

Industrial policy for quality jobs and a just transition

Plotting a route through the fiscal and geopolitical trap

Béla Galgóczi

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is a senior researcher at the European Trade Union Institute (ETUI) in Brussels.

Key messages

- Achieving the prospective 2040 climate targets proposed by the European Commission demands that the pace of decarbonisation be stepped up. This will require the European Green Deal to have dedicated industrial policies and a stronger social dimension.
- Setting the European economy on a viable pathway towards net zero not only needs industrial policy targets but also sufficient financial resources to achieve them.
- Industrial policy has a key contribution to make to ensuring that the digital and green transitions are just transitions, with support for, and the creation of, quality jobs being a paramount consideration.
- Industrial policy must create a level playing field in terms of environmental and labour standards and protect industries in the European Union (EU) from unfair competition. It also needs to mobilise massive investment to scale up low-carbon technologies and innovation.
- Tight fiscal rules and the deadlock on an increase in EU resources seems to lead to incremental adjustments, resources being scraped together from existing EU funds and an excessive reliance on the mobilisation of private investment.
- This practice will not result in closing the investment gap but could end up in industrial policy being driven by the competitiveness agenda and dependent on state aid, flexibilisation and deregulation, all of which undermine labour standards and put pressure on wages and working conditions.

This policy brief makes the case that such a worst-case scenario must be avoided and sets out recommendations for the next EU political cycle.

Introduction

While a European industrial policy framework should encompass all economic activities, including public and private services, to ensure quality jobs in all sectors, the focus of this policy brief will be on having a strong, competitive, low-carbon industrial base. Future-proof industries are vital for economic and social resilience and are expected to provide millions of well-paid, high-quality jobs. Industrial policy can play a crucial role in reaching the EU's net-zero climate targets and in managing the digital transition while it should also ensure that the digital and the green transitions are fair and just, maintaining and creating quality jobs.

Given these challenges, the attention of policymakers is turning towards industrial policy and competitiveness as the main avenues for the next stage of the European Green Deal (EGD). European Commission President von der Leyen has already called, in her 2023 State of the Union address, for industrial policy to be the next phase of the EGD.

A revival of industrial policy has been on the European agenda for quite a while, first with the 2014 Communication 'For a European industrial renaissance', followed by the 'European new industrial strategy' in 2020 as part of the green and digital transitions. The urgent need to have a functioning industrial plan for the zero-carbon age has, however, only appeared after recognition of the geopolitical pressures posed by the war in Ukraine and then by the US Inflation Reduction Act (IRA). At the same time, China's ongoing control of critical raw materials and its dominance of key clean industry segments have also become apparent. Increasing the pressure, China launched its new ten-year industrial strategy 'New Quality Productive Forces' in March 2024, mobilising massive resources and aiming at technological leadership while building up overcapacities.

In response, the Commission presented its Green Deal Industrial Plan (GDIP) with the objective 'to enhance the competitiveness of Europe's net-zero industry and support the fast transition to climate neutrality'. This consists of the Net-Zero Industry Act (NZIA) and the Critical Raw Materials Act (CRMA) with an amended Temporary State Aid Crisis and Transition Framework and the Important Projects of Common European Interest initiative. The Commission also proposed setting up a European Sovereignty Fund to support Member States with lower means to invest, before backing away from it and presenting a much downscaled version in the form of the Strategic Technologies for Europe Platform (STEP).

These last ten years show that, while China moved early and fast to establish a strong low-carbon industrial base and the US woke up later, but acted decisively, Europe is still looking for the right measures. The 2014 document 'For a European industrial renaissance' proposed modernising Europe's industrial base, seeking to secure access to energy and raw materials at affordable prices, and combining EU and national funding to pursue innovation, investment and reindustrialisation goals. Nevertheless, the EU continued to rely on Russian oil and gas even after the Russian annexation of Crimea in 2014. It was only the

GDIP, in 2020, that narrowed the focus to clean, low-carbon industries, while it was 2023 before the NZIA finally reflected on the (geopolitical) urgency, in a context in which the general objectives set out in 2014 were still unrealised.

