions identified by the European Commission in its 2020 communication on "A New ERA for Research and Innovation" and the Council of the EU's "Pact for Research and Innovation" adopted in 2021. While acknowledging the progress made since 2020, the 2024 communication underlines the current absence of a fully effective ERA. First, there is an inadequate prioritisation of RD&I in national public budgets. Next, an insufficient coordination of RD&I policies across the ERA countries and a persistent fragmentation of R&I systems and regulations. Finally, there are performance disparities across the different systems and the persistence of barriers to deploy and exploit R&I results and scale up innovative companies in Europe.

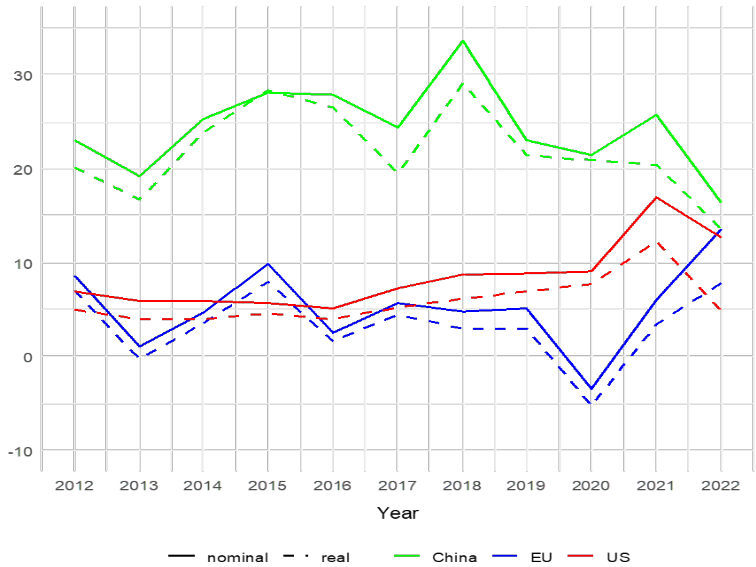
In addition, the European Commission adopted on 29 October the EIC 2025 work programme, aiming to provide funds for 4 main schemes: EIC Pathfinder (€262 million), EIC Transition (€98 million), EIC Accelerator (€634 million) and EIC Strategic Technologies for Europe Platform (STEP) Scale Up (€300 million).

LUHNIP's take

The publication of the report "Align, Act, Accelerate. Research, Technology and Innovation to Boost Competitiveness" and the European Commission communication of the implementation of the ERA come at a crucial time for the future of EU RD&I policies. The EU's weak performance in terms of breakthrough innovation and the primal concentration of its innovation activities in sectors with medium-to-low R&D intensity, as underlined by the Draghi and Letta Reports, forces the new European institutions to adopt a new approach to EU RD&I policies. The "Align, Act and Accelerate" report and the European Commission communication on the implementation of the ERA provide important recommendations in this context.

Firstly, with this report and communication, the European Commission aims to encourage Member States to speed up the integration of national research and innovation policies in the face of the persistence of the fragmentation of national RD&I systems and regulations, and the lack of coordination between Member States. The European Commission's proposal is to create "a fifth freedom" and a "Research and Innovation Union", as recommended in the Draghi and Letta Reports (see the LUHNIP Monthly Briefs for April and September 2024). Secondly, the European Commission's goal is to quickly stimulate public and private investment in RD&I to reduce the R&D spending gap between the EU and its main competitors (**see Graph 2**). The creation of an "Industrial and Competitiveness and Technological Council" to support collaborative research and an increase of national funding of EU RD&I programmes are important proposals to reach this goal. Thirdly, the European Commission shows with this report, communication and the EIC programme that it is determined to reinforce its tools to scale-up tech companies and support disruptive innovation. The proposals to reinforce the funding and to introduce disruptive research programmes of the European Innovation Council represent indeed an important step in this direction. Finally, with that report and communication, we can see the application by the European Commission in its RD&I policies of its programme to simplify EU regulations and speed up procedures (see LUHNIP Monthly Brief for September 2024). The aim is to help companies respond rapidly to the changing global innovation and science landscape to be able to face foreign industrial competition.

