All the opinions expressed in this publication are the sole view of the contributors, and do not represent the position of their Institutes nor of the Trans European Policy Studies Association (TEPSA).

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A first group of experts (Bora, Dumont, McGhie and Roux) focus on the response to the United States’ Inflation Reduction Act of 2022 (IRA) and the possible EU reactions. They all reject the idea of retaliatory actions and any form of transatlantic trade war and plead for negotiating with Washington to avoid the potential negative effects of IRA on European companies. The reasons for this lie both in the geopolitical realities of today, with the raging war in Ukraine, and in the awareness that the EU as the major trade power in the world has more to lose in such a scenario than to win; some also point at that IRA can be a boost for the fight against climate change. Bora points to the regulatory power of the EU and its key role for a functioning global multilateral system. Dumont warns against the dangers of a subsidy race and the risks of state aids for a level playing field within the Single Market. McGhie is not
against relaxing state aids but insists on this being temporary, proportionate and non-discriminatory. He is in favour of more shared debt among Member States and a longer-term financing vehicle and mentions the importance of the Capital Markets Union (CMU) - see below. Roux recognises the risks of the IRA for the EU but thinks that they should not be overestimated. The EU has tools to protect its industry and attract investment. The carbon pricing system is a real asset.

- Chang and Lovec focus on the EU’s own core policies that are more promising than launching an improvised industrial policy or retaliating against the US. Chang recalls the importance of the CMU for European competitiveness and investment. It is time to show more resolve and ambition and to work with full speed on the Commission’s 2020 Action Plan. Lovec sees the Single Market as the best strategic asset for the EU, coupled with the CMU and global trade.

- The next two contributions look at what a smart industrial policy could look like. Schmucker/Mildner point to the fact that the role of the state is growing everywhere in the world. They see the Green Deal Industrial Plan proposed by the Commission as the right answer, provided it avoids a subsidy race and a trade war; in fact, they plead for ambitious free trade agreements to go with it. The support of production at home of strategic products is legitimate, and carefully managed state aids can help. Šitera is in favour of the green industrial policy, but he wonders whether its content lives up to expectations. He insists on the need for a strong social component. Interestingly, he also calls for reducing the EU’s export dependency and targets the Member States with excessive trade surpluses.

- Feás and Steinberg/Otero Iglesias share the view that industrial policy is back, and in this context they strongly plead for EU level-funding and a European fiscal capacity. In their view, this is the only way to avoid a state aid race that would leave most Member States behind and distort competition within the Single Market. Feás regrets that the July 2020 European Council did not include in the overall Multiannual Financial Framework/Recovery and Resilience Facility package the Commission proposal for a Solvency support instrument, which would have go a long way towards solving our problems. Steinberg and Otero Iglesias call for a new investment fund, while developing the CMU and the Banking union.

- Finally, Wessels gives his thoughts on European governance and the European Council’s role in managing the economy. He describes the growing influence of the Heads of state or government in a time of crisis but wonders whether the EU should not take a fresh look at its economic governance. He points to the importance of the interactions between the EU institutions generally.

This summary does not do justice to the depth of the various contributions. They contain interesting facts and figures and thoughtful analysis. There is quite a lot of common ground on the reaction to IRA for instance or the sensitive issue of state aids. Not surprisingly, there are also divergent points of view; we know how controversial the debate is in Europe about the very concept of an industrial policy or an EU fiscal capacity. It is important to continue the discussion on these. As we have seen during the COVID-19 crisis and in the wake of the disastrous Russian aggression against Ukraine, ideas that for a long time looked far-fetched or divisive can suddenly find general approval and become game changers.
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CAP</td>
<td>Common Agricultural Policy</td>
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<td>CBAM</td>
<td>Carbon Border Adjustment Mechanism</td>
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<td>CMU</td>
<td>Capital Markets Union</td>
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<td>ECB</td>
<td>European Central Bank</td>
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<td>EIB</td>
<td>European Investment Bank</td>
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<td>ETS</td>
<td>Emissions Trading System</td>
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<td>EU</td>
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<td>EUCO</td>
<td>European Council</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IPCEI</td>
<td>Important Projects of Common European Interest</td>
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<td>IRA</td>
<td>Inflation Reduction Act</td>
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<td>NGEU</td>
<td>Next Generation EU</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>RRF</td>
<td>Recovery and Resilience Facility</td>
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<td>SME</td>
<td>Small- and Medium-sized Enterprise</td>
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<td>TEU</td>
<td>Treaty on European Union</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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<td>TTC</td>
<td>Trade and Technology Council</td>
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<td>US</td>
<td>United States of America</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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The conclusions of the European Council (EUCO) meeting from 9 February stress that "new geopolitical realities require more voluntarist industrial policy measures, which notably include state aid through Important Projects of Common European Interest" (IPCEI). This meeting lines up with a number of other recent events, including European Commission communications and national policy documents, suggesting a more active role for the European level to revise industry and competition-related provisions and to revive European industrial policy. The global turn towards protectionism is evident and shows no sign of slowing down, especially amidst great power competition between the United States of America (US) and China. The implementation of new trade defence measures and state subsidies appears, at least to a certain extent, inevitable. The Inflation Reduction Act (IRA) in the US confirmed that Washington will prioritise these instruments. However, policy-makers may be making a mistake in assuming that measures that work well for the US will work for Europe. Whereas the US trade-to-Gross Domestic Product (GDP) is 20%, this number rises to almost 30% for the European Union (EU) (excluding intra-EU trade). Simply put, EU countries are considerably more dependent on the rules-based global trade system than the US, consequently, they have much more to lose. Even more importantly, the EU is a union of 27 Member States. The distributive implications of industrial policy are much more explosive politically. Furthermore, an entire toolkit of policies – practically all core state powers apart from monetary policy – is fragmented between 27 national governments, rather than being cohesively implemented at the EU level. Although everyone will lose if the global multilateral trade order collapses into rival protectionist blocs, the EU will suffer the most.

