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## **Taking the territorial dimension of industrial policy seriously: Industrial and cohesion policy in the EU**

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## Taking the territorial dimension of industrial policy seriously: Industrial and cohesion policy in the EU

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### Executive summary

Cohesion Policy and Industrial Policy are at the core of development policy in the EU. Cohesion Policy aims at territorial, social, and economic cohesion, pursued historically via redistributing resources for key infrastructure investments. Industrial Policy, while originally subsumed under the EU's Cohesion Policy, developed gradually into a wholesome strategy aiming to 'direct' innovation and economic transformation, with emphasis on the green and digital transition.

While the 'Lisbonisation' of Cohesion Policy has seen its objectives shift towards technological upgrading and global competitiveness (an 'entrepreneurial shift'), bringing it closer to the innovation focus of Industrial Policy, recent developments in the EU have pushed the latter towards the pursuit of more "macroscopic" objectives, such as 'open strategic autonomy', decarbonisation, 'resilient single market' and, much more recently, (defence) 'readiness'. The coordination of these two policies is crucial to balance the new goals and ambitions of the EU with its Treaty obligation of promoting territorial cohesion. We demonstrate that this is not to be taken for granted. The two policies differ significantly in terms of their principles, governance and fund-allocation criteria; while substantial differences exist also in terms of their thematic prioritising and spatial targeting and selectivity. Taking stock of the differences, we advance two main recommendations. First, that Industrial Policy becomes more 'territorialised' – an *Industrial Policy that 'thinks locally'*. This involves developing a spatial strategy alongside the sectoral-thematic strategies and wider missions, obtaining a more direct spatial character in its financial interventions and support actions, and directing resources also to areas that lack 'excellence' via appropriate instruments able to nurture untapped advantages. Second, that Cohesion Policy becomes more 'strategic' – a *Cohesion Policy that 'acts globally'*. While maintaining its principle of place-based strategizing under locally-advanced logics of intervention, this involves two key changes: a partial re-centralisation of the policy, to connect more organically to (and to influence) the strategic objectives of the EU in the realm of Industrial Policy; and stronger horizontal cooperation in the formulation of the local strategies, so that successful re-specialisations that make sense at the local level also contribute to the overall re-specialisation of the EU's economic space.

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## 1. Introduction

Cohesion Policy and Industrial Policy constitute two core pillars of development policy in the EU. Strictly speaking, Cohesion Policy (henceforth, CP) aims at addressing development blockages in lagging regions and areas of economic decline, with the overall objective of achieving **territorial, social and economic cohesion** across the EU. In turn, the aim of Industrial Policy (henceforth, IP) is to **stimulate innovation and growth** by resolving market, information and coordination failures which prevent the economy from attaining socially desirable equilibria (from global competitiveness to carbon neutrality).

In past decades, the two policies saw little conflict: CP was traditionally focused on supporting development via redistributing resources to less developed regions; while IP was rather rudimentary, with efforts limited to supporting innovation and a general principle of non-interventionism relying on processes of market liberalisation and economic integration (via Competition Policy and the Single Market) to attain its objectives.

As attention to problems of development and competitiveness intensified over the last two decades, both policies experienced significant shifts. CP became more ‘entrepreneurial’ and innovation-minded, extending its aims to support innovation, industrial restructuring and economic re-specialisation across the EU. Industrial policy became more ‘active’, aiming at ‘directing’ growth and stimulating reindustrialisation and economic restructuring that went well beyond the traditional attention to ‘correcting’ market failures.

The emergence, more recently, of various ‘disruptions’ intensified this process – with objectives such as **open strategic autonomy, economic sovereignty, decarbonisation, ‘fair’ competition in a ‘resilient’ single market** (and, more recently, **military and defence-technology ‘readiness’**) obtaining a centre-stage position. Consequently, the EU developed new instruments, legal frameworks and initiatives that appear to ‘compete’ with CP as the EU’s traditional development tool; while CP is increasingly compelled to align with these wider objectives: in the 2021-2027 period, over a quarter of the Cohesion budget is earmarked for “green” actions and about 15% for the “digital” transition. More crucially, as has been convincingly argued in the literature (Bachtler & Downes, 2023), developments in EU industrial policy challenge the core goals of CP (**balanced development and convergence**) by favouring better-off or technologically leading areas and imposing higher transition costs to less developed and less dynamic areas.

These developments raise important questions about the ‘division of labour’ between the two grand policies of the EU, their functional differentiation and potential for coordination. This working paper looks at the tensions between the two policies and their degree of alignment, asking how and whether the interplay between industrial and cohesion policy can be enhanced

to effectively pursue the seemingly divergent goals of fostering green/digital innovation and economic sovereignty and promoting cohesion within the EU.

