POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

STRATEGIC FILE

NO. 2 (92), NOVEMBER 2020 © PISM

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More Autonomous and Greener: A Strategy for EU Industry in the COVID-19 Era

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Faced with the pandemic-provoked economic crisis and spurred on by initiatives from several EU Member States and the European Parliament, the European Commission wants to strengthen and modernise European industry while making it more sustainable and greener. However, individual states remain divided about the optimal balance between self-sufficiency and economic openness, as well as the pace of the green transition. Moreover, the quest for industrial autonomy and the promotion of more sustainable and fairer world trade are likely to complicate the already tense relations with the Union's major economic partners.

The European Commission (EC) was reflecting on ways to adapt European industry to the changing world even before the pandemic struck, and it unveiled its strategy to reinvigorate the industrial sector in March 2020.[1] The health crisis does not eliminate such challenges as climate change, dwindling natural resources, multiple consequences of technological progress, and ever fiercer international competition. If anything, it makes them more pressing. Therefore, the updated plan, announced by Commission President Ursula von der Leyen and scheduled for the first half of 2021, is unlikely to constitute a change of direction. What can be expected is re-prioritisation and fine-tuning of the proposed instruments, along with additional funding, to prepare the EU to operate in an increasingly unstable and antagonistic world.

The EC placed the modernisation of industry firmly within the context of its two grand projects for the current term: the European Green Deal, designed to lay the foundations for a carbon neutral economy, and the digital transition, intended to boost the Union's capabilities in high-tech. The strategy reflected the Commission's conviction that the focus on reaching carbon neutrality does not preclude economic growth or industrial development. Quite the opposite, it can become the engine of expansion. Harnessing the potential of technological innovations is seen as a key factor to fulfil this ambition. At the same time, the EC emphasised the necessity to modify economic relations with partners[2] in order to eliminate disadvantageous terms (such as restricted access to foreign markets for EU companies), and promote its standards in climate policy, trade and the digital economy. The Commission also stressed that there are still barriers to free movement of goods and services in the single market, stifling growth. All in all, the strategy takes a very broad view of the challenges affecting industry, including climate policy, trade and taxation, and could be seen as an impulse for broader transformation of the European economic and social model.

The Impact of the Pandemic

The lockdowns introduced by Member States in the spring 2020 had a devastating effect on many sectors.[3] Some factories limited or stopped production because they were unable to ensure adequate social distancing or had their supply chains, often stretching across several continents, disrupted. Thus, the pandemic has revealed the strong dependence of European industry on imported products, even in strategically important domains such as medicines and medical equipment. That dependence seemed particularly problematic in light of the media and diplomatic activities undertaken by China and Russia, oriented at dividing the Member States and discrediting their authorities in the eyes of their citizens. As people were obliged to limit direct contacts, entrepreneurs and ordinary citizens were confronted with the importance of the digitisation of the economy. A large number of people used digital tools to work remotely, and many other activities (such as shopping, social contacts and entertainment) moved to cyberspace. In this area, Europe's dependence on other powers was also manifest. Developing applications for tracking social contacts in order to facilitate analysis of the spread of the virus turned out to be near impossible without close cooperation with tech giants such as Apple and Google. Finally, while the slowdown of economic activity has raised the prospect of unprecedented recession, it has also provided a striking illustration of the impact of economic activities on the environment. Usually polluted areas enjoyed clean air, and emissions of greenhouse gases fell significantly.[4]

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[1] *A New Industrial Strategy for Europe*, COM(2020) 102 final, 10 March 2020.

[2] According to Eurostat, in 2019, the United States, China, the UK and Russia accounted for 48% of EU imports of goods and 46% of exports.

[3] The economic outlook published by the EC in July forecasted that, in 2020, the EU's economy would shrink by 8.3% with recession reaching double figures in France, Italy and Spain.