There have been calls for the EU to "speak the language of power" or "embrace the grammar of sovereignty". Europeans cannot plausibly compensate for many of their weaknesses and therefore, it will be a more viable strategy to play their strengths. Unregulated globalisation has been deeply damaging at every level and a return to narratives about public power can be helpful. That said, public power needs to be envisioned at the global level. They should not entail fragmentation into self-contained and competing economic blocs. To be sure, the fate of the global multilateral order is uncertain. Nonetheless, it will be a mistake to believe that there are no vested interests in its preservation. The global recovery from the COVID-19 pandemic showed that societies across the world are not willing (or perhaps even able) to de-globalise to any meaningful extent. Some of the most pressing issues including climate change can only be solved through international cooperation. Despite their recent revival, history (European history particularly so) shows that bilateral and ad hoc deals have always been much more fragile and underdeveloped compared to EU-style institution-building and law-making. Europe remains a success story and can take a leading role in embedding globalisation within a global public realm. In some domains, the EU itself and several Member States have already spearheaded such attempts.

The case for strategic patience
The French government, for instance, advocated for taxing digital corporations across the world, albeit with mixed results so far. Similarly, the EU’s data protection rules have become a global standard, and there are signs that a similar outcome may be achieved with the Digital Markets Act. The Carbon Border Adjustment Mechanism (CBAM) was purposefully designed to be compatible with World Trade Organization (WTO) rules and can be part of the same agenda. Even when other actors refuse to play the game, insisting on “reciprocity” (as opposed to “sovereignty” or “autonomy”) and retaliating with strictly proportional measures is more sensitive. It is a safer bet for the EU to work from the assumption that there better days will come for multilateralism. Compared to the intensifying great power competition, the increase in the demand for global public goods is a slower, less perceptible and yet more consistent trend. International cooperation is in the EU’s DNA and, in contrast to military affairs and other forms of organised coercion, the Union can be a credible actor. Making the EU an independent pole in global affairs will require a distinctly European narrative. In this regard, global public goods and regulating globalisation may constitute a better option than the "grammar of sovereignty".
EU facing the IRA: beware of Tit for Tat

Faced with industrial policies in other parts of the world and a surge in energy prices, industrial policy has recently returned to the forefront of the EU’s agenda. In this respect, the IRA has drawn much attention in the EU as it is feared it will take away EU companies and jobs. It is worth stressing that the passage of the IRA is obviously good news for climate action and that the forecasted subsidies are of similar size to those available in the EU. Moreover, despite the fact that the IRA encompasses USD 369 billion of tax credits for low-carbon investments (about 1.5% of US GDP) over a 10-year period and that it includes trade-distortive subsidies, including local-content requirements prohibited under WTO rules, the spectre of production/investment leakage is largely exaggerated as the primary target of the IRA is China. Lastly, trade data from Eurostat shows that the US is the EU’s largest trading partner. Total trade in goods has grown on average by 5% annually from 2010 through 2019 and the trade surplus of the EU with the US has grown from EUR 68 billion in 2011 to EUR 167 billion in 2021. As long as the IRA does not call into question the European Green Deal, Europe’s response should be restrained. Indeed, the EU would have more to lose if it would enter into a frontal trade war with the US.

In this context, policy-makers in the EU have responded to these challenges by having recourse to some "old-favoured" instruments. This could drag the EU into a subsidy race that would be detrimental to all parties.

Among the levers that have been identified to promote industrial policy, state aids, i.e. subsidies or any other aid provided by a Member State, are in the spotlight. State aids represent a distortion of competition and are prohibited under article 107(1) of the Treaty on the Functioning of the European Union (TFEU), unless exceptionally justified by reasons of general economic development, like market failures in environment and innovation. Despite their adverse effects on competition, the EUCO has called on 9 February 2023 for a "targeted, temporary and proportionate" support for sectors that are strategic for the green transition.

State aids have already been used from the onset of the pandemic crisis in March 2020 until the end of 2021 to cushion its economic effects. Data from the Directorate-General for Competition show that between March 2000 and December 2021, the European Commission has authorised in this context EUR 3.1 trillion of aid. In the sole year 2022, the European Commission has authorised EUR 672 billion of state aids, 53% of which went to Germany (representing over 9% of its GDP) and 24% to France. The distribution of aid approved during that period appears to be uneven across Member States and may raise potential concerns on the level-playing field in the Single Market and on the risks of fragmentation of Europe. Moreover, state aids are characterised by a lengthy approval process.
It may thus encourage firms to design their investment below the bloc exemption to avoid the need for notification. This could lead to the development of under-scaled, and hence suboptimal investment projects. In short, state aids provisions should remain a ‘discipline for Member States’.

The second lever proposed by the European Council is to increase the number of IPCEIs. The latter materialise in large-scale consortia aimed at research and development (R&D) and the first industrial deployment stage, excluding mass production and commercial activities. IPCEIs are supposed to overcome market failures and enable breakthrough innovation in sectors and technologies considered strategic, and to deliver positive spill-over effects for the EU economy at large. Several IPCEIs have already been launched in semi-conductors (2018), electric batteries (2019 & 2021) and hydrogen (2022). Others are supposed to follow in the cloud, in photovoltaics and in the health sector.