## 2. Elective affinities: the evolution of policy

Although lacking a precise economic theory as its backbone (Begg, 2016), CP has traditionally defined regional disparities as a ‘regional problem’, whereby market dynamics create investment gaps in specific regions, requiring policy to direct investments there (mainly in the form of hard infrastructure) so as to stimulate an expansion of local productive capacities (*extensive* growth). Intellectual developments in growth theory and new economic geography around the turn of the century challenged this view, reframing the issue as a ‘development problem’ of weak institutions and weak capabilities for mobilising existing resources (*intensive* growth) (Puga, 2002), implying that lagging regions face problems of competitiveness and highlighting the efficiency advantages of agglomeration (and thus of spatial disparities) (World Bank, 2009).

The EU’s response to this was a reframing of CP as the pursuit of *balanced growth*, which maximises the utilisation of available resources and untapped local advantages through context-specific ‘place-based policies’ (Barca, 2009). The latter married well with the concept of “smart specialisation”, developed through the work of the Knowledge for Growth expert group, established as part of the Commission’s plans to reinvigorate the Lisbon Strategy (Foray & Van Ark, 2007). Highlighting the importance of “entrepreneurial discovery” (Foray, 2009) and linked to developing ideas in the literature concerning the transformational potential of “related diversification” (Neffke, Henning, & Boschma, 2011), together they formed a forceful argument pushing policy towards actions aiming at supporting (regional) growth via innovation, risk-taking and sectoral targeting under the premise of a ‘double dividend’ of maximising overall growth (and efficiency) while simultaneously promoting convergence across regions (Farole & Akinci, 2011).

The result was the so-called ‘Lisbonisation of Cohesion Policy’ (Mendez, 2011). The new CP aimed at stimulating industrial upscaling and developing new activities through smart investments that leverage local assets and involve all stakeholders in the process of entrepreneurial discovery. With this, its policy objectives shifted from the pursuit of convergence to that of technological upgrading and competitiveness: regions – that is, all regions, irrespective of their level of development – had to develop their own smart specialisation strategies, with sound analysis of the evidence base, identifying the existing and latent areas of strength where they want to (re-)specialise and develop their future growth drivers, focusing on improving framework conditions that could enable this (Di Cataldo & Monastiriotis, 2020). This also implied a shift in the policy model: from redistribution-oriented grants-based transfers to support infrastructure development to the utilisation of new financial

instruments (that sought to leverage private investments and stimulate risk-sharing) and investments aimed at accelerating growth and supporting EU political priorities (Brunazzo, 2016); from evaluations of programme delivery to results-orientation under each programme's 'logic of intervention' (European Commission [EC], 2014); and from more inflexible allocations with limited conditionality and ever-expanding thematic objectives to more ownership at the national level (Partnership Agreements, expansion of national sectoral Operational Programmes), fewer thematic objectives linked more directly to the wider policy priorities of the EU and tighter conditionalities. The end result is a more 'entrepreneurial', more flexible and less bureaucratic policy, arguably resembling more of a **place-centred Industrial Policy**.

As CP shifted, non-spatial policies for market correction also evolved – as evidenced by a series of policy documents, from the European Commission's 2002 Communication "Industrial Policy in an Enlarged Europe" to the 2021 Communication "Updating the 2020 New Industrial Strategy" and the 2023 "A Green Deal Industrial Plan for the Net-Zero Age". Although the shift seemed originally well-informed by relevant academic debates highlighting the importance of systemic failures and the need for policy to induce economic activities rather than merely address market inefficiencies (e.g., Rodrik's, 2004, 'New Industrial Policy' and Mazzucato's, 2013, 'directionality' of growth), more recently the remit and scope of EU's industrial policy expanded further. Today the EU's IP has become more "macroscopic", focusing more broadly on the union's geopolitical ambitions (Breton, 2022) and on its legislative effort to ensure a "fair but not naïve" competition policy (IPCEIs, Temporary State aid Crisis and Transition Framework, General Block Exemption Regulation), a functioning single market (Banking Union, Capital Markets Union, Digital Services Act), a protective regulatory environment (Net-Zero Industry Act; Critical Raw Materials Act; EU Chips Act; Digital Markets Act), and security of supply (Global Gateways, trade agreements), reportedly focusing on all sectors of the economy.