[4] In April and May, CO_2 emissions in the EU27 and the UK fell by 26.3% and 21.6%, respectively (compared to 2019). Cf. "Near real-time monitoring of global CO_2 emissions reveals the effects of the COVID-19 pandemic," *Nature Communications* 11, 14 October 2020.

Towards Greater Industrial Strategic Autonomy

The pandemic has shown the instability and vulnerability of the world economic system. In addition, some of the Union's key economic partners have seemed more inclined to treat the crisis as an opportunity to undermine the EU rather than engage in a common effort to buttress the system. The drawn-out negotiations on a post-Brexit trade agreement with the United Kingdom contribute to the impression of the EU being assailed by increasingly antagonistic partners. Consequently, greater self-sufficiency is seen by many in the EU as the way forward. The concepts of strategic autonomy and sovereignty, which to date featured mostly in debates focused on international relations and the defence industry, are increasingly being invoked in a wider economic context. The Franco-German initiative of May 2020, proposing the establishment of a recovery fund financed through common debt, called for a "resilient and sovereign economy and industrial base."[5] The shortages of medical equipment that occurred in the spring have encouraged calls for thorough analysis of dependencies, and for production facilities to be re-located to Europe. Attention has also been focused on raw materials, an area in which the EU is often highly reliant on foreign suppliers. Of all the rare earth metals used in production of a variety of electrical devices, 98% are sourced from China. The European Raw Materials Alliance was set up by the EC in September to facilitate common actions by public and private players, aimed at achieving greater diversification of supply, studying the EU's own reserves of raw materials, and developing more effective ways to use and recycle them.[6]

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The Union wants to boost its technological potential, where in many aspects it lags behind the U.S. and China. The Commission President and the European Council see "technological sovereignty" as the Union's objective. In her State of the Union address, von der Leyen stressed several of the Commission's objectives in the digital realm. These include improving the capacity to use metadata for industrial purposes, enlarging the scope of possible applications for artificial intelligence, developing super-computers, and expanding digital infrastructure. To support the transition, the EC wants 20% of grants that Member States will receive from the Next Generation EU recovery instrument to be used for digital projects. In addition, the EC proposed a considerable increase in the budget for Horizon, the main EU programme supporting research, calling for €94 billion over seven years compared to €65.5 billion in the current multiannual budget (the European Parliament (EP) called for €120 billion). Yet, during the budget negotiations, the ambitions of the Commission were curtailed. After the Member States suggested cuts to the Commission's budgetary proposal, Horizon's budget was agreed at €80.9 billion. The European Council also decided to abolish the Strategic Investment Facility (€15 billion). These funds could, according to the EC, help generate investments "in strategic sectors and key value chains."

The push for industrial strategic autonomy has an important external dimension. It entails better protection of European companies against competition from foreign (often state-subsidised) counterparts, and a more determined insistence on reciprocity in international economic relations. "Europeans know that they must again use the language of power, without losing the grammar of cooperation," argues Clément Beaune, French minister for EU affairs.[7] As early as March, the Commission announced that it would cooperate more closely with Member States in screening foreign investments, especially in sectors considered strategic. These efforts are set to continue, especially as some firms weakened by the crisis could become targets of acquisitions. As recession becomes more

[5] *French-German initiative for the European recovery from the coronavirus crisis*, 18 May 2020, www.diplomatie.gouv.fr.

[6] *Commission announces actions to make Europe's raw materials supply more secure and sustainable*, press release, 3 September 2020, https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1542.

[7] C. Beaune, "L'Europe, par delà le COVID-19," *Politique Etrangère*, 3/2020, p. 17.

acute and governments look for income to support recovery, the EU will be more determined to tackle the damaging aspects of its economic relations with foreign partners. There are growing calls for free trade agreements to include more stringent measures that would oblige companies wishing to sell their products and services in the EU to respect ambitious norms regarding climate, environment protection and workers' rights.[8] Failure to abide by them is not only unethical, but also gives foreign competitors an unfair edge over European companies. In October, the EC announced new regulations that would set high standards (pertaining to materials, recycling and labour) for the car batteries soon to be produced in the EU. This is one of the flagship projects through which the Union intends to gain autonomy in a strategic sector.[9] Foreign producers who do not comply with similar norms as the EU will face tariffs.