The public support by Member States to the projects and companies participating under the IPCEI, which constitutes state aid under EU rules, has to be notified to the Commission for assessment and approval to ensure that the aid is limited to what is necessary and to prevent undue distortions of competition. This is again a lengthy process, in sharp contrast with the agility and amount of capital provided by venture capital for instance. Moreover, in order to qualify for an exemption to state aids, IPCEIs must encompass at least four Member States, with the participation of small- and medium-sized enterprises (SMEs), involve substantial co-financing by the companies that will receive state aid; and must comply with the "do no significant harm" principle. These conditions are complex and difficult to meet, compared to the IRA which focus mainly on mass deployment of green technologies rather than innovation as such.

Overall, a comparison of the two sides of the Atlantic shows a pragmatic and massive support based on tax credits in the US versus more indirect and much complex measures in the EU. If the imperative of sovereignty in some strategic sectors make sense, we should be careful to maintain market signals high enough. The development by the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs of an indicator-based mechanism (SCAN) to monitor the evolution of supply chains in the EU and increase EU resilience to trade disruptions is to be welcomed. We should also try to expand the CBAM to make sure carbon-intensive imports in the EU do not substitute to low carbon domestic products. A key advantage of the CBAM is that it is much more compatible with WTO rules. The CBAM on the verge to be put in place by the EU covers only some of the sectors regulated under the EU-Emissions Trading System (ETS). Additional sectors could be included to shield the EU economy against relocations, given that sectors regulated by the EU-ETS are often energy intensive sectors. For those sectors that are not currently covered by the EU-ETS, and which cannot benefit from the CBAM, the EU should either expand the EU-ETS or adopt maximum carbon footprint standards as planned in the battery regulation.
Walking a fine line: state aid and US-EU trade relations

Though initially celebrated by the EU for its pro-climate measures, the IRA has since ignited tensions for what Brussels calls unfair trade practices. The new American law, signed last August by US President Joe Biden, is meant to bolster domestic production in line with the “Buy American” emphasis that the Biden administration has placed on economic policy. European leaders have hashed the law, calling it protectionist and warning that it could “fragment the West” at a critical time for the world’s economic and geopolitical development.

The crux of the issue lies in the massive subsidies provided to green industry and production in the US. For example, electric vehicles have been a specific flashpoint for the EU. The IRA provides a USD 7500 subsidy for each electric vehicle produced, provided that the car’s battery and majority of the parts are produced in North America. This was intended to counter China, whose electric vehicle production has risen steadily, but it has the side effect of hurting the European economy, which produces almost 20% of the world’s electric vehicles. The electric car industry is only one of several that would be negatively influenced by the IRA. European firms will now be forced to compete with subsidised American producers and may even be tempted to move their operations altogether.

Though European leaders are understandably deeply upset by these IRA provisions, to undertake blatantly retaliatory actions would likely be a mistake. Some leaders have threatened quick action to prevent the US bill from being fully implemented, such as bringing a grievance before the WTO. This threatens an escalation of tensions in what risks becoming an all-out confrontation. Given the already potent threats to the rules-based order and Western influence, the last thing that the world needs is a European-American trade war. Furthermore, it doesn’t appear to be a battle that the EU would stand a good chance of winning. The US enjoys the dominance of the dollar, a more robust system of financing projects, and much lower energy prices, all of which would likely give it the edge in a potential subsidy war with Europe. Additionally, after Russia’s invasion of Ukraine, Europe is already heavily reliant on the US for both conventional security aid and liquefied natural gas energy assistance. The IRA only passed the US Congress after multiple rounds of contentious negotiations, and Americans are not likely to be willing to overhaul the law for which they so bitterly fought.
The best course of action, then, is likely for Europe to pursue a two-pronged approach: negotiate a resolution to the subsidy issues with the US while adapting policies to bolster its relative negotiating position in the meantime. Biden has expressed willingness to adapt the rules to accommodate some level of exemption for European businesses and deployed a joint task force to try to come to an agreement. A compromise would be far preferable to a lengthy adjudication of WTO rules infringement. With signs of strengthened European leverage, a US-EU agreement could be reached in the coming months, perhaps at the G7 Summit in Japan later this year. In the meantime, Europe must show that it can adopt its own state aid policies to strengthen industry without rupturing the Single Market.

The first important step to take is relaxing of state aid regulations. State aid must be improved more quickly, reliably, and with less red tape. This will be critical for bolstering the EU’s industrial capacity and bargaining power when coming to the negotiating table with the Americans. To walk the fine line between competition and confrontation, leaders must work hard to ensure state aid remains “temporary and proportionate”, as the EUCO conclusion states. The EU must facilitate high-level meetings between Heads of state, economic ministers, and business leaders to avoid subsidy competition within Europe, as this would be highly counterproductive.

Another core problem is that each Member State has vastly different levels of fiscal capacity to provide subsidies. The EUCO conclusions state that “existing funds should be deployed in a more flexible manner”, which would surely bring financing and expand state aid possibilities. This more flexible manner should surely include significantly more shared debt among Member States and could mirror COVID-19 relief strategies, as France and Germany have suggested. European leaders must also think seriously about a longer-term financing vehicle, most likely by speeding up the development of the Capital Market Union (CMU).

As a final important note, time is of the essence. There are less than two years left in Biden’s first term, and very little is known about what a Republican president would be willing to accommodate to Europe. Though not simple, the measures proposed here would help the EU walk the line between strengthening its own economic sovereignty and finding a suitable agreement for IRA exemptions with the US.
Who is afraid of the IRA?

At their 9 February meeting in Brussels, European leaders discussed how to respond to US President Joe Biden’s latest climate bill. The EU new strategic industrial policy and European Commission President Ursula von der Leyen’s comments on China’s hidden support to its industries show how vast the European challenge really is. In the face of the new geo-economic reality, the EU must redefine its priorities to ensure its long-term competitiveness, prosperity, and role on the global stage.

