

## Is the EU's Green Industrial Policy Doomed to Fail?

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The European Union aims to stimulate the domestic production of net-zero technologies through industrial policy interventions. However, due to a lack of European funding, this policy risks falling short, slowing down the green transition, and fragmenting the European single market. A successful green industrial policy requires targeted and conditional European subsidies to better stimulate the production of green technologies, safeguard the single market, accelerate decarbonisation, and contribute to making a fairer green transition.

“The policy that shall not be named” is making a comeback.<sup>1</sup> Industrial policy, which involves active government intervention in the economy to ensure that certain strategic goods are produced domestically, is no longer taboo. Previously, mainstream economists since the 1970s agreed that industrial policy does not work, often leading to a waste of money and capture by politically powerful companies. But even the European Union, whose core principles have always been market liberalisation and strict competition policy, has newly embraced an active industrial policy.

There are several reasons for this shift. Expediency is a key factor: the market alone cannot facilitate the sustainable transition quick enough to meet the Paris Agreement's climate goals. Economic prosperity is also important: a stronger industrial base in Europe leads to faster growth and well-paid jobs. But above all, policymakers want to increase their societies' resilience by reducing import dependencies of strategic green technologies such as solar panels, wind turbines, and batteries. The use of gas as an economic weapon against Europe since Russia escalated its war on Ukraine has shown that dependencies can be used as leverage by strategic rivals. Policymakers do not want to make the same mistake with renewable energy technologies as they did with gas.<sup>2</sup>

China's increasing dominance in the green technologies market is a major concern. Its growth in the so-called “new three” – solar panels and wind turbines, batteries, and electric vehicles – is a key development in China's export strategy. The Inflation Reduction Act (IRA), a package of measures providing hundreds of billions of dollars in support to greening the American economy, approved in the summer of 2022, has added to EU fears that European industry, already plagued by high energy prices within the Union, will be lured not only eastward but also across the Atlantic.

In 2023 the EU therefore instigated several plans for a green industrial policy: the Green Deal Industrial Plan, the Net-Zero Industry Act, the Critical Raw Materials Act, and the Economic Security Strategy. If there is one commodity that the EU produces in abundance thanks to its new industrial strategies, it is paper. For now, the Union mainly excels in setting ambitious goals, lacking the funding to make them a reality.

### **Ambitious production targets**

The Net-Zero Industry Act (NZIA) in particular sets sharp objectives for the production of green technologies within the Union. By 2030 the EU aims to produce enough renewable energy technologies

domestically to cover 40 per cent of its installation needs. The law translates this general objective into specific technologies.<sup>3</sup> The EU aims to have the capacity to produce at least 30 gigawatts of solar panels in one year by the end of the decade. Currently, that capacity stands at only 1 gigawatt. The production capacity for wind turbines is set to nearly triple from 13 gigawatts now to 36 gigawatts in 2030. The growth ambition for batteries as a percentage increase falls in between these two targets (see Table 1).

	<b>EU's current annual manufacturing capacity</b>	<b>EU's 2030 annual manufacturing target</b>	<b>Growth required to meet the 2030 target</b>
<b>Wind</b>	13 GW	36 GW	177%
<b>Battery cells</b>	75 GWh	549 GWh	632%
<b>Solar PV</b>	1 GW	30 GW	2900%

*Table – Current EU manufacturing capacity and 2030 goals*

However, the EU is at risk of not meeting these ambitious goals. The most concrete NZIA measures involve streamlining permit procedures when companies want to build a new factory to produce renewable energy technologies. While this may shorten the timeframe for building new production capacity in the EU, it does not change the main obstacle to the viability of the European green industry. The production of net-zero technologies within the EU is significantly more expensive than in the US, since the IRA, and especially in China, where green-sector companies benefit from various forms of state support, in addition to lower labour and energy costs. It is estimated that China can produce solar panels at about half the cost of production in the EU,<sup>4</sup> its batteries at a third cheaper,<sup>5</sup> and wind turbines approximately 20 per cent cheaper.<sup>6</sup>

Closing the price gap can essentially be done in two ways: either by financially supporting European production, or by making imports more expensive. Given the various layers of governance in the EU, measures can be taken at both European and national levels, through European subsidies, national state aid, non-price criteria in national public procurement procedures, and supranational trade defence instruments. At present, there is insufficient support for deploying new European subsidies. The other three instruments, on the other hand, face their own obstacles and may lead to adverse effects.