Consequently, while the evolution of CP saw it moving towards alignment with the 'entrepreneurial shift' in IP, the more recent shifts in the latter (towards both carbon neutrality and economic sovereignty) create the potential for new misalignments and tensions – with new IP objectives and actions potentially widening territorial disparities across the EU, and the increasing focus of CP on smart growth and 'entrepreneurial discovery' potentially diminishing its likelihood of addressing these disparities. This raises two questions. The first concerns the issue of territorial cohesion: how can an innovation-oriented CP ensure the support for those who fail to cultivate the new comparative advantages allowing them to thrive in the "new economy" of the twin transition. The second concerns the issue of policy alignment: with CP commanding fewer resources for regional targeting, and IP actions taking a more place-blind perspective, what mechanisms are there to ensure that the place-based IP delivered by CP will work and, moreover, that it will remain aligned – and supportive of – the macro-IP of the Green Deal and the EU's New Industrial Strategy? As the first question has been the subject of intense

discussion within the policy community (e.g., High-Level Group on the Future of Cohesion Policy), our main focus is on the second question.

### 3. Empirical analysis: synergies and misalignments

#### 3.1 Funding modes and governance

As a mature EU policy, CP has well-defined funding mechanisms and criteria, which follow specific rules for thematic and geographical allocations ('financial envelops'). Funds are largely allocated based on regional GDP and national GNI per capita (with minor adjustments for unemployment, education, net international immigration, and total greenhouse emissions), with the main beneficiaries being regions with GDP per capita below 75% of the EU average (ERDF funds). Investments and programmes are jointly agreed upon in advance of the programming cycle between the European Commission and national authorities ('shared management'), with the direct involvement of authorities from beneficiary regions. Once programmes are approved, projects are selected by the managing authorities and funded based on eligible costs and programme-specific selection criteria. While performance assessments are carried out ex post, fund allocation and project approval procedures follow stringent regulations and requirements (Molina & Lleal-Fontàs, 2020), with adherence to ex-ante conditionalities ('enabling conditions') as an on/off criterion.

In contrast, IP funding is very fragmented, with different rules depending on the instrument. For example, Horizon Europe, the European Research Council and the European Innovation Council allocate funds through competitive calls (c.€95bn in 2021-2027) based on proposal excellence and impact, favouring firms and research institutes that already possess significant knowledge and technological advantages. InvestEU guarantees (c.€26bn) and the EU Innovation Fund (estimated to raise €40bn in 2020-2030) also use competitive application processes, with beneficiaries from both the public and private sectors. Other components, such as the relaxation of state-aid rules for IPCEIs or assistance offered to entities participating in Industrial Alliances, also lack a spatial dimension or specific allocation rules. The only instrument with allocation rules and conditionality criteria is the Recovery and Resilience Facility (RRF).<sup>3</sup> Still, RRF grants are not directly income-dependent, while RRF loans do not follow a fixed allocation key. Programmes are governed at the national level, with National Recovery & Resilience Plans setting specific objectives and milestones for the investments and reforms to be implemented ('direct management'). Fund disbursement depends on performance against milestones, with a much greater flexibility in re-allocating funds across

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<sup>3</sup> Strictly speaking, the RRF is not part of the EU's Industrial Policy. It is, however, the main funding vehicle for the green and digital transition currently.

investments, no systematic obligation for territorial earmarking and, importantly, without national co-financing requirements.<sup>4</sup>

Overall, funding under CP is slower, more bureaucratic and taxing for countries with limited resources and regions of limited capacities; but it is also more participatory and with a direct focus on territorial cohesion. Instead, funding under IP follows market principles, offering more flexibility and control to beneficiary countries (RRF) and entities (Horizon, EIC, InvestEU, etc), but lacking emphasis on stakeholder involvement, territorial cohesion and regional convergence (Bachtler, Mendez, & Begg, 2020).

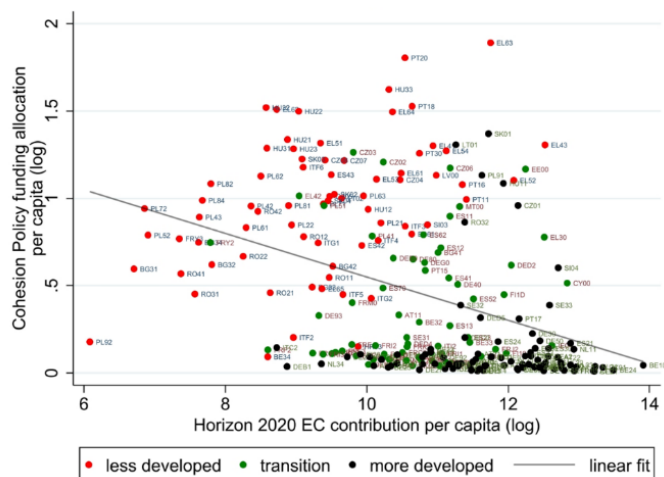
### 3.2 Targeting and funding allocations

To compare the targeting of the two policies we draw on some indicative examples, as the fragmented nature of the EU's IP and the absence of aggregated data on investment allocation across its various instruments make direct comparisons with CP impossible.