During this decade, the situation of European industry in the global context has only aggravated, with mounting concerns about deindustrialisation.

The next sections consider the EU's current industrial policy framework, address the main challenges EU industry is facing in the transition to net zero and conclude that, while the objectives and targets are set, the route to achieving them remains unknown. Policy recommendations are then made which attempt to bridge this gap.

Signs and concerns of deindustrialisation

Between 1990 and 2021, industry contributed to European climate policy targets by reducing greenhouse gas emissions by 43% compared to the 30% achieved across the EU27 economy as a whole (Eurostat 2023). In the same period, the share of manufacturing in EU GDP shrank from 19.7 to 14.9% (World Bank n.d.).

Beside this fall in the share of manufacturing in the EU economy, significant output loss in 2023 raises further concerns about Europe's deindustrialisation. According to Eurostat (2024), by November 2023 industrial output in the EU27 was down by 5.8% compared with November 2022. As regards manufacturing jobs, Eurostat sectoral data (lfsq_egan2) reveal a loss of employment in the EU27 from 34.3 million to 30.7 million between 2008 and 2010, followed by a 1.25 million increase by 2019, shedding again 550 thousand jobs in the last four years to reach 31.4 million by the end of 2023.

The International Energy Agency (Zeniewski et al. 2023) establishes that shrinking industrial activity has played a role in delivering REPowerEU gas demand reduction targets. Accordingly, in 2022 nearly half of total gas demand reduction in the EU was delivered by industry, half of which came from the curtailment of production.

While EU policy has repeatedly stressed the need to maintain a strong industrial base in Europe, these trends show that this has been eroded in the past decades. The main reason is not decarbonisation but two-fold: the collapse of traditional industries in central-eastern Europe in the 1990s; and the effects of the 2008 financial crisis.

Decarbonisation itself will also not be a job killer for the energy-intensive industries of the future (Kiss-Dobronyi and Fazekas 2022). The actual effects will depend on several details, from financing and technology solutions to compensation mechanisms and support. Among the three main decarbonisation scenarios, employment loss under the circular economy pathway is estimated as highest, to somewhat over 1% by 2030 and to 2.4% by 2040.

The main question is how to avoid deindustrialisation in the future. *For this, the crucial question is how well prepared European industry is for the zero-carbon age.* Decarbonisation needs enormous investment in manufacturing processes and in industrial infrastructure, with deep restructuring at production locations and across value chains. European industry is also facing enormous

challenges in international competition, with trade and industrial policy battles for clean industry sovereignty.

The material inputs in a green economy will be much smaller than those in a fossil fuel-based economy, even if the need for essential materials for the green transition will grow (Atlantic Council 2024). While decarbonisation has significant upfront investment costs, it will reduce material dependence and free up huge resources in the future. This in itself makes it clear that investment in the green economy has high and secure returns; tapping these future savings by issuing debt for investment in renewables is thus a win-win strategy.

There are three main industry policy challenges that the EU faces in securing strategic autonomy and resilience in the process of the green transition: a weak geopolitical position; paralysing fiscal rules; and fragmentation and a lack of collective action.

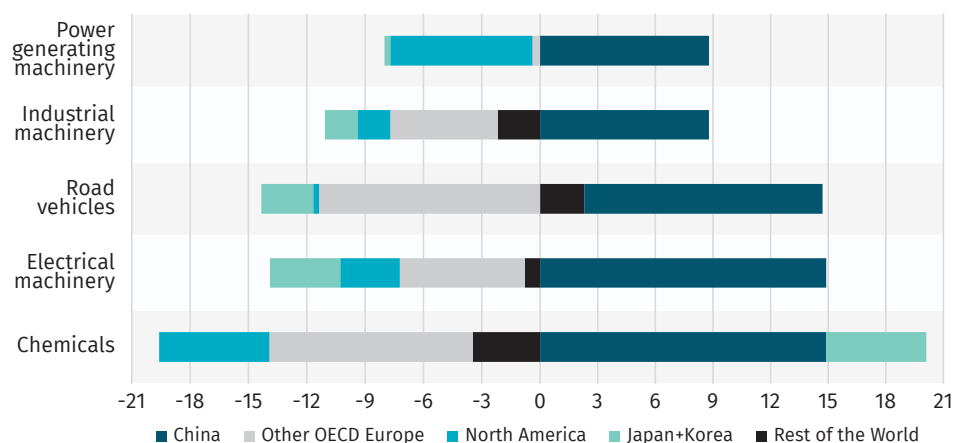
Weak position in the global low-carbon race