Graph 2: Nominal and Real R&D Growth Rates of EU, US, and China (2012-2022)



Source: Our elaboration based on The Industrial 2023 R&D Investment Scoreboard

Guest contribution

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The Trump Effect and the Draghi Report: A Critical Juncture for EU Industrial Policy

On 5 November, the United States re-elected Donald Trump as its president, a development that will significantly impact EU industrial policy for years, possibly decades. Three policy shifts will have profound consequences for the industrial strategies of the EU and European countries.

First, the US promises increased economic isolationism. Whether this materializes through higher tariffs and import duties, as announced, or increased subsidies to domestic manufacturing industries, or both, the impact will be significant. An increasingly closed America calls for accelerating policies toward the EU's strategic autonomy goal. This requires two parallel tracks: securing critical raw materials and dramatically scaling up Europe's innovation capabilities. To achieve the latter, the EU must accelerate the implementation of Important Projects of Common European Interest (IPCEIs), substantially increase both public and private R&D investment, and streamline regulations to allow faster deployment of innovative technologies. Only by combining secure supply chains with home-grown innovation can Europe achieve true strategic autonomy in key industrial sectors.

At the same time, a less open America is likely to reduce the scope for trade globally and increase the necessity of an ever-closer union underpinned by the strengthening of the single market, as export-led growth strategies pursued by Germany and other economies of the EU are likely to bear less fruit.

Second, the US is likely to renounce its climate objectives, or at least to dismantle a number of incentives for energy transition, giving free rein to its domestic oil industry and exploration abroad. Europe will remain the only large bloc (possibly with other OECD economies like Canada and Japan) to exert global leadership in this domain, which may prove insufficient to reach the global objectives to contain rising temperatures. At the same time, this shift will embolden domestic European interests opposed to the green transition, potentially slowing its pace. However, two factors must be taken into consideration. First, most US investment in renewable energy is scheduled to happen in counties that supported the president-elect. Second, investment in renewables (and storage) is largely under way in most European countries. In short: the green transition, differently from even five years ago, now has powerful vested interests in its defense. Hence, while we are likely to see some reduction in transition speed, sheer market forces are likely to continue pushing toward a decreased importance of fossil fuels, at least in OECD countries. However, if climate change is left unfettered as a consequence of a changed US position, increased focus should be put by the EU on technologies geared toward climate adaptation, in its different dimensions.

Third, President-elect Trump has announced his intention to return to decreased engagement with NATO. While complete withdrawal seems unlikely, we can expect a reduced American defense presence and spending in Europe and beyond, precisely at a time of heightened tensions and open war in Ukraine and the Middle East. This development obviously calls for increased investment and stronger coordination across the EU on defense. However, this is not a sinecure. As explained by Samuel Faure in a recent policy chapter written for the LUHNIP EU Industrial Policy Report, while desirable from many viewpoints, a stronger integration of the European military-industrial complex requires investment, as well as institutional and technological change.

In light of these broad new challenges, the recently published Draghi Report on EU Competitiveness takes on new significance. The report presents a comprehensive vision for European economic renewal that has become even more relevant in this new geopolitical context. The report advocates for transformative change through coordinated action, including the issuance of common European debt—successfully tested through the Recovery Fund—to finance long-term infrastructure projects and promote growth. Furthermore, it challenges other established paradigms, for example in the EU's competition policy, to enable the emergence of European industrial champions capable of competing on a global scale.

It presents a new approach, that of public-private partnership, which can accommodate the diversity of European capitalisms, transforming what was once considered a weakness into a potential source of continental competitive advantage. This approach has to be taken seriously if Europe wants to support the resiliency of industrial ecosystems in the context of a more closed and protectionist America.

In other words, the report proposes an ambitious expansion of European policies and cooperation as a response to increased challenges, which we can only expect to increase in the forthcoming future. Indeed, the Draghi Report responds to current anxieties not by advocating protectionism, but by suggesting that Europe must strengthen its capacity to act independently while maintaining its commitment to an open and multilateral world.

Looking ahead, the expected policy shift that will be coming from the new American administration creates urgency in front of the opportunity. Europe stands at a critical juncture where it must choose between fragmentation and deeper integration. Politically, Europe will have to show if it is able to unite behind a shared vision of its future in an evolving global order, or if the divided member states will follow the model of emboldened, self-centered leaders from other areas of the world.