The adoption last summer in the US of the IRA is a boost for the transition towards cleaner energy and industry. Washington’s commitment to subsidise the green transition by massively spending on greening its energy, industry, and transport is good news for the world and for Europe. The real peril would have been the US failing to address climate change.

These concerns are real, as we will see below, but they should not either be exaggerated. After all, the EU has plenty of tools to attract green investments: a firm commitment to phase out carbon-intensive activities, a carbon pricing system, a possible carbon border mechanism, and finally, subsidies from various sources including the Recovery and Resilience Facility (RRF) to finance IPCEIs.

What the EU needs to do now - and what the Heads of state and government have agreed to do at the 9 February meeting of the EUCO - is to make these tools more efficient, faster to access and utilise, and better funded. Further raising the cost of emissions while subsidising the cost of decarbonisation should accelerate the necessary investments. That means expanding the carbon pricing and tariff policies as well as putting more public money toward research capacities and innovation.

European leaders realise that the IRA’s noble climate objective is only secondary to its main geopolitical objective: decoupling the US from the Chinese economy. The issue here is the fight between the US and China for world technological leadership. In this, the EU has a lot to lose starting with access to technologies from both the US and China.

Facing this situation, Europe cannot rely anymore on its traditional specialisation policy by producing and exporting goods and services where it enjoys a “comparative advantage” in an open market governed by multilaterally agreed trade rules. China already leads in the production of electric vehicles as well as a quasi-monopoly on the transformation of rare earth minerals. By adopting a strategy of massive national subsidies and imposing a “local content policy”, the US is shifting towards protectionism.
Compared with China and the US, the EU is much more vulnerable to trade and supply chain disputes. It desperately needs access to the global market for the supply of raw materials as well as for the export of its manufactured goods and services.

Unfortunately, technological decoupling risks accelerating the shift to economic closure. Innovation thrives on disruptive, cross border collaborations. The rise of “techno-nationalism” is the inevitable outgrowth of a generation of technologies including artificial intelligence that are intrinsically multi-use. As President Putin bluntly said in a speech to Russian students in 2017 “the leader in artificial intelligence will rule the world”.

Beijing’s emphasis on indigenisation and Washington’s efforts to relocate supply chains and sequester technology suggest that the future will belong to “techno-nationalists”. But taking decoupling too far will impede innovation and potentially obstruct world-changing basic research in reducing carbon emissions.

The IRA starkly contradicts WTO rules against discriminatory trade policies. However, there is a strong case for trying to settle IRA-type disputes without going to the WTO. In the present geopolitical context, the EU and the US cannot afford another trade war. They should concentrate on building a common approach to secure supply chains and forging common responses to China’s rise as a strategic rival.

The February EUCO conclusions clearly indicate the path to strengthening Europe’s sovereignty by referring to the tried and tested method of free-trade agreement negotiations with fast growing economies that could provide alternatives to Chinese inputs. This should certainly not exclude deepening transatlantic trade as an answer to supply chains concerns as well as the EU’s poor macroeconomic outlook. Regrettably, the US-EU Trade and Technology Council (TTC) is not mentioned in the EUCO conclusions, even though it is exactly the type of coordination mechanism that could make the Green Deal industrial plan a geoeconomic success.
Here we go again: restoring European economic competitiveness through Capital Markets Union

Recent events have prompted the EU to consider (again) how to maintain or even improve competitiveness. Though numerous innovations are currently being discussed on how to respond to challenges facing European industry, one should not forget longstanding initiatives that have lost political momentum, specifically the CMU. In the 9 February 2023 EUCO conclusions, “the European Council calls on the co-legislators to accelerate the implementation of the Capital Markets Union Action Plan by advancing and finalising work on the legislative proposals in this area”.

Improving access to capital is more important than ever. Not only could additional capital be instrumental in the financing of the European Green Deal, it would help stabilise the European economy by spreading risk and enabling greater cross-border investment. Indeed, the fragmentation of the European economy has long been a stumbling block in reaching the potential of the single market. The inherent limitations of bank balance sheets acts as a constraint on lending that a CMU could alleviate, particularly for small and medium-sized enterprises.

Despite these benefits, the political momentum for CMU waned shortly after its announcement in 2015. Moreover, despite the catchy name that linked it to the much-heralded “banking union” that had been announced a few years prior, the CMU was far more modest in scope and ambition. That must change. The Commission’s 2015 CMU Action Plan and 2017 mid-term review have achieved most of the identified legislative objectives. The Commission’s 2020 Action Plan is more ambitious and proposes 16 legislative and non-legislative actions. The most important aspects related to taxation and investment protection are more controversial and prone to more political interference. This is what makes them the key to create a CMU worthy of the name. They must also go further. For example, while the Commission proposes a common withholding tax proposal (Action 10), a broader harmonisation of taxation on savings and investment would be desirable to reduce market fragmentation.

Admittedly, transforming capital markets is not a quick process. Moreover, there will be a distributional impact as Member States’ financial markets will not benefit uniformly. While this poses an important political impediment, it should not overshadow the longer-term economic benefits.
Deeper and more liquid capital markets would address numerous aspects of our current polycrisis. Indeed, well-functioning capital markets would provide a stabilising influence as well as funding for more investment, thereby enhancing the competitiveness of European industry. The benefits would not be limited to the financial industry but to the broader European economy. Moreover, the stabilisation of European financial markets and increasing the funding possibilities will become more important if European companies lose out to American ones in the wake of the IRA. Additional private capital rather than public subsidies could improve the competitiveness of European industry, as had been argued over a decade ago.