#### *Innovation policy instruments*

We first draw on data from EC Cordis to develop a regionalised measure of Horizon funding allocations – which we contrast with the regional distribution of CP funds in the 2014-2020 period. A clear misalignment emerges between the two funding sources (correlation coefficient is  $r=-0.31$ ), indicating an inverse relationship between a region's capacity to attract funding for innovative research projects and its overall level of development (Figure 1). This is further illustrated by the concentration of more (less) developed regions on the right (left) side of the scatterplot.

Figure 1: Horizon and Cohesion Policy funds across regions.

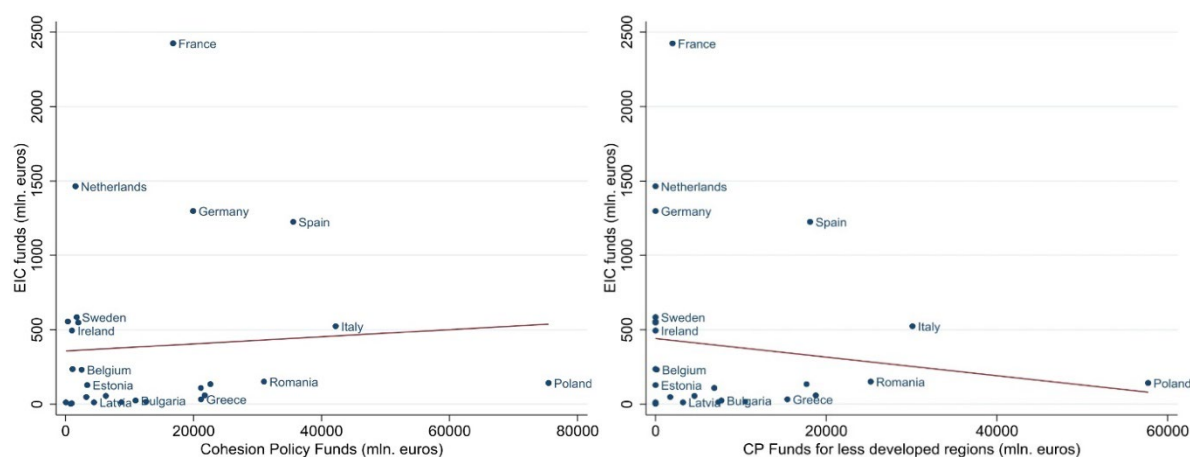


Source: Author's elaboration based on Crescenzi et al. (2021) and EC Cordis.

<sup>4</sup> For a more detailed comparison between the RRF and Cohesion Policy see Molica and Lleal-Fontas, 2020; Koopman, 2022; Bachtler et al, 2020; Bachtler and Mendez, 2021.

Second, we do a similar analysis for funds allocated through the European Innovation Council – this time at the national level but looking both at total CP funds and CP funds directed to less developed regions (Figure 2). Allocations of EIC grants and CP allocations are weakly correlated ( $r=0.07$ ), while for funds targeting less developed regions correlation is negative ( $r=-0.14$ ). Thus, on the whole, research and innovation policy, as proxied by Horizon 2020 and EIC grants, is inversely redistributive, potentially amplifying territorial inequalities.<sup>5</sup>

Figure 2: EIC and Cohesion Policy funds across Member States



Source: Author's elaboration based on EIC data

### Recovery and Resilience Facility

Replicating the above analysis for the case of the RRF – as one of the instruments that currently support the EU's IP objectives (Bachtler & Mendez, 2023) – produces a much higher correlation ( $r=0.59$ ), indicating that RRF and CP funding are better aligned at the cross-country level. To further this analysis, we compare the alignment of the two funds' thematic prioritisation, drawing on data from Crescenzi et al. (2021) on the thematic priorities of CP allocations in the 2014-2020 period and matching them with the thematic pillars of RRF allocations developed by Darvas et al. (2023).

As shown in Chart 3(b), in most countries allocation of the two funds is directed to different priorities (negative or near-zero correlation).<sup>6</sup> Positive correlations (alignment of thematic allocations) are observed mainly in southern and eastern European countries (plus Finland and Sweden). Overall, the correlation at the country-pillar level is weakly positive ( $r=0.16$ ), reflecting

