3 Main Points

- How should the European Union rethink its industrial policy in light of global shocks, strategic dependencies, and growing competition from the U.S. and China?
- Fragmented national industrial strategies risk deepening inequalities, weakening competitiveness and undermining the Single Market.
- The EU needs a coordinated framework that ensures that interventions are aligned with shared European goals.

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A Wake-Up Call for Industrial Policy?

How Global Shocks and Geopolitics Are Redefining Europe's Industrial Strategy

When the European Commission announced its Clean Industrial Deal in February 2025, it presented the plan as the next step in Europe's green reindustrialization. Yet for many in Brussels and beyond, the proposal also reflects the pressure the EU faces to respond to the U.S. Inflation Reduction Act (IRA) and China's state-led industrial strategy. The proposal

clearly demonstrates how the EU has shifted from its traditional market-driven model towards a more interventionist industrial policy.

This shift did not happen overnight. In the last years, the European Union has been confronted with several global shocks. The COVID-19 pandemic revealed the vulnerability of supply chains, and the Russian invasion of Ukraine highlighted the risks of energy dependencies and ultimately led to an energy crisis. Lastly, the green transition has increased the demand for critical raw materials and since Europe is heavily dependent on such imports, it exposes the EU to significant geopolitical risks. Additionally, protectionist approaches which were considered exceptions before, have become increasingly common.

These global developments have forced the EU to rethink its industrial policy. The guiding framework for this rethink has been the notion of open strategic autonomy, which reflects Europe's need to reduce its strategic dependencies while still preserving the benefits of an open, rules-based global economy.

1. But what exactly is "industrial policy," and why is it making such a comeback?

Industrial policy is back at the centre of economic debates. After decades of being dismissed as distortionary or outdated, governments across the world are once again using it to shape their economies. At its core, industrial policy refers to deliberate "interventions targeting sectors or firms directed at changing the structure of economic activity within an economy." In the past, this usually meant supporting important manufacturing industries like steel, automobiles or aircraft but these goals can also extend to promoting innovation, economic growth, climate transition or regional development. The most common type of industrial policy are subsidies but also import restrictions, tariffs or other specific regulations are considered a type of industrial policy.

1.1. The Cons of Industrial Policy

In an IMF Working Paper from 2019, industrial policy was labelled as the "policy that shall not be named." This is because industrial policy comes with many downsides. Firstly, industrial policy might give an advantage to big local companies, and this could mean less competition. If the government helps established companies too much, it can be difficult for new and inventive companies to get into the market. Secondly, governments are not always good at picking "winners", as they lack the necessary information needed to make the best choices. In cases where industrial policies have failed, public funds were often wasted, sometimes to the expense of consumers. Economists also warn about the risk of regulatory capture which occurs when firms exert disproportionate influence over government decisions, shaping industrial policy to serve narrow corporate interests rather than the broader public good.

Next to the above-mentioned issues there is also the danger of trade conflict and retaliation. When trade barriers are used as industrial policy tools, partners may respond with countermeasures, further distorting market outcomes. The IMF has noted that a subsidy race to the bottom could "undermine the level playing field in global trade, contribute to geoeconomic fragmentation, and impose large fiscal costs", and eventually reduce efficiency. This risk is especially relevant in the EU, as "overall welfare" is a core principle.

1.2. The Pros of Industrial Policy

Nevertheless, there are also several reasons that legitimize state interventions. During COVID-19, we have seen a single company's supply chains can have negative effects on the wider economy. The damage often goes beyond the sales lost by that individual firm. Similarly, if companies rely on key inputs, like energy from just one country, the entire country can become vulnerable to pressure, which can undermine its strategic autonomy. Left to themselves, markets do not account for such geopolitical risks or externalities,

whereas governments may intervene through industrial policies to mitigate them. Therefore, especially for the European Union, strategic autonomy has become a key argument for industrial policy.

According to economists, another reason that legitimizes state intervention is also known as "path dependence". Companies tend to keep innovating in areas they already know well. For example, car makers that have focused on combustion engines are likely to keep improving them. By using industrial policy, governments can guide innovation towards new priorities, like green technologies, through targeted support. Lastly, governments can help solve coordination problems, where no company wants to be the first to pay the high costs of entering a new market. Without government support, companies may wait for others to take the risk, creating a "free rider" problem. To fix this, the state can provide subsidies to the first company that enters the market.

2. The Evolution of Industrial Policy in the European Union

The European Union's industrial policy has gone through various phases. Before 1980, many countries had their own "vertical" industrial policies that favoured certain industries. Later, from 1990 to 2000, the focus shifted to market deregulation and the creation of a single market, with competition policy playing a central role for ensuring a level-playing field for businesses in Europe. Reforms also aimed to increase innovation and R&D investment and create a more integrated internal market. A consensus on a "horizontal" approach to industrial policy only began to form in the 2000s. Horizontal policies are measures that support innovation and growth across the whole economy, rather than helping only specific industries or companies.

The most significant shift, however, has occurred in recent years under the European Commission led by Ursula von der Leyen. The European Green Deal and the Fit for 55 package include several measures that can be seen as forms of industrial policy. Many of these policies were introduced in response to supply chain disruptions and shortages of medical goods during the COVID-19 pandemic, followed by the energy crisis. A key instrument was the use of general exemptions, allowing member states to provide state aid without going through the full EU notification process. During this period, the EU also broadened its use of Important Projects of Common European Interest (IPCEI) to support strategic sectors. In 2023, several initiatives were launched, including the European Chips Act and the Critical Raw Materials Act. The European Chips Act allows member states to give state aid to semiconductor producers when certain conditions are met. Another crucial industrial policy regulation was introduced in 2024, the Net-Zero Industry Act (NZIA), also seen as a response to the IRA of the United States. The NZIA sets the goal of producing at least 40% of the EU's required net-zero technologies domestically by 2030. To reach this target, it focuses on speeding up permitting for strategic green technologies, creating EU-wide standards, and using regulatory sandboxes to support innovation.