The EUCO should provide additional political impetus for the development of the CMU beyond the February 2023 conclusions to prioritise the CMU and to ensure the political momentum that will be needed for a complex and long-term process. Demanding progress on measures within specific time frames, for example, rather than vague encouragements of "acceleration", would underline the urgency of the CMU. The EUCO could also repeat the 2010 experiment of creating a special task force as the Van Rompuy Task Force had contributed to the development of economic and fiscal policy measures to combat the euro crisis. The Capital Markets Union goes beyond a technocratic exercise and requires the investment of political capital at the highest level.

The EU could offer a bold new industrial policy in the face of today’s economic challenges that would be politically contentious and take many years to implement. It could also finish what it started in the name of improving the competitiveness of European industry by creating a genuine Capital Markets Union.
The February EUCO discussed ways of responding to the IRA adopted by the Biden’s administration while avoiding any direct reference to the latter. The IRA package provides large tax incentives for energy and climate measures and puts competitive pressure on EU governments to follow suit and adopt similar measures. The EU discussed the theme of European competitiveness more widely but did not go into the issue of the integrity of the EU market.

According to the conclusions, the Single Market is one of the most important achievements and strategic assets of the EU; it has been, as the Heads of states or government recognise, the strongest common denominator of the EU over the last 30 years. Interestingly, however, in the document, two major concerns regarding the Single Market – (1) the US IRA, and (2) the public deficit and debt issues (in the Eurozone), amidst attempts of the European Central Bank (ECB) to curb inflation – are not directly referred to (the former), or are not referred to at all (the latter). While this may be due to geopolitical concerns such as the war in Ukraine and the need to avoid divisive issues in the Euro-Atlantic partnership as well as in domestic EU governance, it bears risks for the Single Market as the most important strategic asset the EU has.

The EUCO conclusions mostly focus on investment to ensure EU competitiveness; although IRA does not appear in the document, this is a response to it. Several sources from which money could come are identified such as state aids, European Investment Bank (EIB) loans, simplified regulation, strategic skills and a possible European Sovereignty Fund, but this does not yet amount to a fully fleshed out response to match IRA.

State aids, including tax reductions, come first in the conclusions and take up most of the space. The text seem to imply that EU capitals want to get a blank cheque. It is true that state aids are to be “targeted”, “temporary” and “proportional”, but it remains to be seen how these criteria can be respected if the Commission is only to provide an ex-post assessment. Moreover, in the state aid section, the integrity of the Single Market only comes second. To avoid fragmentation due to unequal access to finance in some parts of the EU, the EUCO foresees EU-level solutions that are limited in scope and size, such as increased flexibility on some of the existing EU instruments (the cohesion policy is mentioned briefly). The RRF could also play a role, especially since some of the credit funds available remain unused. The increase of interest rates decided by the ECB could make recourse to these funds more attractive.
As for the rest of the ‘sources of finance’, EIB is listed without providing further detail on its role. The role of green and digital skills and demographic challenges seem to be more an issue that itself requires further investment rather than being a source of investment. The European Sovereignty Fund to support investments in strategic sectors is yet to be defined and will be different from IRA, which is a macroeconomic tool.

In the final part of the economy section, the CMU and multilateral trade system are discussed, but the ideas listed there, such as support for a rule-based WTO system, balanced trade and investment agreements with the US as well as other strategic partners, protection from unfair practices and from coercion, basically repeat what has already been said many times before in EUCO conclusions.

In summary, opening the door to state aid to boost investment that responds to IRA will contribute to the strategic EU objectives of investing in zero-carbon economy and strengthening resilience but will, as opposed to the RRF, also strengthen existing inequalities in the EU. It would be better to use external trade instruments and EU-funded and managed financial and structural instruments. This would, while being politically more challenging in the short term and potentially going against some of the current geostrategic considerations, strengthen the EU market as the EU’s most important strategic long-term asset.
In a changing geopolitical environment, the EU needs to align smart industrial policy for the green and digital transformation with trade policy to establish a competitive green economy and to avoid a global subsidies race.

The geopolitical environment is changing rapidly. Not only is the largest war since the end of World War II raging on the European continent, the rivalry between Western democracies and autocratic regimes, foremost China, is intensifying. Severe supply chain disruptions of critical inputs and products during the COVID-19 pandemic and as a consequence of Russia’s war on Ukraine have led to a new awareness of dependencies and vulnerabilities not only in the EU but also in many of the EU’s partners such as the US. Around the world, governments are passing new regulations and setting up new funding programs to strengthen the domestic production of strategic products which are indispensable for the green and digital transition. The role of the state in the economy is increasing, and industrial policy is gaining new geopolitical and geoeconomic significance.

This relates, among others, to the US IRA, through which the US government plans to invest USD 369 billion in US energy security and climate change programmes over the next 10 years. Because of several nationalist provisions (particularly through domestic content requirements), the IRA poses a risk for the future competitiveness of European industry through national tax breaks, lower energy costs, and higher economic growth predictions.

In response, the European Commission drafted a Green Deal Industrial Plan, which includes proposals to simplify state aid policies, to support education, training, and reskilling for the green and digital transitions, and to establish a possible European Sovereignty Fund before summer 2023 to support investment in strategic sectors. The European Council reiterated the need for a new industrial approach in its special meeting on 9 February 2023.

Without doubt, the EU needs to react to the changing geopolitical environment. However, the Green Deal Industrial Plan, if not modified and implemented carefully, poses the risk of a subsidies race, where both the EU and the US invest huge amounts of money in parallel structures, which might not lead to more competitiveness in the long run. Rather, EU Member States need to agree on a Smart Industrial Policy Plan which pays tribute to the unique position of the EU in the world economy and aligns state aid with an open and rules-based trading order. Thus, international trade and investment are indispensable pillars for economic growth, jobs, and prosperity in the EU. Without them, the green and digital revolutions will fail.
What does "smart industrial policy" mean? It means supporting the production at home of strategic products while at the same time avoiding a subsidy race with such important partners as the US. State aid thus needs to be targeted, timely, temporary and transformatory. These "Four Ts" should be a guiding compass for the EU’s Green Deal Industrial Plan. The Council Resolution also referred to the first three of them; but now they also need to be put into practice.