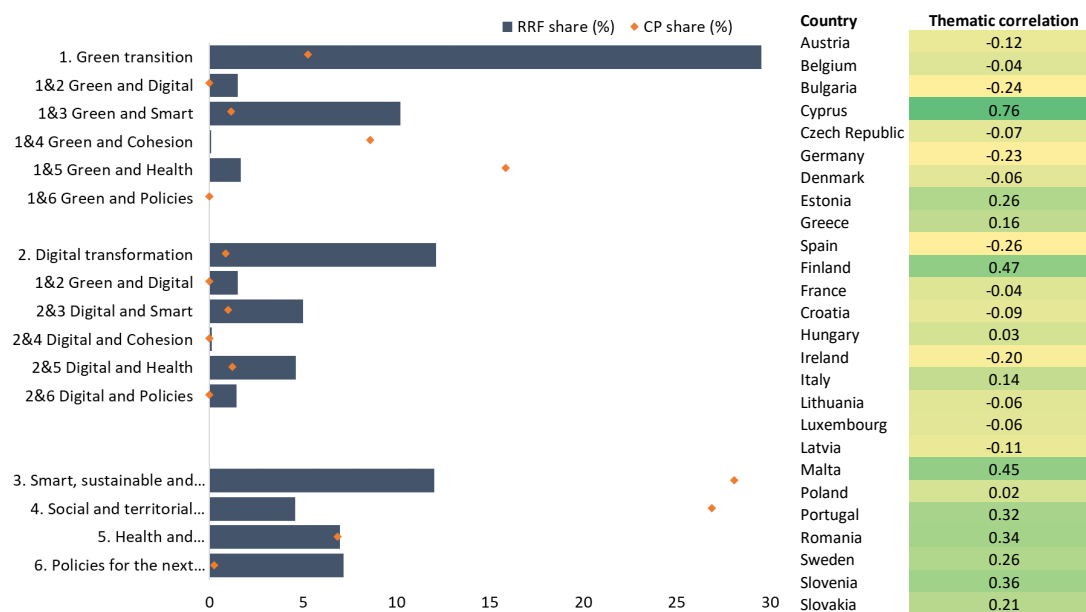
<sup>5</sup> Note that the analysis here is at the national level and thus underestimates the full extent of regressivity. EIC grants tend to concentrate in national capitals and major cities, which are typically not main CP beneficiaries. Similar spatial patterns exist also for the case of grants awarded to firms through the InvestEU Programme.

<sup>6</sup> Note that this also applies to some countries (such as Spain) where National Plans pursue explicitly territorial cohesion.



limited alignment between RRF and CP priorities. Still, some aspects of alignment, or synergy, can also be observed (Figure 3(a)): while allocations to digital transition and social/territorial cohesion are different between the two funds, both funds allocate significant amounts to the green transition – albeit mostly within sub-areas of their own prerogative (e.g., ‘green and smart’ for RRF; ‘green and cohesion’ for CP).

Figure 3: Thematic alignment between RRF and Cohesion Policy funds



(a) Thematic allocations in CP and RRF

(b) Correlation of allocations, by country

Source: Author’s elaboration based on Crescenzi et al. (2021) and Darvas et al. (2023).

### 3.3 The spatial footprint of non-funding instruments

Lastly, we examine the differences in prioritisation in the EU’s IP more generally, as captured by its attention to decarbonisation and wider priorities (Sensitive Ecosystems, Industrial Alliances, etc).

#### Decarbonisation and green transition

We ask whether regions more strongly affected by the green transition are more (or less) heavily supported by CP. To examine this, we compile data on the sectoral intensity of ‘brown’ sectors by region (extrapolating GHG emissions per worker using Eurostat’s Air emissions accounts by NACE Rev. 2 activity and multiplying by each region’s sectoral employment share) and juxtaposed it with the regional allocations of ERDF payments (in per capita terms, for the 2014-2020 period). We complemented this with data from the ‘Regional green transition vulnerability index’ (Rodríguez-Pose & Bartalucci, 2024).

Figure 4: Brown jobs / green vulnerability and ERDF allocations

Region	Mean values		Correlations with ERDF allocations	
	GHG emissions per worker	Green transition vulnerability	GHG emissions per worker	Green transition vulnerability
Less developed	19.17*	1.11*	-0.18	-0.16
Transition	13.09	-0.12	0.43	0.24
More developed	14.62	-0.87	0.21	0.29
All regions	15.59	-0.119	0.237	0.472

Notes: asterisks (\*) show a statistically significant difference from the values observed in the other regional categories.

Source: Author's elaboration based on Eurostat, Cohesion Policy data and Rodríguez-Pose & Bartalucci (2024).

Overall, there is a strong positive association between exposure to the green transition and ERDF payments (Figure 4). Thus, regions that receive more support from CP are expected to be more heavily (negatively) affected by the priorities set out in the EU's Green Deal. While this may be read as a source of synergy (whereby CP targets exactly the most vulnerable regions – also in relation to IP objectives), our reading is rather that the objectives of the EU's IP, with regard to the green transition, impose higher burdens exactly on those regions that have the lower levels of development and thus receive the largest support from CP. While this does not seem to apply in the same way within the group of less developed regions (first row, columns 3 and 4), we note that, as a group, these are the regions with the highest exposure to those risks (first row, columns 1 and 2).