EU industry finds itself in a vulnerable international situation amidst the rivalry between the US and China. Europe is under pressure from both sides.

The asymmetry in the trade of goods with China is striking. Eurostat data show that, in 2023, while China made up 8.8% of EU goods exports, the share of China in total EU imports was 20.5%.

Figure 1 shows that EU imports from China in industrial product groups grew significantly over the 2018-22 period: up by 8% in power generation machinery and by 15% in road vehicles, electrical machinery and chemicals.

Figure 1 **Change in EU imports from world regions by key product groups between 2018 and 2022 (%)**



Source: Romei (2023) based on OECD data.

At the same time, the second big concern for the EU is the effects of the US IRA and the CHIPS and Science Act that are intended to boost US low-carbon industries. It is estimated that the IRA's upfront investment tax credits could lower investment costs for renewable energy technologies by up to 70% as well as halve the generation costs of onshore wind and solar energy, while stimulating both local and foreign investment in US-based decarbonisation. The IRA also

provides targeted domestic content tax credits for US-based companies to produce iron and steel for renewable energy projects within the country, raising concerns about diverting investments from Europe toward the US.

If this combination of tax credits and domestic content rules means that the US is sucking in private foreign capital, China is amassing huge resources to build significant overcapacities in clean technology in the next decade (in the case of batteries, more than quadrupling its current capacities).

Chinese companies dominate the resource and manufacturing supply chains, as well as the overriding technologies, which are crucial not only for electric vehicles and batteries but also for wind and solar energy.

China’s dominance in global electric vehicle supply chains ranges from 60% in battery manufacturing and 75% in lithium refining to 85 and 90% in electrolytes and anodes (ECA 2023).

As Table 1 shows, Europe’s own current manufacturing capacities in renewables are a fraction of what is needed to achieve its 2030 targets. While several EU industrial policy initiatives have announced ambitious targets for EU content in strategic manufacturing segments, the resources to achieve these have not been secured.

Table 1 **Current EU manufacturing capacity (2022) and 2030 goals**

	EU’s current annual manufacturing capacity	Annual manufacturing capacity needed to meet 2030 EU target	EU manufacturing share in meeting the 2030 target
Wind	13.6 GW	37 GW	36.7%
Battery cells	75 GWh	549 GWh	13.6%
Solar PV	1 GW	30 GW	3%

Source: European Council (2023).

There is major concern that the key industry segments for the green transition are in a weak and vulnerable position in the context of this fierce international competition.

Lack of fiscal space is the main hurdle

The EU needs to speed up green investment not only to meet its own climate objectives but also to face the challenge of increased international competition for green manufacturing. In 2021, the Commission calculated that, in order to achieve the EGD objectives, additional investment of 520 billion euros per year would be needed.

The average yearly investment need is at least 813 billion euros (5.1% of EU GDP) if the 2030 EU climate targets are to be met (I4CE 2024). Given the current level of investment, the yearly European climate investment deficit is thus estimated at 406 billion euros. Industry makes up a significant share: wind energy deployment would need 74 billion euros extra yearly investment, electricity grids 40 billion, electric cars 79 billion and heat pumps 37 billion.

The New Economics Foundation (NEF), jointly with the ETUC (2024), estimates that only Denmark, Ireland and Sweden would be able to create

adequate fiscal space to cover climate and social investment gaps under prevailing EU fiscal rules.

