

## Policy Position

# Energy-intensive industry should manufacture in Europe's most favourable locations

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#IndustrialPolicy

#Energy

#Relocation

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**The fear of deindustrialization looms over the European election campaigns. In addition to measures that reduce energy prices, Europe also needs a debate about industry relocation within Europe. Climate and competitiveness benefit when production within the EU is located where energy is cheapest. Necessary industrial subsidies should therefore be anchored at European rather than at national level.**

The spectre of „deindustrialization“ looms over the political campaigns for the EU election in June. Many political parties promise to safeguard the locations of energy-intensive industry by temporarily lowering high energy prices with subsidies. In the medium and longer term, they aim to reduce energy costs structurally by expanding cheap solar and wind energy.

However, these national strategies fall short if they only focus on lowering energy prices and thus attempt to prevent the relocation of energy-intensive industry completely. Instead, the EU and the member states should develop a joint strategy that does justice to the climate policy and economic complexity of the situation and includes the partial relocation of energy-intensive industry. Policymakers should actively shape this relocation to aid the European economy and decarbonization efforts.

**Many of the current production locations have permanently high energy prices**

Clean, cheap energy is unevenly distributed geographically. In many regions, solar and wind energy will remain a scarce and therefore expensive commodity, while in others there will be a surplus – simply because they have lots of sunshine and constant wind. Nuclear power will not be able to equalize prices either, as almost all studies predict that nuclear energy

will remain very expensive. Because transporting energy over long distances always incurs considerable costs, some regions in the EU will pay significantly more for energy than others in the future. This could only be prevented at high economic costs and inefficiency, for example by decoupling grid fees from the actual costs.

For the majority of industry, such energy price differences are not very significant, but for energy-intensive companies, a few cents more per kilowatt hour can make or break the viability of a production location. Unfortunately, a large share of existing energy-intensive industry is located in European regions with limited potential for wind and solar power. A pressure therefore exists for them to relocate – not just now because of the energy crisis caused by Putin, but also in the long term. Andalusia, for example, will simply be more attractive than Ludwigshafen in the future, at least for the energy-intensive industry.

### **Economically, relocation is manageable for the regions**

Energy-intensive sectors, which mainly include chemicals, paper, some metals such as steel and some basic materials such as cement, together account for only two percent of Europe's economic GDP and provide only about [two percent](#) of jobs. Even in Germany, Europe's industry powerhouse, they only account for 2.5 percent of GDP. And there is [very little evidence](#) for the indirect value they supposedly create for other parts of industry, for example due to cluster effects. It is likely that, in the medium term, most energy-intensive input products can be imported more cheaply, and do not have to be produced in close proximity. Countries could, hence, cope economically with decreasing production of energy-intensive industry without falling off an economic cliff.

### **Intra-European relocation helps climate efforts and the economy**

If national subsidies for the energy-intensive industry are not permitted, parts of the energy-intensive industry will give in to cost pressures and relocate from energy-poor to energy-rich regions. It would be very beneficial if this relocation took place within the EU for several reasons: First, the EU as a whole will be able to produce more cost-effectively and thus become more competitive internationally.

Second, it helps to achieve climate targets, as the decarbonization of energy-intensive industry, which requires large amounts of electricity, will be easier to achieve where clean energy is abundant. In addition, climate efforts will be aided in the regions from which industry is moving away, because scarce energy can decarbonize the transport sector or household heating, instead of being used for glass or paper production.

Third, in the absence of national energy subsidies, there are no distortions in the internal market in favor of the richer member states, which could afford expensive subsidies and, thus, retain industry. This would come at the expense of financially weaker countries, which often have better renewable potential.

### **Extra-European relocation harbours risks**

In view of these three positive effects, intra-European relocation should be promoted rather than combated. However, relocation cannot be controlled at the drawing board, and factories could also move to countries outside of the EU where production can be even cheaper. This would be problematic for two reasons: first, the vast majority of non-European countries will pursue less stringent climate policies in the foreseeable future and provide fewer subsidies for green industrial production. Consequently, relocation to third countries increases global emissions. Second, relocation of production away from the EU

could potentially increase „resilience risk“, i.e. cause a deterioration in security of supply and geoeconomic dependencies.

### **What measures should policy makers take now?**

First, European and national politicians must work hard to reduce structural energy costs in Europe, in particular by further improving the conditions needed for the expansion of renewables and storage capacities. In addition, electricity and hydrogen grids need to be expanded so that, for example, southern Italian sun can be used in Poland and Germany. Grid expansion must be tackled quickly, but should not exceed efficient levels. To take a previous example: Supplying entire German chemical plants completely with energy from Andalusia would entail enormous grid costs and not make economic sense. Structural measures to reduce energy costs alone will, therefore, not be enough to keep all factories in place.

In view of the high climate risk and potential resilience risk associated with non-European relocation, subsidies are therefore needed. However, in order to realize the benefits of intra-European relocation described above, these would have to be disbursed at European rather than national level, for example in the form of European Carbon Contracts for Difference. As a result, new investments would take place in Europe, but in the locations where it makes the most economic sense – not where national pockets are deepest.

However, EU funds are currently in short supply, and it will take political skill and time to get a European solution off the ground. The European Commission should therefore also temporarily allow national subsidies to avoid too much industrial expertise exiting Europe. However, a European approach must remain the goal, and national subsidies should be clearly communicated as a suboptimal interim solution.

The EU will only become carbon neutral and internationally competitive if it produces at the best European locations. Instead of romanticizing national industrial production, the upcoming EU election campaign needs a fact-based debate on the advantages of relocation within the EU.

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