### Other initiatives

The EU's IP places significant emphasis on 'industrial ecosystems', which are clusters of entities forming distinctive value chains. The EU provides support and technical assistance to Member States aiming to enhance coordination among businesses and industries within each ecosystem, thereby strengthening their resilience and reducing external dependencies of the single market. To analyse how support for these ecosystems may unevenly affect different EU regions, we calculate each NUTS2 region's notional participation in each ecosystem and analyse how this varies across types of regions and how it correlates with the regions' CP allocations.<sup>7</sup>

<sup>7</sup> Notional participation is calculated by multiplying each region's sectoral employment shares across NACE 2.0 sectors with the NACE 2.0 sector weights for each industrial ecosystem (which we draw from the European Cluster Collaboration Platform – [https://www.clustercollaboration.eu/sites/default/files/2023-05/Methodology\\_Notes.pdf](https://www.clustercollaboration.eu/sites/default/files/2023-05/Methodology_Notes.pdf)):

$$Ecosystem\_participation_{re} = \sum_s \frac{Employment_{rs}}{Employment_r} * W_{se}$$

Across the EU, the largest employment shares are in the ecosystems of Retail, Construction and Tourism (Chart 5). Specialisations across types of regions, however, are different.<sup>8</sup> Relative to the average (LQ columns), less developed regions specialise more in ecosystems such as Agri-food, Tourism, and Energy-intensive industries; while more developed regions participate disproportionately in ecosystems such as Digital, Electronics, Health, Aerospace & Defence and Cultural & Creative industries (in most cases, more developed regions also exhibit stronger specialisations / more extreme LQ values). A correlation analysis (between ecosystem participation and ERDF allocations – last column) confirms this ‘division of labour’. ERDF allocations show strongly negative correlations with the specialisation in ecosystems related to Textiles, Digital, Cultural & Creative industries, Health, Construction and Electronics; and positive with Tourism, Energy-intensive industries, and Agri-food.

This suggests a potential disadvantage for regions targeted by CP. Unless all industrial ecosystems enjoy the same degree of technological sophistication and face similarly disruptive supply chain challenges, the focus on industrial ecosystems in the EU’s IP could create relative disadvantages precisely for those regions (*Franco & Wilson, 2022*).

Figure 5: Notional participation in ‘sensitive ecosystems’ by type of region

Ecosystem	All	Less developed		More developed		Transition		Correlation of regional shares with regional ERDF funds allocation
	Share	Share	LQ	Share	LQ	Share	LQ	
Aerospace and defence	2.9%	3.0%	1.02	3.1%	1.07	2.6%	0.89	-0.01
Agri-food	6.4%	8.3%	1.30	4.8%	0.76	6.5%	1.02	0.32
Construction	20.5%	18.8%	0.92	20.6%	1.00	22.3%	1.09	-0.20
Cultural and creative industries	2.9%	2.2%	0.77	3.5%	1.23	2.6%	0.92	-0.27
Digital	4.2%	3.0%	0.70	5.8%	1.37	3.4%	0.80	-0.29
Electronics	1.2%	1.0%	0.86	1.5%	1.24	1.0%	0.81	-0.11
Energy intensive industries	6.1%	6.7%	1.10	5.7%	0.94	6.0%	0.99	0.13
Energy-renewables	0.8%	0.9%	1.09	0.9%	1.01	0.7%	0.88	0.10
Health	2.2%	1.7%	0.79	2.6%	1.20	2.1%	0.94	-0.24
Mobility-Transport-Automotive	10.7%	11.2%	1.05	10.6%	0.99	10.2%	0.96	0.10
Proximity, Social Economy and Civil Security	5.9%	5.7%	0.97	5.8%	0.99	6.2%	1.05	-0.01
Retail	24.2%	24.9%	1.03	23.5%	0.97	24.5%	1.01	0.07
Textile	0.2%	0.1%	0.82	0.2%	1.17	0.2%	0.96	-0.39
Tourism	15.2%	16.0%	1.05	14.4%	0.95	15.4%	1.02	0.18

Source: Author’s elaboration as described in the text

Similar conclusions can be drawn for other initiatives, such as the formation of Industrial Alliances and the approval of Important Projects of Common Economic Interest, which benefit from exemptions from state-aid restrictions. While granular data on participation in these schemes is not available, anecdotal examination shows that participation from peripheral and less developed regions is uneven. Concerning the Industrial Alliances, the general pattern as portrayed by the European Commission<sup>9</sup> is that participating entities are on the main (besides national and professional organisations) large national and multinational companies and

<sup>8</sup> Indicatively, notional participation in Electronics ranges from below 1% in Melilla, Ceuta (Spain) and Notio Aigaiio (Greece) to over 4% in Freiburg, Dresden (Germany), Vest (Romania) and Észak-Magyarország (Hungary).