It is Europe's fiscal straitjacket that is the main blocking factor in achieving the 2030 decarbonisation targets laid down in the EGD and REPowerEU. This remains the case even with the reformed risk-based framework for fiscal rules that took effect from April 2024. While reference is made to the European Pillar of Social Rights, energy security and defence spending, all these have to be compatible with the net expenditure set out in fiscal structural plans. On the positive side, national cofinancing of EU projects will not be accounted for in deficit calculations.

Although this new EU fiscal framework provides some incentives to raise public investment, it creates new pressures on 'non-investment' budgetary categories and severely constrains vital public spending, such as social expenditure, especially in high-debt EU countries.

Furthermore, the report by Enrico Letta (2024), former Prime Minister of Italy, on the future of the Single Market stated that common strategic goals need common EU funding. Currently, a part of the energy transition investment needs of Member States is being cofinanced by the Recovery and Resilience Facility (RRF) within NextGenerationEU (NGEU). This ad hoc instrument for cofinancing the green transition is available only until the end of 2026 and there are, as yet, no specific plans for a follow-up scheme. Given the stiffening fiscal rules that remain in place, one viable option to make industrial policy initiatives work would be to establish a follow-up NGEU 2.0 instrument.

Fragmentation of interests and lack of collective action

The EU has limited capacity for policy direction and regulation in some key areas (as for example taxation) where national competences are still predominant.

Unlike the US, where simple, upfront tax credits can make a business case and easily divert capital flows, this option is not open to the EU as a result of its lack of tax revenues. Instead, there are fragmented interests in many dimensions between Member States, regions and sectors, let alone a multitude of trade and investment partnerships and diverse energy and fiscal policies.

The relaxation of state aid rules under the GDIP to level the playing field between European companies on the one hand and Chinese and US companies on the other leads to unfair competition between Member States, some of whom can allocate more money than others to attract investment in green technologies. Recognising the investment gap and the difficulty of raising resources at EU level, Letta proposed a state aid contribution mechanism, but this alone will not solve the funding problem.

While public procurement is another important tool for industrial policy, and Member States are encouraged to go beyond 'price only' criteria during bids, there is a risk that Member States that must reduce spending under the fiscal rules will be under pressure. A revision of the public procurement directives is therefore even more urgent.

The need for a comprehensive and holistic policy framework

Given these challenges, policy gaps and shortcomings, recommendations for the next EU policy cycle are as follows.

Public policies at EU and national level have a pivotal role in setting up a comprehensive and holistic policy framework where climate, economic (fiscal, taxation), industrial, labour market and social policies build a coherent system. Policy instruments must also balance soft law and hard law elements, not with economic policies tending to be based on hard law and social policies more often on soft law. Policy tools must strike a delicate balance between regulation, market mechanisms, taxation and standard setting. Industrial policy should focus on innovation and investment in low-carbon technologies by mobilising investment and providing public funding for the necessary infrastructure while creating a level playing field in environmental and labour standards, also making sure that newly created jobs are quality jobs.

Bridging the investment gap with EU funding

Bridging the climate investment gap with EU funding is the most critical point as, without further funding, neither industrial policy nor just transition and social objectives will be achievable. Trying to address the investment gap, current policies aim at exploiting, reshuffling and re-prioritising existing EU funds (e.g. Cohesion Funds) and revenue sources (e.g. from the EU Emission Trading System and the prospective ETS2) but, given the lack of new resources, this patchwork approach will not solve the fundamental financing problem.

With the reform of the EU fiscal framework in place, the most viable way to secure EU funding for both industrial policy and just transition objectives is the creation of an NGEU 2.0 Fund. This could take the shape of a 1 trillion Climate and Social Investment Fund, secured via EU bond issuance covering both industrial policy and just transition objectives with the retention and creation of quality jobs in clear perspective. Although this Fund would be set up on a similar basis to the RRF, its operation would need to be based on social conditionalities. Furthermore, it should apply criteria and policies which address spatial and social inequality, while also being more decentralised and ensuring the involvement of the social partners.