Many point out that the EU has not drawn sufficient benefits from granting foreign companies access to its market. The European Commission, Parliament and a large number of Member States have been advocating the creation of a digital tax. This would apply to the largest companies (most of them American) active in the sector, which currently pay disproportionately little in taxes using a variety of optimisation mechanisms. The introduction of such a tax would not only make economic relations in cyberspace fairer, but could also provide the means to repay the debt that is soon to be taken to create the recovery fund. On foreign markets, the EU will be more determined in demanding equal rights for European companies and contesting discriminatory practices. China is the greatest challenge in this respect. In spring 2019, in the EU-China Strategic Outlook, the EC advocated a more assertive posture towards this important economic partner, formulating demands for access to public procurement and better protection of intellectual property. The Commission president's recent declaration that the trade and investment relationship remains "unbalanced" clearly suggests that this course will be maintained.

While re-balancing economic relations with partners, the Union wants to avoid antagonising them as it draws significant benefits from trade. Between 2013 and 2019, trade in goods generated a surplus for the EU of around €200 billion per year. The European Council stated that it wants to "achieve strategic autonomy, while preserving an open economy."[10] But, despite the Union's good intentions, the push for strategic autonomy may well strain relations with economic partners. China, Russia and the U.S. have already voiced concerns regarding some aspects of new taxes and levies that the EU wants to introduce to gain new sources of revenue. The negotiations for a new investment agreement with China proceed slowly. EU leaders hope that, in the United States, the Joe Biden Administration will adopt a less confrontational position on trade and be more receptive to their ideas regarding WTO reform. Finally, even if partners accept European standards and requests, ensuring their effective implementation (for example, proper working conditions or measures to reduce emissions) may be difficult.

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Friction with major trade partners will not be the only obstacle to the drive for industrial autonomy, as even within the Union there is no consensus about the adequate balance between self-sufficiency and openness. France tends to be the most vocal about adopting a more assertive stance. A more moderate position is defended by Northern European states. Since the UK's departure, they have become the most outspoken advocates of liberal international trade policy in the EU. They fear that various protective mechanisms could hurt the prospects of European exporters. "Strategic autonomy

[8] A draft report on a new long-term strategy for Europe's industrial future (2020/2076 (INI)), currently under discussion in the EP's Industry, Research and Energy Committee, argues that "negotiations on free trade relations must reflect […] the EU's environmental targets. Market counterparts will be selected more rigorously and sustainability clauses will be made far tougher going forward," 26 May 2020, p. 11.

[9] F. Simon, "EU to push new standards for 'greenest' car batteries on earth," *Euractiv*, 19 October 2020, www.euractiv.com.

[10] Special meeting of the European Council (1-2 October 2020) – Conclusions, point 3.

is not a goal in itself," argue Dutch ministers, who emphasise that addressing vulnerabilities in value chains must not lead to disruption of trade relations.[11] "Finland wants to believe in competitiveness and does not want to take the road of customs, protectionism, state aid and subsidies," emphasised the Finnish minister for EU affairs.[12] In line with the proponents of greater industrial autonomy, the Polish government has stressed the need to fight tax evasion, establish new sources of revenue for the EU, and review overstretched value chains.[13] However, as many Polish companies are closely linked to the German export-oriented industry, Poland also expects the EU to maintain a trade-friendly stance. Similarly, many other Member States, even if they subscribe to the general idea of greater self-sufficiency, are likely to want to avoid decisions that could trigger reprisals from their key trading partners, thus making the adoption a coherent EU position difficult.