## **No European Sovereignty Fund**

When Commission President Ursula von der Leyen delivered her annual State of the Union address to the European Parliament in 2022, a little over a month after the approval of the IRA in the US, she sounded determined: “I will push to create a new European Sovereignty Fund. Let’s make sure that the future of industry is made in Europe.”<sup>7</sup> She received support from, among others, the French Commissioner for the Internal Market, Thierry Breton, who said: “It is high time we show more assertiveness – including the necessary financing – to defend our European strategic interests.”<sup>8</sup>

However, traditionally “frugal” member states, such as the Netherlands, Denmark, Finland, and Sweden, have opposed the idea of a European Sovereignty Fund. Sceptical member states have referred to the fund as “French plans” and even as “Marx on steroids”.<sup>9</sup> Due to a lack of sufficient support in the Council of the European Union, the ambitious idea of a European Sovereignty Fund was eventually watered down to the Strategic Technologies for Europe Platform (STEP), established in February 2024, where only a limited sum of existing resources would be allocated for investments in green technologies.

## **Fragmentation of single market**

With no consensus over joint European funds, the focus has quickly turned to member states investing individually in green industries. Following the Green Deal Industrial Plan, the European Commission adopted the Temporary Crisis and Transition Framework (TCTF) in March 2023. This framework relaxes European state aid rules so that member states can more readily provide subsidies to companies for greening their production processes or setting up new production capacity for renewable energy technologies.<sup>10</sup> The most prominent measure of the TCTF is that it allows member states to provide extensive subsidies, known as “matching aid”, to individual companies if necessary to prevent investments relocating from the EU to other countries.

*The relaxation of EU rules on national state aid not only risks tearing apart the European single market but will also not be sufficient to expand the green industry in Europe.*

However, this relaxation of state aid rules to level the playing field between European companies on one hand and Chinese and American companies on the other leads to unfair competition among EU countries. Some member states have deeper pockets than others and can therefore allocate more money to attract investments in green technologies to their countries. While Belgium collected 275 billion euros in taxes in 2022, its bigger neighbours France and Germany collected 1,412 billion and 1,831 billion euros respectively.<sup>11</sup> Therefore, France has five times as many resources as Belgium and Germany almost seven times as many, which could theoretically be used to attract companies to their green transition markets.

It is no coincidence that, in the context of an earlier relaxation of European subsidy rules following the 2022 escalation of war in Ukraine, Germany was responsible for more than half of all state aid issued by European member states that year, and France accounted for another quarter.<sup>12</sup> The first case of “matching aid” allowed by the TCTF involves 902 million euros in subsidies from Germany to the Swedish multinational Northvolt for the construction of a factory that will produce electric vehicle batteries.<sup>13</sup> Smaller member states do not have the resources to come up with such amounts that enable the establishment of sufficiently large “gigafactories”.

The relaxation of EU rules on national state aid not only risks tearing apart the European single market but will also not be sufficient to expand the green industry in Europe. All member states, including the most affluent, are bound by the rules of the Stability and Growth Pact (SGP), which limits their industrial spending. SGP budget rules, therefore, may prevent the EU from meeting its own stated climate and industrial objectives.

## **Buying European**

The NZIA provides yet another way to support European production of green technologies. When member states purchase renewable energy technologies through public procurement or auctions, or when they take measures to encourage consumers to purchase those technologies, they are now encouraged to consider criteria other than the price of bids. If the EU becomes too dependent on one country for a product, member states are expected under the “resilience criterion” not to accept bids from that dominant export country. Member states can also steer their purchase of imported technologies towards those of European origin, supporting stringent environmental and labour conditions.

However, through this route, member states cannot explicitly ensure that additional government spending flows into their own economy, and sometimes they simply do not have any domestic production in the green technology sector. If a member state without its own wind turbine production, such as Croatia or Hungary, has the choice between purchasing cheaper Chinese wind turbines or more expensive Spanish or Danish ones, it is questionable whether it will take advantage of the opportunity to favour the more expensive EU suppliers. Countries that need to reduce their spending under the influence of the SGP will be incentivised to choose the cheapest bidder. The NZIA allows member states to circumnavigate non-price criteria in their public procurement procedures if this would lead to a “disproportionate” cost difference above 20 per cent. The cost disadvantage of EU green technology producers vis-à-vis their Chinese rivals often comes in above that threshold.

### **Restricting imports risks slower transition**

Making imported products more expensive is the final possibility for the EU to support its own net-zero technology producers. Traditional anti-dumping and anti-subsidy tariffs protect European companies against unfair imports. The European Commission launched an investigation last October into the import of potentially subsidised electric cars from China, which could result in additional tariffs on their import.<sup>14</sup> However, while this approach would protect European car manufacturers from Chinese competition, electric car purchases would become more expensive for European consumers.