<sup>9</sup> [https://single-market-economy.ec.europa.eu/industry/industrial-alliances\\_en](https://single-market-economy.ec.europa.eu/industry/industrial-alliances_en)

research institutes specialising in high-end technologies, typically located in national capitals or regions of high development and accessibility. Similarly, emerging evidence suggests that IPCEIS may have “limited or even detrimental effects on the prospects for convergence within the EU” (Lopes-Valenca, 2024). The example of the most recently approved IPCEI (Move4Cure) shows that, of the 13 beneficiary companies, nine are in regions classified as ‘more developed’, another two are in a ‘less developed’ national capital (Budapest), while a third have multinational operations. Again, it can be argued that the alignment of such interventions with the objective of territorial cohesion is, at best, extremely limited.

#### *A note on the defence industry*

Recent global events have shown that economic autonomy encompasses not only supply-chain issues but also issues of security. The European Commission’s White Paper ‘Readiness 2020’ is a bold response to this realisation. Although not strictly part of the EU industrial policy architecture, the so-called ReArm Europe Plan seeks to mobilise €800bn to finance “a massive ramp-up of defence spending”. This includes funds generated both at the national level, through the relaxation of deficit rules, and ones distributed centrally, via the Security Action for Europe loan instrument and EIB loans directed to defence and security projects. These actions create a strong momentum for the acceleration of the development of the European Defence Industrial Strategy, whose main aim is to strengthen the EU’s Defence Technological and Industrial Base (EDTIB). With regard to territorial cohesion, this presents an enormous challenge, as the defence industry in the EU is very highly concentrated.<sup>10</sup>

## **4. Conclusions and Policy Recommendations**

We have argued that Industrial and Cohesion Policy appear to have rather limited alignment. Despite both policies experiencing an ‘entrepreneurial’ shift in recent decades, the emphasis on excellence in innovation policy and the advancement of increasingly challenging “macroscopic” ambitions and objectives may be difficult to reconcile with the realities of many of the EU’s regions and territories. For Cohesion Policy to support these new ambitions, and for the two policies to become more synergetic and mutually reinforcing, two things need to happen. First, IP should obtain a more ‘territorial’ character, developing a spatial strategy alongside its thematic and geopolitical objectives, understanding territorial cohesion and harmonious development as key constituent parts of any strategy for growth. Second, CP should become more ‘strategic’, linking more organically to the strategic priorities and ambitions of the EU and

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<sup>10</sup> Three countries (France, Germany and Italy) account for some 40% of the sector in the EU. The same countries account for 12 out of the 16 EU-based companies making the SIPRI list of the top-100 arms-producing and military services companies globally (<https://www.sipri.org/databases/armsindustry>).

understanding that a fragmented set of local strategies (for smart specialisation) cannot sufficiently deliver on the EU-wide key objectives.

### Recommendation 1. A ‘territorialised’ Industrial Policy

As we saw, the EU’s IP has a potentially regressive ‘territorial footprint’, amplifying regional disparities. To be aligned with the CP objective (and the EU’s own Treaty obligations) of territorial cohesion, IP needs to internalise the logic of the *double-dividend of balanced growth* guiding the modern CP (whereby supporting lagging regions releases untapped potentials that maximise overall growth) and apply it in its own interventions.

- **Devise a spatial strategy alongside the various sectoral strategies and mission-oriented policies.** Spatial strategies set strategic priorities for specific areas and regions, under a systemic view of enhancing *functional connectivity* (e.g., supply-chain networks) across space. Their need derives from the realisation that regional disparities and disadvantage are a form of systemic market failure, similar to the ones that IP is already called upon to address. A spatial strategy will allow the EU to formulate a plan not only for ‘what goes where’ (in terms of funds or supported activities) but, importantly, also for *why* (how a particular allocation connects to other activities across and other assets/advantages within). This requires the more direct involvement of “spatial” institutions – such as DG Regio or the European Committee of the Regions – in the design and governance of IP, in closer coordination with local ‘smart specialisation’ plans.
- **Introduce a direct spatial character in IP interventions, consistent with the overall spatial strategy.** Assistance by IP programmes should incorporate spatial criteria consistent with the overall spatial strategy in the allocation of funds and other forms of support, thus directing resources to (low-capacity) regions to allow them to move to new position(s) in the European and global supply chain. For example, EU support for the establishment of Gigafactories in Europe (via InvestEU) or for deep-tech investments (via the EIC) should avoid leaving the (al)location choice to the free market (by supporting the most ‘competitive’ bid) and instead factor-in how the resulting economic activity is distributed across space. Or, grants under Horizon and state-aids under the ICPEIs could include quotas for participation by entities from less developed regions in their selection criteria, consistent with the overall spatial strategy, similar to Widening Participation and Spreading Excellence actions under Horizon Europe currently.
- **IP initiatives should measure their extent of regressive selectivity and apply corrective actions to support the involvement of entities from less developed regions.** As demonstrated, the participation of regions of different types in the various industrial ecosystems, industrial alliances and IPCEIs is uneven. Support and planning for