3. How U.S. and China's Industrial Policies Reshape Europe's Choices

As noted earlier, both China and the U.S. are pursuing increasingly interventionist policies, in some cases in ways that even breach international trade rules. Already in 2015, China launched its Made in China 2025 strategy, aimed at boosting the share of high-tech goods produced domestically. In the U.S., major development was when Joe Biden signed the IRA in August 2022 which consists of a variety of proposed measures. The main aim is to boost the green energy sector by offering subsidies and tax credits to clean energy technologies, electric vehicles, and the domestic production of key components. By "linking" these subsidies, for example supporting mineral extraction, solar panel production and clean hydrogen together, the IRA aims to lower costs more effectively and build a self-sustaining

green energy ecosystem that can compete with fossil fuels. Even though large production subsidies can be helpful in supporting the green transition, they can also pose a challenge for the EU. The U.S. incentives could attract companies to move production and investment to the United States, which could lead to an outflow of capital, tech, and workers from Europe. The IRA's domestic content rules might also disadvantage European producers of goods like batteries and renewable energy by restricting their access to U.S. subsidy programs.

Some have argued that the IRA has served as a 'wake-up call' for the European Union to rethink its industrial policy and put greater emphasis on net-zero technologies. But how should the EU answer specifically to the U.S. and China? Unfortunately, the answer is not that straightforward. Economists are worried that too much state intervention could hurt the EU's single market and rules based international trade. It remains a tricky question to what extent governments should be involved in shaping market mechanisms. It is also important to remember that the EU's structure differs from China and the U.S., in that it is not a single fiscal entity. Industrial policy and its funding are mostly managed by national governments, which creates a risk of fragmentation. If member states use uncoordinated national subsidies to respond to geopolitical shocks, the Single Market could be weakened.

4. Fragmentation Risk: Lessons from the Energy Crisis

The dangers of such fragmentation became clear during the energy crisis. The EU Temporary Crisis and Transition Framework (TCTF), introduced in March 2022, allowed governments to provide large-scale state aid to businesses struggling with rising energy costs. While the EU collectively allocated over €650 billion in fiscal relief, this spending was highly uneven among member states. Germany spent €158 billion, while Italy and France each spent around €90 billion, making it difficult for smaller economies to match this kind of financial support.

Wealthier countries like Germany were able to subsidize their industries more, while fiscally constrained nations were not able to do the same. This disparity can create competitive advantages for industries in stronger economies, increasing existing social and economic inequalities within the Single Market.

Financing for major initiatives such as the Important Projects of Common European Interest (IPCEI) comes primarily from member states and they are the ones that can initiate, design and develop projects. As a result, some economists have warned that governments tend to prioritize their own national interests over collective European ones.

The lesson is therefore clear: Europe needs a more coordinated industrial policy. Why? Because when industrial policy remains fragmented, member states are pitted against each other. This leads to a situation where richer countries are able to outspend poorer ones and collective resources are deployed less efficiently. Greater EU-level coordination would allow Europe to pool resources and to channel subsidies into projects that enhance global competitiveness while upholding the integrity of the Single Market.

5. Expert Recommendations

5.1. Strengthen EU-level fiscal capacity

To compete with the U.S. and China, the EU must develop the means to finance large-scale industrial projects. Most economists now agree that this requires more public borrowing at the EU level, in the same way as the NextGenerationEU programme (NGEU). This would

involve issuing a common debt to fund joint investment projects and increasing the EU budget to provide “European public goods”, as well as common industrial and geopolitical strategies.

5.2. Reform the IPCEIs

While increasing EU spending might prove politically difficult, IPCEI’s are instruments which are already in place, but their potential remains untapped. Recent high-level reports, including those by Enrico Letta and Mario Draghi, have acknowledged the value of this instrument. Reforms could include expanding their scope, simplifying administrative procedures to allow smaller countries and SMEs to join, and turning them into an instrument for regulatory innovation and financial pooling.

5.3. Preserve the integrity of the Single Market while adapting state aid rules

State aid, as highlighted in the Draghi Report, is a useful tool in the EU’s industrial policy, but projects need to complement rather than compete with each other, to prevent subsidy races among Member States. As highlighted in a report by the IMF, well-coordinated production subsidies can enhance overall welfare. Furthermore, subsidies should only be allowed if it does not reduce competition or prevent new, innovative firms from entering the market.

5.4. Complete the internal market in strategic sectors

Financing alone is not enough: the EU needs deeper integration in energy, digital, and financial markets. As the Letta Report emphasizes, insufficient integration in these sectors is a key factor behind Europe's declining competitiveness. Greater harmonisation of industrial policy tools and facilitating the movement of skilled workers and firms across the single market can maximize policy benefits, lead to more efficient allocation, fair competition, and long-term competitiveness.

5.5. Anchor the EU industrial strategy in open strategic autonomy

Finally, we argue that Europe's industrial strategy must balance resilience (reducing dependencies, securing critical technologies) with openness (avoiding protectionism, preserving rules-based trade). Europe should not fall into the trap of protectionism, and it should reinforce, not weaken existing international bodies like the WTO.

6. Conclusion

Ultimately, the industrial policy debate in Europe should not be about whether we should implement it or not, but on how we can make it compatible with the various objectives the EU is striving for. While the EU has taken significant steps in industrial policy, there is still room for improvement in order to make the policy the most effective. The EU will be confronted with the task of finding the right balance between resilience in geopolitics and economic efficiency, and between openness and strategic autonomy.