In addition, trade policy must be part of smart industrial policy. In order to support the green and digital transition of the economy, the EU needs resources and products from other countries. This relates, among others, to critical metals and minerals. At the same time, the EU also depends on sales markets abroad. The EU therefore heavily depends on trade and rules-based open markets. This means the EU needs to focus on the negotiation and implementation of ambitious free trade agreements with like-minded partners like Australia, Chile, or Mexico, as well as on partnerships on raw materials, which can provide improved access for critically important products. At the same time, defensive trade policy measures can be a tool to level the playing field, by fighting existing economic distortions through opaque subsidies.

Within the transatlantic relationship, the US-EU TTC is the obvious forum to exchange best practices and to prevent a subsidies race, which would be detrimental to public budgets and be implemented at the expense of smaller European countries. Among others, an early warning mechanism for new state aid programs should be implemented.

To sum up, the EUCO’s decisions for a Green Deal Industrial Plan are important. However, the EU needs to avoid a global subsidies race. Therefore, clear criteria for industrial policy measures are important. In addition, there are close interlinkages with trade policy, which have to be taken into account. The EU will and should never aspire to be autonomous in the green and digital transition. De-coupling is not a solution. Trade can help to lower costs and reduce critical dependencies in this area.
Europe’s ambivalent response to the IRA reminds a story of the emperor’s new green clothes. Although the EU’s discourse of strategic sovereignty has promised to make Europe ready to act independently, the continent still seems to be reacting to the global developments. Indeed, the EU’s fear that its own Green Deal could be inadequate compared to the IRA raises an inevitable question; is the emperor naked?

This leads us to have a closer look at the newly proposed Green Deal Industrial Plan. Is this Plan more about repackaging than a genuine industrial policy? The proposal includes some new initiatives but also others that have been long in the making, such as the Critical Raw Materials Act. It recycles and rebrands existing funds from the EU budget and the Next Generation EU (NGEU). The Plan also gives green light to continuing with the loosening of state aid rules.

Another question arises. Despite rhetorically defending a rule-based free-trade order and opposing protectionism, is the tilt towards a green industrial policy compatible with this? Framing the Green Deal Industrial Plan as an enforced reaction to industrial policies in other parts of the world risks making the EU look purely reactive at home and hypocritical abroad. Instead, the moment can be carefully embraced in favour of a much needed coherent approach.

This approach should factor in that successful industrial policies are based on strong place-based conditionnalities attached to state subsidies for large (foreign) investors and to other public investment. Reflecting primarily the often conflicting diversity of social market economy in Europe, it can additionally learn from foreign practices, such as the IRA.

First, the Green Deal Industrial Plan must be explicitly social, not only about building investor-friendly competitive green economy. The Commission’s proposal on the Green Deal Industrial Plan and the Council’s support for its further elaboration, surprisingly, have no links to the European Pillar of Social Rights. Contrary to the IRA, which has an explicit social conditionality, binding the tax incentives to investors’ compliance with the so-called prevailing wage and apprenticeship requirements, meaning that the green jobs and reskilling must generate good-paying jobs. It is imperative to integrate the social dimension into the Green Deal Industrial Plan, as such a social-green industrial nexus would limit the fragmentation risk of social dumping in the EU.
Second, the multiple risk of subsidy race, rising government debts, and single market fragmentation should not be underestimated. But neither should be the long-term underinvestment and uneven distribution of infrastructural, R&D, and industrial capacities in the EU. The skepticism of many Member States to the loosened state aid and the formation of (yet another redistributive) European Sovereignty Fund is understandable. The alternative is, however, an underfunded green transition and growing technology gap with the world, as well as between Europe’s economic cores and peripheries.

The best way may be to start by using and repurposing the already existing funding in a more green value-adding and targeted way under the Green Deal Industrial Plan. It should be recalled that the EU rules on the regional state aid proportionally condition the maximum levels of public subsidies with the different levels of regional development, and thus contribute to the socio-economic cohesion. Enabling more strongly conditioned state aid, which is simultaneously combined with the new funding opportunities for small member states and less developed regions according to the cohesion policy principles, can make the Single Market stronger.

Finally, although the EU, understandably, wants to retain its outward-oriented profile, the Green Deal Industrial Plan must reduce the continent’s export dependency. The IRA’s inward-looking buy-American conditionality is, among other things, also a macroeconomic act of balancing the US deepening trade deficit, as well as of enlarging domestic tax base for financing the public debt. In contrast, the Green Deal Industrial Plan must focus on balancing the asymmetrically high dependence of the EU’s export-led core economies on trade surpluses. The Green Deal Industrial Plan proposes to solve this through a gradual trade diversification from China to old and new partners, namely by using new trade defence instruments and by offering a reciprocal and open public procurement markets.

Without being pragmatically combined with a coherent industrial policy inside the Single Market, this trade defence and diversification might turn out to be a half-solution. This would make the emperor half-naked, and thus not fully able to deliver the promise of a less reactive stance of the EU. It is time to start acting more independently from the industrial policies in other parts of world.
The debate about state aid in the EU has become kind of schizophrenic. On the one hand, countries want to make it more flexible, as the current geopolitical context requires a straightforward implementation of industrial policy. On the other hand, the extension of the State Aid Temporary Framework is clearly threatening the Single Market.