Speculation is currently underway regarding similar investigations into solar panels and wind turbines. It is no coincidence that the Commission uses trade instruments to pursue the goals of industrial policy. Within the EU, it is easier to impose trade protective measures than to grant European subsidies. For new European expenditure, at least a qualified majority of member states must agree to the proposal, while anti-dumping and anti-subsidy tariffs can be adopted unless a qualified majority of member states objects.

However, even under these permissive decision-making rules, it is not guaranteed that such measures will be adopted. SolarPower Europe, the European industry association for the solar panel sector, for example, has strongly opposed trade protective measures.<sup>15</sup> Additional import tariffs not only disadvantage consumers but also installers of solar panels or wind turbines, or sellers of electric vehicles. Member states without their own production can be expected to resist the use of these trade defence instruments.

Recently, the Commission has gained another instrument that it can deploy entirely autonomously, without any approval from member states: the Foreign Subsidies Regulation (FSR). Through this instrument, the Commission can initiate an investigation into companies participating in public procurement in the EU if it suspects that they benefit from unfair subsidies from third countries. Indeed, it has already initiated investigations into the participation of Chinese companies in European public tenders in the rail,<sup>16</sup> solar panel,<sup>17</sup> and wind<sup>18</sup> sectors.

Chinese state-owned company CRRC decided to withdraw from a Bulgarian tender for electric trains after the Commission announced the launch of its first investigation. The contract will now likely go to a Spanish company but at an additional cost of hundreds of millions of euros to the Bulgarian taxpayer. In two other initial applications of this instrument, Bulgaria, once again, and Romania are potentially being affected. The instrument threatens to cause a regressive redistribution from poorer East European to richer member states and provoke consequent resistance, which may lead the Commission to be more cautious in its use. Any form of trade restriction on green technologies in the short term makes the

energy transition more expensive and thus risks slowing it down.<sup>19</sup> Due to the perverse effects of the other instruments, new European subsidies for cleantech manufacturing should be reconsidered.

## **European funds as optimal instrument**

European subsidies are the only way to stimulate the production of green technologies in the EU without fragmenting the single market or slowing down the climate transition. This, of course, requires an increase in the European budget. Member states must realise that it is impossible to simultaneously have strict budgetary rules, a limited European budget, a real single market, and a competitive and resilient Europe. Or, as Commissioner Breton recently put it: “Without the capacity to establish common budgetary instruments, our only alternative is fragmentation. We cannot be both frugal and a friend of the single market.”<sup>20</sup>

In his report on the future of the internal market, former Italian prime minister Enrico Letta proposes to gradually phase out the relaxation of state aid rules and simultaneously build up European financing.<sup>21</sup> In the meantime, member states providing national subsidies should proportionally contribute to a “State aid contribution mechanism” to finance European subsidies. In his own forthcoming report, former president of the European Central Bank (ECB) and former Italian prime minister Mario Draghi will also advocate for common European financing for climate projects, including manufacturing of renewable energy technologies.<sup>22</sup>

Due to geopolitical threats, some traditionally frugal countries, such as the Baltic states, are now changing their stance, especially as they realise that strengthening European defence requires joint investments.<sup>23</sup> This could provide opportunities to achieve a broader increase in the European budget or new European lending facilities like “Sovereignty Bonds”. Negotiations on the next Commission programme and on the next multiannual budget (2028-2034), will be crucial to truly realise European green industrial policy through European financing.

As advocated by, among others, economists Mariana Mazzucato and Dani Rodrik, industrial policy must be linked to conditionalities to be effective and ensure progressive outcomes in relation to labour conditions, sustainable production, and corporate governance (including no share buybacks, and restrictions on dividend payouts and CEO bonuses).<sup>24</sup> A genuine industrial policy must go beyond merely “derisking”<sup>25</sup> private investments, where decision-making power and the benefits of investments remain entirely with private actors.

Conducting industrial policy at the European level is advantageous because it provides fewer opportunities for multinational corporations to organise bidding wars between member states and makes it easier to impose conditions on them. Furthermore, European subsidies can be used for a place-based industrial policy to ensure that all regions benefit, especially those at risk of economic loss from the green transition. Thus, European industrial policy can contribute to a “just transition” on both intra- and international scales.

Finally, European industrial policy must make clearer strategic choices.<sup>26</sup> The EU should not aim to produce every possible renewable energy technology domestically. At present, the NZIA does not dare to make clear decisions about which technologies we truly want to produce ourselves and where it would be better to reduce our dependence by diversifying imports. By not making choices, limited available public funding risks being dispersed and therefore less effective.

A strategic industrial policy through targeted and conditional European subsidies would strengthen European cohesion rather than undermine it, accelerate the green transition rather than slow it down, and can make that transition fairer rather than allowing large corporations to play member states against each other all the more.

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