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LUHNIP Monthly Brief on EU Industrial Policy

December 2023

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Every month, LUHNIP's Monthly Brief on EU Industrial Policy provides a bullet-point recap of the month's main events, followed by three reasoned deep dives into significant developments of EU Industrial Policy. Our analysis is complemented by a monthly guest contribution from renowned experts or practitioners in the field.

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Last Month in Brief

- 5-6 December: EU-China Summit in Beijing (**see Deep Dive 1 below**)
- 8 December: The European Parliament and the Council of the EU reach a political agreement on the Artificial Intelligence Act (**see the Monthly Guest Contribution**)
- 12 December: The European Parliament adopts the provisional agreement on the Critical Raw Materials Act
- 13 December: the Council of the EU and the European Parliament reach a provisional agreement on corporate sustainability due diligence directive
- 14 December: The Council of the EU and the European Parliament reach a deal on European electricity market reform (**see Deep Dive 3**)
- 14-15 December: the European Council meets in Brussels to discuss, among other things, the mid-term review of the Multiannual Financial Framework (MFF) (**see Deep Dive 2**)
- 18 December: The Council of the EU and the European Parliament reach a provisional agreement on emission limits for road vehicles (Euro 7 standards)
- 19 December: European energy ministers meet in Brussels to discuss the extension of the emergency measures adopted to tackle the energy crisis
- 31 December: the Spanish presidency of the Council of the EU ends

LUHNIP's Deep Dives

1) The outcome of the 24th EU-China Summit (December 7, 2023)