industrial ecosystems, under the European Monitor, should also include analysis of “notional regional participations”. This would help identify those less developed regions that could potentially participate in each ecosystem; and support their participation either by leveraging on existing advantages or by helping them diversify into relevant sectors and activities. Similarly for participation of businesses and other entities, from less developed regions, in Industrial Alliances and IPCEIs – or even in Procurement for Innovation and Alliances for Innovation actions. This requires the development of specific funding and technical assistance measures (e.g., quotas and incentives in IPCEIs; brokering and coordination services for Alliances) and relevant quotas and selection criteria (for Innovation actions) targeting specifically regions of economic disadvantage and linking directly to those regions’ strategies for upgrading.

- **The spatial costs (and proceeds) of IP should be turned into an opportunity for the economic upgrading of affected regions.** As shown, some IP objectives (e.g., green transition) impose larger challenges to less developed regions. While the Just Transition Mechanism was devised in part to address exactly this problem, its resources are limited; while its instruments (co-financing for grants under the Just Transition Fund; leveraging for InvestEU and EIB loans) generally put less developed regions at a disadvantage (Volintiru & Nicola, 2024). Funding for such initiatives should increase substantially (whether via taxes capturing the ‘proceeds’ of IP or via direct debt-issuing, as with the RRF), moving from a compensatory logic to one that understands green investments in these areas as a *public good* which creates social value for *all* territories; while support should shift towards less risky instruments (e.g., tax and investment/production credits, as in the very successful example of the ‘Energy Communities’ programme under the USA’s IRA) that will support more directly ‘clean investments’ in ‘green vulnerability’ regions. Similarly for other types of ‘vulnerability’, e.g., with regard to critical raw materials.

### Recommendation 2. A ‘strategic’ Cohesion Policy

While our interest is not specifically in the reform of the Cohesion Policy, two important measures derive from our recommendations on the fine-tuning of Industrial Policy.

- **Connect smart specialisation strategies into a network of local strategies that adhere to the EU’s overall spatial strategy.**

The shift to ‘place-based’ initiatives and locally-inspired “logics of intervention” in CP affords a great amount of autonomy and discretion to regions on how (and where) to re-specialise in their pursuit of economic upgrading, raising the question of whether successful re-specialisations that make sense at the local level may actually contribute to, or hinder, the overall re-specialisation objectives (decarbonisation, sufficiency in

sensitive products and critical raw materials) at the EU-wide level (Di Cataldo et al, 2022). This calls for stronger horizontal cooperation in the formulation of these strategies (among regions, at different spatial scales), but also for some degree of re-centralisation of the policy (with oversight and actioning power by the Commission or some appropriately delegated authority) to facilitate a spatially coherent prioritisation of re-specialisations for the European economic space at large. Leveraging on existing policy structures and initiatives (e.g., Interreg, Trans-European Networks, the EU Territorial Agenda and ESPON as the legacy institution of the 1999 European Spatial Development Perspective) could be important both in terms of knowledge transfer and in terms of the legitimacy of the process.

- **Integrate more organically the developmental tools and priorities of CP with the strategic thinking and priorities of the EU.** We have argued that CP has in some respects transformed into a “place-centred industrial policy”. We also saw that some of its thematic priorities adhere increasingly to those of the EU Green Deal and digital transition (e.g., earmarking of expenditures for green and digital transition objectives). Still, most of CP is not concerned with the strategic priorities and wider ambitions of the EU – e.g., regarding economic sovereignty, sensitive products, critical raw materials, etc. To increase its alignment and adherence to such objectives, the design of CP should be integrated more organically with that of IP. While the overall principle of ‘place-based’ policy should not change, a degree of (re-)centralisation may be due, so that objectives are (at least partly) decided at the same level as with Industrial Policy. This would require the more direct involvement of “industrial policy” institutions – such as DG Growth, the European Innovation Council, SMEs Executive Agency, etc. – in the design of Cohesion Policy, at least at a consultation level.

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