The Climate Challenge is Not Going Away

The March industrial strategy labelled the digital and green transitions as two key processes influencing the development of industry. While the pandemic has clearly demonstrated the importance of cyberspace, and thus validated the Commission's focus on this domain, one could suspect that it could derail the Green Deal as states could be expected to engage in saving their companies regardless of the ecological cost. The Commission, however, encouraged by a large number of Member States and growing civic concerns about the climate, believes that the COVID-19 crisis provides an opportunity to speed up the green transition. This objective could be achieved by channelling considerable sums from the recovery instrument into green investments. The EC suggests that 37% of grants that states will receive to support economic recovery should be spent on the latter. On top of that, states (especially those particularly reliant on fossil fuels) will be able to draw money from the Just Transition Fund. Its budget will be boosted (though it will be less than half of the €40 billion that the EC wanted). In parallel, there are efforts to mobilise the private sector. In the spring, the Council and the EP agreed on a system for assessing the environmental impact of economic projects in order to provide clear signals to investors and encourage them to fund green undertakings.[14] The EC has high hopes for hydrogen, which could become an important emission-free fuel, including for energy-intensive sectors such as the chemical industry and steelworks.

While the EC strives to secure more funds for the transition, it also encourages Member States to adopt more ambitious objectives, including updating the emission reduction target for 2030 from 40% to 55%. The Commission's green ambitions were supported by the EP, which backed an even greater revision of the reduction target, to 60%.

Exploring the nexus between ensuring a level playing field and accelerating the green transition worldwide, the EC wants to create a Carbon Border Adjustment Mechanism (CBAM) within the next few years. This could take the form of a tariff imposed on products imported from countries with less stringent emission standards. This would eliminate the incentive for EU companies to move production abroad ("carbon leakage"), while encouraging foreign competitors to cut emissions.

Even though the objective of the green transition is commonly accepted in the EU, it remains to be seen whether the Commission will convince Member States to proceed at its preferred pace. Industry representatives stress the cost of the transition[15] and, as economic forecasts worsen, it becomes less and less probable that Member States will be able to mobilise the necessary funds. The strongly

[11] *Letter from the Minister of Foreign Affairs and the Minister of Finance to the House of Representatives concerning the government's assessment of the Commission's proposals for the MFF 2021-2027 and the COVID-19 outbreak recovery strategy*, Government of the Netherlands, 12 June 2020, www.government.nl.
[12] P. Vänttinen, "Helsinki – No to 'Fortress Europe' and strategic capitalism," *Euractiv*, 8 October 2020, www.euractiv.com.
[13] M. Morawiecki, "Ein neues Gleichgewicht für Europa," *Frankfurter Allgemeine Zeitung*, 22 April 2020; M. Morawiecki, "United we can do more," *Euractiv*, 17 June 2020, www.euractiv.com.
[14] *Framework to facilitate sustainable investment*, 2018/0178 (COD).
[15] F. Schulz, "German industry sceptical about new EU's climate goals," *Euractiv*, 17 September 2020, www.euractiv.com.

contested vote in the EP on the 60% target (supported by 352 MEPs, opposed by 326) reflects a rift in the assessment of the Union's capability to accelerate the transition. Sceptics emphasise that, while long-term investments are necessary, additional funding from the recovery fund is only planned for a couple of years. A left-right split is visible on the climate issue, with the Greens and Social Democrats opting for more ambitious targets than the centre-right. This overlaps with geographical differences, as representatives of the Central European Member States tend to be more cautious about climate targets. Different reactions to instruments proposed by the EC blur the picture even more. For instance, the CBAM, intended to tackle carbon leakage, is supported by Poland, but perceived with scepticism by the climate-sensitive Nordic governments who fear reprisals from trade partners.

As in the case of trade, the ultimate success of the Union's green objectives is dependent on its counterparts. European efforts will have a bearing on the global fight against climate change only if other large emitters decide to follow suit. The Chinese declaration to reach carbon neutrality by 2060, and the election of Biden, who declares the intention to abide by the Paris Agreement, are encouraging in this respect.