These apparently contradictory messages are simply two sides of the same coin: the absence of a sound European industrial policy scheme which common funds for both innovation and support for viable companies in case of structural crises (like COVID-19 or the Ukraine war). What we have now is the worst of both worlds: state aid for scattered national industrial policies, and state aid to rescue the companies of rich countries, regardless of their competitiveness or viability.

We often forget that the European Commission’s original proposal of a NGEU instrument specifically included a Solvency Support Instrument for “viable European companies in the sectors, regions and countries most affected”, with a budget of "31 billion Euros aiming to unlock 300 billion Euros”. It made sense: facing a global crisis (like COVID-19) should guarantee the survival of all viable European companies, and not only the companies of countries with a sound fiscal position. However, the July 2020 EUCO decided to drop the Solvency Support Instrument. Most likely, countries with a wider fiscal space, which were solidary enough to support the issuing of European debt, did not want any restriction to save their national companies. This was a big mistake in terms of cohesion of the Single Market. That day, the State Aid Temporary Framework (approved in March 2020) became dangerously anchored in the EU regulatory landscape. In fact, it has been extended a few times even after the COVID crisis, when Russia invaded Ukraine. Like many temporary things in life, the State Aid Temporary Framework seems today more permanent than ever.

On the other hand, the IRA has triggered, despite its name, a global inflation of industrial subsidies. The US Chips Act has also heated up a global state aid race. Since mid-2022 – and especially since October 2022 – the US is no longer satisfied with keeping a sufficient technological lead against China, but its objective is now maintaining “as large of a lead as possible” (in the words of the National Security Advisor). This means that export controls are no longer enough, but public funds for supporting research and development have also become a key part of the US national security strategy. And, when US national security is at stake, the respect for the WTO rules becomes secondary. This makes industrial policy no longer an option for the EU, but a real necessity. The EU Green Deal Industrial Plan seems to realise the seriousness of the situation, but its proposals might not be up to the challenge.
the problem is twofold. First, if technology (mainly green and digital) becomes a European public good, its provision on a national level would be insufficient. Second, if industrial policy remains mainly a national competence, there will be no coherence at all at the European level and from the point of view of the Single Market.

The EU should therefore face the hard reality: the only way to make sure that competitive companies remain solvent in case of global shocks and that the EU stays in the technological race (the key for growth in the 21st century) is with a common industrial policy with EU-level funding. This, of course, should be complemented with a regulatory simplification which goes way beyond a simple streamlining of aid regulations. EU rules have already become a heavy load on companies and a real threat for EU competitiveness (as the EUCO Conclusions of 9 February 2023 implicitly acknowledge). Regulation is an area in which quantity is almost never correlated with quality, and a predictable and clear framework conditions for investment in the EU are essential, especially amid a war to attract high-tech investment.

Once again, the solution to a European problem is deeper integration. Let us hope that this time EU Member States realise in time.
In the current era of climate change and great power rivalry, industrial policy is back and this necessarily implies greater public investment and participation in the economy. The EU needs to adapt to this new reality, but if it wants to maintain the level playing field in the Single Market, it must develop a supranational fiscal capacity.

The US has joined China and other big players in the global economy in heavily subsidising companies and citizens to accelerate the green transition and acquire leadership in key economic sectors. This support puts the economies of the EU at risk. They could de-industrialise and fall behind in the development of new technologies. Therefore, the EU must respond. However, instead of undermining the Single Market by making state aid rules more flexible (which could generate unfair competition within the Single Market), it should move forward in its much-needed fiscal union.

Only the creation of a permanent fiscal capacity to finance European public goods such as strategic autonomy, energy independence or the green transition can provide an effective response to this challenge. Moreover, deepening economic and fiscal integration would reduce internal economic divergences and increase the EU’s clout in the global scene.

China has been subsidising its state-owned enterprises for decades. And the US, with its IRA and its Chips act, passed in 2022, will invest billions of dollars to transform its economy to ensure global economic leadership. As part of the IRA, USD 369 billion will be dedicated to investments to promote the transformation of the energy sector. Among other things, there will be substantial subsidies and tax credits to promote the use of electric vehicles, facilitate electrification, produce solar panels, and develop green hydrogen.

However, the IRA has complex “buy American” provisions that will make European companies unable to benefit from government support. For example, to qualify for the subsidies and tax credits, battery components must be produced in the US and electric cars must be produced mainly in American factories. Moreover, a free trade agreement, which the US has with Canada and Mexico, or with South Korea, but not with the EU, the United Kingdom or Japan, is also a prerequisite to be eligible for some elements of the IRA’s support.
The stated goal of the IRA is not to damage European producers. It is to accelerate a transition to a low carbon economy, to reduce greenhouse gas emissions and to diversify away from China, who is a world leader in battery production and mines 73% of the critical raw materials required to produce batteries for electric vehicles. These goals are also supported by the EU. However, major European companies feel discriminated against and argue that the IRA is protectionism in disguise.

The EU should work with the US to ensure that changes to the IRA are made. This would reduce discrimination against European companies. However, despite America’s willingness to make tweaks in its legislation, it is unlikely the act will be substantially modified. The US Congress has a Republican majority and President Biden has reinforced his belief in "buy American" in his last State of the Union address. Therefore, the EU needs to change track, and fast. The 9-10 February EUCO summit outlined a combination of relaxation of state aid rules and the reshuffling of common funds to respond to the challenge.

However, this is not the best response. Efforts should concentrate on the creation of a permanent fiscal capacity to finance European common investments, and the creation of a European Sovereignty Fund, as proposed by the European Commission, would be a first step in this direction. Relaxing state aid rules, as agreed by the Council, will undermine the single market because some countries have much more fiscal space than others. As a matter of fact, since March 2020, Germany (53%) and France (24%) alone have accumulated almost 80% of all state aid in the Union.