Enhancing social and labour conditionalities

The US experience adds further evidence that, when coupled with social conditionalities, public investment is crucial in delivering an industrial policy that protects and creates quality jobs. The IRA mandates firms seeking tax credits to hire apprentices for at least 15% of the work, support unionisation and the payment of fair wages and set up in deprived or former fossil-heavy regions. The current EU industrial policy framework has no such criteria. It is therefore vital that it also applies strict social and labour conditionalities in public procurement, state aid and investment subsidies. Environmental conditionalities are likewise essential. It is particularly urgent to revise the public procurement directives to ensure that public money goes to organisations

that respect workers' and trade union rights, that negotiate with trade unions and whose workers are covered by collective agreements. Moreover, regional disparities and those between SMEs and large enterprises need attention. As industrial policies additionally address the demand side, securing the accessibility and affordability of green technologies is key.

Strengthening the participatory dimension

Principle 8 of the European Pillar of Social Rights highlights the need to promote social dialogue and the involvement of workers in social, economic and employment policies, and encourages collective bargaining. Facing the historic challenges of the just transition, the knowledge and experience of the social partners is indispensable in establishing transition plans that are just in outcome and in process. Collective bargaining must be strengthened to deal with these new challenges. Therefore, in the next legislature, the EU should:

- Develop a Just Transition Legal Framework at European level that guarantees the essential role of collective bargaining to anticipate and manage change and to maximise the transformative potential, while ensuring just transition and quality jobs.
- Take initiatives to facilitate labour market transitions, not least by ensuring the right to training without cost to workers and during working time, fend off the detrimental distributional effects of climate policies for vulnerable groups and make low-carbon and innovative technologies affordable and accessible to all.
- Ensure full respect for the right to collective bargaining based on the prerogatives of trade unions as the bargaining agent for workers, as recognised by the Directive on Adequate Minimum Wages in the EU.
- Take specific initiatives to support collective bargaining and social dialogue in Member States that do not yet have a strong framework.
- Empower the social partners to shape Europe's economic future.

Conclusions

Industrial policy for the net-zero age has two main functions: creating a level playing field in terms of labour and environmental standards to protect EU industry from unfair competition; and developing the EU low-carbon industry by boosting innovation and investment. By now, the EU has a well elaborated legislative framework setting concrete targets among others for renewable energy deployment, the decarbonisation of road transport and the energy performance of buildings. It has a new batteries regulation setting targets for collection, recovery and recycling, while the NZIA sets ambitious targets for Europeanising supply chains in green technologies.

The EU is, however, short of the policies and funding required to implement these targets and embark on a green industrial revival. The relaxation of EU rules on national state aid would have limited effect given the restrictive rules of the Stability and Growth Pact.

Keeping climate policy ambitions high intensifies the social effects of the transformation. This includes the differential distributional effects of climate

policies, labour market change and the accessibility and affordability of low-carbon technologies. All these contain different dimensions of vulnerabilities that are often cumulative and intersectional. Specific policies focused on the social impacts of climate change and the green transition were, however, only developed after the announcement of the EGD: first, the Just Transition Mechanism was established in 2020; then the Social Climate Fund in July 2021, coming into effect only from 2026.

This patchwork policymaking is far from the holistic, comprehensive approach that was supposed to be the basic principle of just transition. No direct link has been made with industrial policy, although industrial policy and just transition are deeply intertwined. If climate policy ambition is eroded and industrial policy fails to mobilise the necessary green investment, Europe will lose ground in clean technology development, putting millions of jobs at stake.

A serious climate ambition will have enormous effects on the world of work in terms of labour market transitions, skills development and plant-level restructuring. Industrial policy therefore needs to muster public resources, also at European level, build up the green industrial infrastructure and not excessively rely on private capital. It cannot be based deregulation or on putting pressure on wages and working conditions. It is also vital that workers have the right to contribute to managing this change with strengthened collective bargaining and stronger information-consultation practices.

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