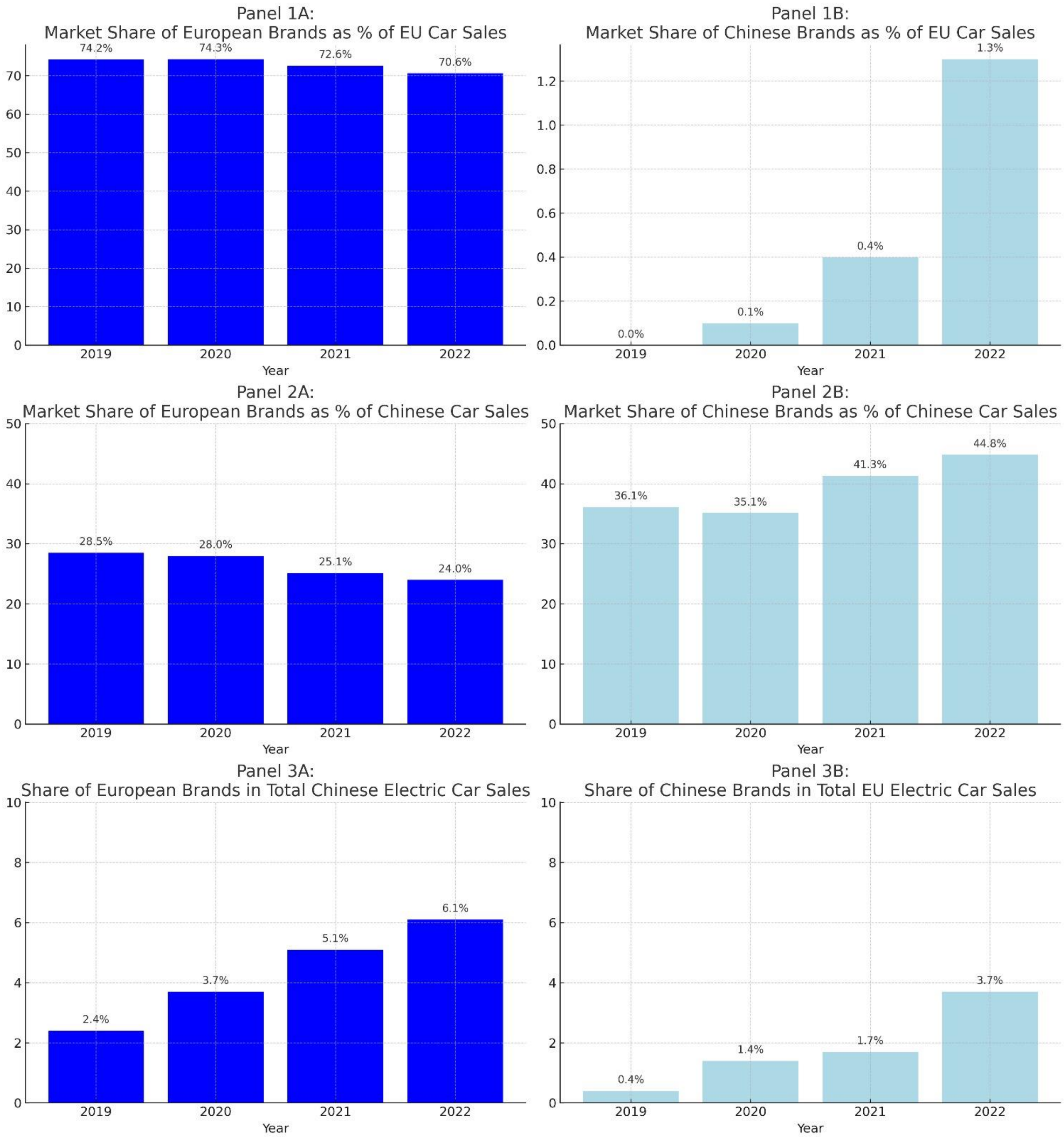
The representatives of the European Union (Charles Michel, Ursula Von der Leyen and Josep Borrell) and China (Xi Jinping and Lian Qiang) met last December 7 in the framework of the 24th EU-China Summit. This summit was organised against the backdrop of major tensions between the EU and China, marked notably by the Commission's recent launch of different trade defense actions against imports of Chinese industrial products and the EU initiatives to reduce technological dependence on China. Topics discussed at the meeting included trade issues (the EU's large trade deficit with China, European companies' poor access to the Chinese market, China's discriminatory industrial policy measures), the fight against the Russian invasion of Ukraine, events in the Middle East or the fight against climate change. On the subjects of trade and environmental policies, representatives of the European Union and China agreed on the need to pursue cooperation on these issues by relaunching in 2024 the High Level People to People Dialogue (HBBD), established in 2012, and continuing the work carried out in several existing joint working groups, such as those on custom and intellectual property rights or export controls.

LUHNIP's take

Despite the salience of trade disputes between China and the EU, the EU-China summit of last December 7 did not result in the adoption of any new agreements or guidelines to resolve the various ongoing conflicts between the two powers. The summit appeared to be no more than an exercise in demonstrating that political dialogue was continuing between the EU and China, and that the technical work addressing the opening of the Chinese market had made several advances and would continue. The results of the last EU-China Summit are therefore similar to those of the summit between Biden and Xi Jinping last November 15. Despite these positive political statements by Chinese and Western leaders, the confrontation over industrial and trade policies between the different powers is set to continue in 2024. The European Commission is preparing a new package of measures to strengthen its economic security, particularly with regard to China, and has announced a new antidumping investigation on biodiesel imports from China on December 20, 2023. The leaders of the Chinese Communist Party, for their part, have announced that they will continue to reinforce their national value chains and restrict the export of a series of technologies linked to the extraction of strategic metals for the digital transition.

One of the major trade conflicts between China and the European Union that is also likely to continue into 2024 concerns the question of heavy subsidies by the Chinese government for the domestic electric vehicle industry. Last October 4, the EU launched an anti-subsidy investigation into China's electric vehicles industry in the hope of preventing European carmakers from being priced out of this fast-growing market by rising Chinese competitors backed by government subsidies. The EU is particularly concerned about not repeating last decade's disruption that was brought upon Europe's solar industry by China's subsidized players – resulting in China becoming "the solar factory of the world." China's dominance in battery production presents a challenge to the European car industry as the Chinese electric vehicle industry is expanding at record pace, driven by fast-growing manufacturers like BYD and Chery.

