Mistaking the Wood for the Trees: Five Ways the EU can Deliver a more Competitive Industrial Policy

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Introduction

The recent launch of the European Commission's Green Deal Industrial Strategy was supposed to set the "framework for the transformation of the EU's industry for the net-zero age". Unfortunately, it's now viewed as a panicked reaction to the Biden administrations Inflation Reduction Act (IRA) in the United States.

While the American legislation will increase the attractiveness of the US as a "green" investment location – a move which is positive for global efforts to combat climate change - it will not automatically result in a flight of capital and employment across the Atlantic. Rather, there is a real possibility that the hurried implementation of Brussels' current proposals may, unintentionally, undermine the European Single Market, increase friction between member states and ultimately weaken the Transatlantic economic relationship.

Politically, the Industrial Strategy proposals cannot be considered in isolation. They are closely linked to a whole array of interlinked proposals regarding Trade Policy, State Aid Rules, the Competitiveness Agenda and Education to name but a few. They also form part of a significantly wider debate about the future direction of the EU itself. In this context, increased protectionism, supporting national champions and more EU-level borrowing represents a more statist, more centralised vision of European integration. A vision which challenges the Single Market underpinnings which have formed the basis of Europe's decades-long economic expansion.

Rather than attempt to match the US incentive-based approach the EU should focus on addressing the following five issues through which a more competitive European Industrial Policy can be delivered. These five priorities will help the EU increase the attractiveness of the EU as an investment location, maintain the EU-US economic relationship and, perhaps most importantly, underpin Europe's commitment to enhancing the resilience and potential of the Single Market.

1. *More Comprehensive Analysis of the Projected Impact of the IRA is Required*

Remarkably, for all Commissioner Breton's angst about the "*protectionist threats*" posed by the IRA there is, as of yet, limited analysis of the actual impacts of this legislation on the EU. Initial analysis of the effect of the IRA on the German car industry indicates that current fears of a mass migration of investment are exaggerated owing to the number of European car makers already manufacturing in the US (including BMW and Mercedes), the relatively low price level at which the US subsidies will cease being available and the small penetration of European car brands into the wider US automotive market. It also remains unclear as to the exact conditionality of the "made in America provisions" for non-US companies.

In addition, European concerns over the potential negative impacts of the IRA disregard the positive spill-over effects on the EU of previous US fiscal expansion packages. Both Covid era US spending packages – the $1.7 trillion American Rescue Plan (ARP) and the $550 billion Infrastructure, Investment and Jobs Act (IIJA) will continue to drive an increase in EU exports to the US. In 2021, EU exports of goods to the US reached almost €400 billion, a near doubling in the decade from 2011.

2. *Realise that you cannot Subsidise your way to Competitiveness*

The stated goal of the Green Deal Industrial Plan is to “speed up investment and financing for clean tech production in Europe”. However, such a necessary objective should not be used as a convenient excuse for prioritising public subsidies in every industrial sector over a real, economically driven competitiveness agenda. Economic history and industry leaders are clear in highlighting the mistaken belief that subsidises can bring about long term competitiveness. Rather than engage in a race to supply constant public financing, the EU should address the well-known structural challenges which impede European businesses from competing on a global stage. Essential elements of this agenda include, but are not limited to:

- The need to further deepen Capital Markets Union (CMU) to allow more cross border financing options for European business;

- Competition and State Aid Rules can be simplified in a way that protects the overall integrity of the Single Market. A clear focus should be on reducing bureaucracy, facilitating quicker decisions and enabling Member States (especially those that are net beneficiaries of EU budget transfers) to utilise existing, unused EU funding as business support, if they so wish. The EU must ensure that smaller member states are not disadvantaged in a rush to match US actions;

- Industrial success tomorrow will be measured by enabling innovation today. To support the further development of the Single Market the EU must lead in R&D. This can best be achieved by redoubling efforts to untangle the EU’s regulatory framework, removing barriers to trade and deepening public-private partnerships (across both industry and academia) with a real focus on commercialisation and real-life applications.

3. *More Trade will Grow Economies and Jobs*

Trade conflicts and excessive protectionism are economic costs which result in inefficient outcomes for both businesses and consumers. There is a difference between strengthening the Single Market through necessary protections (such as implementing foreign investment screening) and a blanket policy of restricting market access. In this context, the EU should recommit its resources to furthering its global footprint as a leader in concluding strategic trade agreements. Deepening trade and investment ties are essential to the EU’s ability to trade globally.

Mexico, Chile, India, Indonesia, Australia, New Zealand, Great Britain and Mercosur provide opportunities in the short, medium and longer term. Such agreements can also facilitate the EU in accessing and utilising critical raw material sources in the decades ahead. An issue which also requires a fundamental change in the long term strategic planning of many private companies.

In tandem with efforts to reform the World Trade Organisation (WTO) the EU can become the guardian of a rules based global trade system.

4. *The Transatlantic Relationship is a Global Driver of Economic Growth*

According to the European Commission, “the European Union and the United States have the largest bilateral trade and investment relationship and enjoy the most integrated economic relationship in the world”. It is a relationship supporting over 6 million jobs directly and over 15 million jobs indirectly. Yet, suddenly with the passing of the IRA, the United States is being portrayed as an unreliable economic partner for Europe. This interpretation is both economically and geopolitical erroneous.

The emergence of China, and its non-democratic political system, renders the Transatlantic alliance even more essential to maintaining basic democratic values globally. The EU must avoid the mistake of causing self-inflicted damage in any broader geopolitical conflict between the US and China. As the ongoing conflict in Ukraine is illustrating, the US remains a committed and invaluable partner for the

EU in defending democratic freedoms. Freedoms which the EU lacks the military capability to defend alone.

Rather than engage in self-harming protectionist policies, the EU should intensify cooperation with Washington to mitigate any negative impacts on EU industry arising from the IRA legislation. The EU should use the EU-US Trade and Technology Council as a means of progressing a system of common EU-US norms and standards for industrial goods that will serve to increase exports and employment on both sides of the Atlantic.

5. **A Debt Fuelled European Sovereignty Fund: a Recipe for a Politically Divided and Economically Underperforming Europe**

Commissioner Breton has been explicit in promoting the concept of an EU Sovereignty Fund based on "the right budgetary means to be credible. It's design should allow for direct, fast and flexible budgetary support to well identified projects of interest for EU sovereignty across any sector of our industrial spectrum". In reality, the Commissioner is proposing a debt-fuelled carte blanche for EU level intervention across Europe's entire industrial base.

This approach reflects the different national strategies evident in EU member states regarding State Aid and Industrial Policy. Differences which are matched by the perception that larger member states have greater financial resources to better support their important industrial companies.

However, the current proposals are neither a rational, or proportional response to the provisions of the IRA. Rather, it is a political strategy to designed to use Industrial Policy as a tool to increase state control of the EU economy.

This is a recipe for political division and economic underperformance. It also runs contrary to the basis of the Single Market which has underpinned the EU's economic growth over many decades. It is important that any future proposal for a European Sovereignty Fund is not debt-financed. This is essential for the EU's continued financial stability. The borrowing already undertaken for the European Recovery Fund remains unfunded. No agreement has been reached on how to raise revenues (i.e., own resources) to repay these loans. In this context, it is neither appropriate, or advisable, to pursue a further debt-driven initiative which lacks a clear economic rationale.

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