The national logic in state aid is easier to implement but distorting. Many Spanish firms, for example, were not able to participate in the IPCEIs until the NGEU funds arrived. To compete with the US and China, the EU needs to increase its joint borrowing which needs to be financed by own resources. These funds can then be used for joint, cross-border research and development, public procurement and regional convergence which should be based on best practices in public-private collaboration, multi-level governance and place-based regional productive specialisation to create agglomeration economies.

Many are skeptical about the effectiveness of fiscal transfers, but these are what keep political unions together. The key is to design and implement them as best as possible and for this the EU needs to develop appropriate indicators, ex-post independent evaluations and the administrative flexibility and agility to change course whenever the evidence on the ground requires it.

Ultimately, analysing the bigger picture. A central fiscal capacity would facility the completion of the banking and capital markets union, because it would produce a risk-free asset, and it would support the international role of the Euro, which in turn will lower the financing costs of the Union, which will give the EU more fiscal space to compete with the US, which – we should not forget – enjoys the "exorbitant privilege" of issuing the dollar.
The European Council’s role in the Union’s economic governance: evolving into a “gouvernement économique”?

The EU’s economic governance is a key issue for the future of Europe. That is why economic issues are high on the agenda of the EUCO. The latest and the coming sessions confirm this assessment.

In view of this relevance it makes sense to discuss the role(s) and powers of the EUCO in this area: is it becoming, to use a French-led narrative, a form of "gouvernement économique"? To answer that question, it is necessary to not just look at individual sessions, but at the leaders’ activities over time in several pillars of the EU’s economic governance. Those are based on different sets of competences and procedures as set out below:

- the internal market with four freedoms and regulations concerning rules for competition and state subsidies;
- trade and development policies with a set of provisions for common agricultural policy (CAP), development cooperation and humanitarian aid;
- a broad and differentiated set of sectoral Union policies from the common agricultural policy and research via transport and social policy towards energy and environment (like enumerated in art. 3-6 TFEU);
- the Monetary Union with a single currency for the Euro member countries and a ECB;
- the Economic Union with hard forms of cooperation for fiscal policies (like the Stability and Growth Pact) and soft forms of coordination in economic and employment policies;
- the EU budget with financial provisions for the Union’s own resources, concerning the income side, and for the multiannual financial framework fixing the expenditure side as well as the Union’s annual budget.

The EUCO has spent considerable time and effort dealing with these various aspects of economic governance. In fact, two of the founding fathers of the EUCO, President Giscard d’Estaing and Chancellor Schmidt, both former finance ministers, looked for a way to deal with the economic poly-crises of the 1970s. Each generation of Heads of state or government has followed their problem-solving instinct to tackle the economic challenges of their time in the EUCO. They have shaped - via pre-legislative political orientations - community policies, like the CAP, energy, environment, climate, and digitalisation. They have influenced the implementation of the (national) state aid regimes and the EU’s trade policies, including on economic sanctions. As constitutional architects, they have created and adapted the legal provisions for the Economic and Monetary Union, they have also formulated guidelines for fiscal discipline of Member States via the Stability and Growth Pact (hard coordination).
They have used soft coordination to monitor national economic and employment policies. The leadership role of the EUCO as crisis manager was very much strengthened during the subprime crisis and the Corona pandemic. The heads have always played a key role in exercising the power of the purse by shaping the Multiannual Financial Frameworks that determine the EU budget for seven-year periods; this is a key part of the Union’s economic governance.

In line with the treaty provisions (Art. 110ff. of the Treaty on European Union [TEU]), the EUCO, legally, is not empowered to take the formal acts but it clearly is the institution that sets the key orientations. But as always in EU life, the picture is more complex: the Commission plays a key role both because its President is part of the EUCO and because of the treaty powers the Commission has in the legislative area. And to adopt legislation, you must also find an agreement with the European Parliament. The follow-up to the July 2020 political agreement on the seven years’ budget and especially on the New Generation EU instruments with the RFF demonstrates that the EUCO needed the other institutions to put their package into adequate legal forms and for securing credible commitments by strengthening supranational modes of governance.

We see an ongoing process of interaction between institutions in the EU’s architecture, merging economic competencies and instruments for problem-solving. That is also why the President of the ECB is invited to the sessions dealing with monetary issues and contributes to the problem-solving. To take this point further, the question arises as to whether this “fusion of democratic principles” via the sharing of responsibility between institutions based on an EU-wide legitimacy - the EP, the Court, and the Commission - and institutions based on a national legitimacy, the EUCO and the Council, (see art. 10 TEU), leads to some kind of a new consensus model of democracy.

In assessing the power exercised by the national leaders, we should also look at the performance of their body. Generally, it seems that the EUCO is able to reach decisions under time pressures and in crisis situations. Such a rating of the capacity and willingness to act does not include an assessment if the agreements, reached in difficult negotiations, are effective in solving the problems on the agenda. Even with a record of multiple activities and considerable agreements in all pillars of economic governance, the EUCO has not developed into a fully–fledged “gouvernement économique” in a conventional sense. It cannot coordinate as much as maybe it should precisely because, as the masters of the treaty, the Heads of state or government are reluctant to give up significant competences of their national economic sovereignty. This to some extent limits the capacity of the EUCO to plan ahead and “provide the Union with the necessary impetus for its development” (Art. 15(1) TEU) in the area of economic governance. Maybe the time has come for a fresh and bolder look at the competences and the procedures of the Union’s economic governance.

The present situation allows for muddling through, but effective economic governance will require much more work and imagination. This is an issue that will remain high on the agenda of future sessions of the European Council.