Figure 1: Comparison between market share of European and Chinese brands in car sales



Source: our elaboration based on data from ACEA.

In this regard, data from the European Automobile Manufacturers' Association (ACEA) reveal some interesting insights:

1. If European brands remain dominant in car sales across the EU (Panel 1A), their EU market sales will decrease fast, while the market share of Chinese brands (Panel 1B) has tripled between 2021 and 2022 (beware of the differences in the Y-axes scales between Panels 1A and 1B when interpreting the figures);
2. European carmakers are rapidly losing market shares in China (Panel 2A), while the market share of Chinese brands' sales in the Chinese market is growing steadily (Panel 2B);
3. Regarding electric vehicles, the share of Chinese brands in total EU electric cars sales jumped from 0.4% in 2019 to 3.7% in 2022 (Panel 3B), signalling the steady expansion of Chinese electric cars in the European single market. European brands' sales of electric cars in China have also expanded, although at a much slower pace, reaching a total of 6.1% of market share in 2022 (Panel 3A).

2) The outcome of the last European Council meeting in Brussels and the political perspectives for 2024

Last December 14 and 15, the European Heads of State and Government met in Brussels for another European Council meeting. Topics on the agenda included the future of EU military support for Ukraine in the face of Russian aggression and the sanctions against Russia, as well as the mid-term review of the Multiannual Financial Framework (MFF). To weaken the Russian army, European leaders adopted the twelfth package of economic and individual sanctions, including the prohibition of re-exportation from the EU to Russia and for use in the latter of sensitive goods and technology which can be used by the Russian army. Also, it was decided to introduce import bans on liquified propane gas (LPG) and include Switzerland in a list of partner countries applying a set of restrictive measures on imports of iron and steel from Russia. At the same time, the European Council asked the Council of the EU to speed up its work on reforming the European Peace Facility (EPF) and increasing its funding. The objective is to better address Ukraine's defence needs by speeding up the supply of military equipment to Ukraine, the training of its soldiers and raising the financial ceiling of the EPF. Discussions on the mid-term review of the MFF were, for their part, blocked because of the Hungarian government's opposition to the inclusion in the MFF of a €50 billion budget to support Ukraine. This decision was taken despite the European Council Presidency's proposal to reduce the amount allocated to EU support for Ukraine in the MFF and other funds like the STEP (Strategic Technologies for Europe Platform) to satisfy the "frugal countries". Following the failure of the December European Council to reach an agreement on the mid-term review of the MFF, Member States will try to reach an agreement on the subject at their next meeting on February 1, 2024.

LUHNIP's take

The outcome of the European Council meeting shows the robust determination of European leaders to continue strengthening their strategic autonomy in the field of defence and to support the Ukrainian people against Russia's aggression. The aim was to show that despite the "war fatigue" affecting the different Member States after Russia's invasion of Ukraine, the European Union has maintained its policy of strong support for the Ukrainian army and the weakening the Russian war machine. However, the adoption of a substantial budget to develop the European defence industry and support the strengthening of the Ukrainian army's military capacity took place together with the reduction the EU's budget for the development of strategic technologies for the twin transition. As the following table shows, the proposed budget allocated to the Strategic Technologies Platform has fallen in the space of a few months from 10 billion euros (in the Commission's proposal for a regulation to establish the STEP platform of June 2023) to 1.5 billion (in the Presidency of the European Council's MFF 2021-2027 Negotiating Box). According to a number of experts and politicians, if this proposal is finally adopted at the next European Council meeting, the European Union will not be able to achieve its objectives in terms of strategic autonomy and climate transition.