Between Convergence and Competition on the Single Market

Lockdowns provoked fears about the future of the single market, as significant disproportions became obvious between national emergency programmes set up by Member States to support their companies and workers. The establishment of the EU recovery fund, directed especially at states that have had little fiscal room for their own initiatives, is supposed to remedy that problem. The EP rapporteur on industrial strategy urged states to "replace national support schemes for businesses and workers with Commission-managed EU programmes."[16] Yet, as a second wave of COVID-19 broke over Europe and the negotiations on the recovery instrument proceed slowly, European funds could face delays and turn out to be insufficient to make up for the disparities in Member States' fiscal firepower.

Even though Member States agreed to take on common debt to shoulder economic recovery, differences remain regarding the preferred development of the single market. The Franco-German initiative on the recovery fund, in line with earlier calls formulated especially by the French president, stressed the need for greater convergence and suggested the adoption of a Common Corporate Tax and a framework for a minimum wage. Echoing these requests, Spain advocates full tax harmonisation. In the meantime, Northern European states, usually in unison with those in Central and Eastern Europe, tend to stress removing the remaining barriers to free movement of goods and services. Some of those states (Ireland, Luxembourg and the Netherlands) that offer preferential rates to large foreign corporations are loath to see tax harmonisation. The north is also wary of the idea of modifying competition policy to allow greater consolidation of European companies, advocated by France and Germany with backing from Italy and Poland. The "European champions," created this way, would, in the eyes of their proponents, constitute powerful players capable of taking on foreign rivals in global competition. Opponents, however, fear that such heavyweights could crash competition on the internal market. Moreover, the EU fiscal rules, which have been temporarily suspended to enable Member States to pump more money into their ailing economies, are also bound to become the subject of discord. The frugal alliance (Austria, Denmark, the Netherlands, and Sweden, often supported by Finland) is likely to advocate a quick return to fiscal discipline, fearing that the highly indebted south may keep taking on liabilities and end up needing

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[16] *Draft report on a new long-term strategy…*, *op. cit*., p. 12.

another bail-out financed by the north. The Portuguese prime minister, in the meantime, has already called for prolonging the suspension of the fiscal rules until 2022.

Conclusions

The pandemic has revealed the EU's vulnerabilities, and thus created a favourable context for the proponents of industrial strategic autonomy. There is general agreement between the Member States and EU institutions that the EU needs to become less dependent on foreign powers, reduce the gap in the global technological race, and draw greater benefits from the single market, while at the same time reducing the negative impact of economic activities on climate and environment. However, as the discussion shifts from general objectives to more concrete targets and ways to proceed, the consensus vanishes. There are different views about the degree of autonomy that the EU should seek, the nature of a level playing field (on the internal as well as the international market), and the best instruments to achieve those aims. Besides, Member States are not always ready to secure the funding that would match their declared ambitions. Therefore, the road to more autonomous and greener European industry is bound to be a winding route marked by clashes with major trading partners and disagreements between Member States. The most immediate challenge for the EU institutions and Member States is to quickly conclude the budgetary negotiations, launch the recovery fund and ensure that it is invested in a way that contributes to a genuine modernisation of European industry.

The twin transition constitutes a daunting challenge for Poland. Several factors, such as reliance on coal for heat and electricity, a perennially underfunded research community, and the competitive advantage built around cheap labour, suggest that following the Commission's development path will demand considerable adjustments and investments. But the influx of money from the recovery fund provides a unique opportunity to accelerate transformation of the energy sector. Poland could also benefit from the relocation of production activities to Europe, especially in areas such as the pharmaceutical industry, which can work closely with advanced research and provide a stimulus to the innovative sector. Given the growing importance of technological innovations, a thorough assessment of the education system would be needed, with a view to making it capable of providing a qualified workforce for the increasingly digitised economy.[17]

[17] According to the March industrial strategy, there are currently 1 million vacancies in Europe for digital technology experts.