Table 1: Comparison between the Commission's initial proposal and the European Council Negotiating Box

EU Strategic Priorities	Commission's initial proposal (June 2023)	European Council Negotiating Box (December 2023)
Support Package for Ukraine	50 billion	50 billion (17 grants + 33 loans)
Migration and External Challenges for the EU	15 billion	9.6 billion
STEP (Strategic Technologies for Europe Platform)	10 billion	1.5 billion (allocated to the European Defence Fund)

Source: European Commission, SWD(2023) 336 final, Mid-term revision of the multiannual financial framework 2021-2027, 20 June 2023; European Council, EUCO 23/23 CO EUR 18, European Council meeting (14 and 15 December 2023) – Multiannual Financial Framework 2021-2027 Negotiating Box, 15 December 2023.

3) The agreement of the European Parliament and the Council of the European Union on the reform of the European electricity market

Last December 14, the Council of the EU and the European Parliament reached a provisional agreement to reform the EU's electricity market design (EMD). Afterwards, a provisional agreement between the two institutions on the regulation to improve the EU's protection against market manipulation through better monitoring and transparency (REMIT) was reached on December 16. The improvements of the EMD and the REMIT form the two pillars of the reform of the European electricity market proposed by the Commission in March 2023. The latter aims to improve the functioning of the European internal energy market for consumers to juggle price rises during energy crises, to secure energy supply, but also to facilitate industry investment in clean technologies to reach the objectives of the European Green Deal. The structural reform of the EU electricity market had been a constant demand of European leaders since Russia's invasion of Ukraine in February 2022 because of its significant effects on energy prices and the need to reduce the EU's dependence on Russian fossil fuels.

The provisional agreement between the Council of the EU and the European Parliament to reform the EMD gives Member States the option to exclusively support the purchase of new renewable generation in line with their decarbonisation plans and after an assessment from the EU Agency for the Cooperation of Energy Regulators (ACER). On the other hand, the agreement gives the Council the power to declare an electricity price crisis based on a Commission proposal. Also, the agreement provides measures to protect vulnerable and energy poor consumers, such as the obligation for Member States to encourage regular meter readings or the ban on unilateral price increases in fixed-price or fixed-term contracts. Next, the agreement provides for the introduction of a potential and exceptional derogation from the application of the CO2 emission limit for already authorised capacity mechanisms, when justified. This allows the national gas and coal-fired power plants to be subsidised until 2028. This provision represents a victory for Poland, France and Bulgaria. Finally, it was agreed that Contracts for Difference (CfDs) could cover investment in existing nuclear power plants. This had been a strong demand of the French government from the start of the negotiations on the reform of the EMD, in opposition to the European Parliament, which feared that this measure would distort competition in the single market. At the same time, the provisional agreement between the Council of the EU and the European Parliament requests that Member States encourage the use of power purchase agreements. However, these should not "encourage in particular" renewable energies, as requested by the European Parliament.

LUHNIP's take

The provisional agreement reached by the Council of the EU and the European Parliament on December 14, 2023 marked an important step in the legislative process initiated in March 2023 to reform the European electricity market. This reform will have both economic internal consequences and political external effects. On one hand, the economic repercussions will be multiple at the level of consumers and firms, as it will transform the way Europeans consume energy and produce. The EU industrial policy will be closely affected by this provision, as industries will have to change their energy supplying, embracing more and more the renewable energies. In the same way, consumers will be more protected from price spikes, but will also have to make choices that will shape the electricity market and various economic sectors. On the other hand, the external political consequences are linked to the EU's common stance in freeing itself from energy dependencies on Russia. It is a clear example of how EU internal objectives, in this case of green transition and consumer protection, go hand in hand with its external action goals. By strengthening its internal energy market, the EU also reinforces its stance against Moscow by further cutting its energy dependence. Finally, the agreement of the European Parliament and the Council of the European Union on the electricity market reform shows how difficult it will be for the EU to achieve its energy transition targets, given the different national energy mixes and the presence of important fossil fuel producers like Poland.

*** Guest Contribution of the Month ***

Prof. Maria Savona

Maria Savona is Professor of Economics of Innovation at the Science Policy Research Unit (SPRU) at the University of Sussex, UK and Professor of Applied Economics at the Department of Economics and Finance at LUISS University, Rome. She coordinates the Industrial Policy Area within LEAP. She has been awarded the Linceo Prize for Economics in 2023 by the Italian Academy of Lincei. She is a former member of the High-Level Expert Group on the Impact of Digital Transformation on EU Labour Markets for the European Commission. She is the coordinating editor for the journal Research Policy.

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Economists of innovation know too well that the governance of emerging technologies to prevent potential side effects of uncontrolled developments usually requires more time than firms need to enter those markets. The unprecedented pace of development of digital automation technologies and artificial intelligence (AI) makes the formulation of digital industrial policy and AI governance challenging from two perspectives.

The first one is techno-legal and concerns the pervasiveness of AI applications and the need to regulate them in very diverse realms. The second one is geopolitical and specific to AI, which seems to have sparked a wave of "new protectionisms" and ensuing tensions among China, the US and the EU, on pretty much every aspect related to digitalisation, from domestic chip making to digital trade and cross-border data flows.

The European regulatory framework of emerging technologies has traditionally been at the forefront of what has been named the "Brussels effect". When the GDPR (the General Data Protection Regulation) became law in 2016, US tech giants had to comply, and several governments chose to align themselves on main principles and rules to protect citizens' privacy and digital rights more broadly. It will be interesting to see whether the EU AI Act, once it becomes law, triggers the same effect. A few considerations are in order.

First, since the GDPR, the development of AI applications, the market concentration and the lobbying of US Big Tech now require articulated and comprehensive governance of data and AI that goes well beyond individual privacy protection. The version of the AI Act discussed in the EU Parliament last December includes not only a systematisation of high-risk cases, such as predictive police, social scoring, and algorithmic management in workplaces, but also an attempt to regulate foundational models such as LLMs, sparking much debate in the case of generative AI such as ChatGPT. As it has been pointed out, the regulation of foundational models is at the root of AI governance, and this is essentially what will be at stake over the next few years.

This opens up a Pandora box and leads to my second point: there seem to be hints that the US is moving closer to the EU's regulatory framework on AI challenges that have emerged very recently. One of the issues at stake is the alleged copyright infringement on digital texts copied from the web and used to train LLMs and generative AI. Recently, the New York Times has filed a complaint against OpenAI-Microsoft. In this instance, the complaint crucially goes beyond the infringement of copyright law and lays down the case for regulating AI more broadly, borrowing much of the thrust and the principles of risk-adverse and rights-preserving the EU AI Act. It raises concerns that touch upon misinformation, the protection of human creativity, the social value of professional and truthful journalism, as well as democracy itself. A highly reputable US company is suing a priorly non-profit and now for-profit billionaire US company.

A further instance where the US has moved quite unexpectedly toward the EU regulatory framework is in the sudden change of its position on digital trade. The US has announced last month that it was withdrawing its position on digital trade from the WTO to allow for stronger regulation. This might certainly be in line with the protectionist strategy in the context of geopolitical tensions mentioned above and the wish to maintain the US forefront position in the global AI race. However, it is not inconsistent with the Biden administration's Blueprint for an AI Bill of Rights.

In sum, the EU AI Act might still not be an optimum and would require further debate and public scrutiny. However, it might lead to a new wave of the Brussels effect, as the governance of AI and data is and will increasingly be challenging. As I have argued elsewhere, one of the challenges of AI and data governance is to reconcile often conflicting objectives: to create (and maintain) incentives to maximise data sharing for purposes of public interest, such as health or research; to limit the concentration of private value arising from (involuntary or voluntary) data collection and analytics as in the case of LLMs training; to protect privacy and other rights such as copyright in a context where human creativity (still) has a social value.