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Policy Position

Chasing Shadows: What the Net Zero Industry Act Teaches Us About EU Industrial Policy

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#IndustrialPolicy
#NZIA
#GreenDeal

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The Net Zero Industry Act (NZIA) was touted as the EU's big response to the US Inflation Reduction Act. After a year of negotiations, it will finally hit the legislative books. In his policy position, Nils Redeker analyses what has become of the EU's green industrial policy ambitions, what the NZIA teaches us about Europe's role in the clean tech race, and what the next Commission needs to do to formulate a constructive answer to the global return of industrial policy.

The Net Zero Industry Act (NZIA) was touted as the European Union's big response to the US Inflation Reduction Act. A year ago, the Biden administration's new green subsidy program spooked the EU into a flurry of industrial policy announcements. Now, the political dust has settled, and the EU's main green industry initiatives will finally hit the legislative books. So, what has become of the EU's new green industry agenda, and what can we learn from it about Europe's role in the new global age of industrial policy?

The detailed answer – as always with the EU – is complicated. However, it boils down to a simple truth: The NZIA shows that the EU remains fundamentally incapable of formulating a constructive answer to the return of industrial policy for three reasons: First, the EU lacks the analytical capacity and political will to formulate meaningful industrial policy priorities; second, it does not have the regulatory levers to support selected industries; and third it lacks the financial firepower to leverage the scale of the European market and reach its goals without hurting fair competition.

Lacking Strategy

The first issue is that the NZIA lacks a strategic focus. Targeting the right sectors and technologies is crucial for the effectiveness of any industrial policy that aims at changing the composition of the economy in the service of political goals. Yet, one year in, the NZIA's criteria for such selections remain unclear. The act officially aims at "accelerating the development and production of net-zero technologies" to increase the "competitiveness and resilience" of the EU's green industrial base. Putting this goal into a practical strategy would require answering difficult questions. Which technologies and sectors are under real pressure from foreign competition? Where does the EU already have a competitive edge that warrants temporary defense and where would domestic production require permanent subsidies? And where is the risk of sudden import stops so acute that building up domestic production should take priority over the goal of fast and cheap deployment of clean (imported) technologies?

The Commission's initial proposal largely dodged these questions. Instead, it established the goal for the EU to achieve a domestic manufacturing capacity that meets at least 40% of its annual deployment needs for a list of eight key technologies by 2030. This list included sensible areas in which the EU already adds significant value through leading manufacturers such as the wind component industry. However, it also contained domestic production goals for cheap mass-produced goods such as solar cells in which the EU lacks a competitive industry base.

The political negotiations with member states and the European Parliament did not add much nuance to these goals. Instead, they appended the original shopping list with some more technologies, added the goal to reach a world market share of 15%, and clarified that the production targets could also be reached for net zero technologies as a whole instead of aiming for the benchmark in every single sector. To be clear, this softer benchmark is an improvement over the attempt to micro-manage sectoral output goals. However, the overall picture remains unchanged: the EU currently lacks the analytical capacity and strategic political will to decide where in the global green tech race it can and wants to set its mark. An industrial strategy that aims to do everything, is unlikely to achieve much.

Lacking Tools

Second, the NZIA lacks convincing regulatory tools to reach its goals. The legislation puts a lot of emphasis on cutting red tape and speeding up permitting procedures for clean tech manufacturing projects. It prescribes maximum permitting times for manufacturing projects in net-zero industries (between 6 and 18 months, depending on the size and sector of the project). It encourages member states to give such projects priority status in judicial and dispute resolution and it asks governments to provide authorities with some extra discretion in planning procedures by declaring net-zero projects to be in the public interest. The act also introduces the option to establish the so-called net-zero industry valleys in which new clean tech industry clusters could benefit from even faster regulatory treatment. Bureaucratic streamlining is certainly commendable. Especially for the deployment of renewable energies, lengthy notification and permitting procedures constitute a central drag on the transformation.

However, when it comes to manufacturing projects, the NZIA's strong focus on speeding bureaucratic procedures looks more like a solution in search of a problem. Permitting times in industry are already shorter than in deployment, they do not seem to be the main driver of the lead times for project planning and there is little evidence that companies currently perceive permitting to be the key bottleneck in their investment decisions. So, while the goal of lowering bureaucratic hurdles could help on the margins, it is unlikely to result in a major boost for the industry.

The more important question, therefore, is what support the NZIA and the Green Deal Industrial Plan deliver beyond regulatory streamlining. The short answer is not much. The most tangible measure is that the NZIA nudges member states to use their public contracting systems more strategically. The act introduces new non-price criteria for net zero technologies in public procurement procedures, renewable energy auctions, and other support schemes. So, member states should not simply look for the cheapest bidder when they go into the market for clean tech products. Instead, they should make sure that providers fulfill minimum requirements on things like cybersecurity or environmental standards and most importantly do not rely too heavily on a single country of origin for their supplies.

In theory, these provisions could have been an important lever. The public sector is an important market for many clean technologies, and non-price criteria can be designed to privilege EU producers or even effectively bar Chinese imports from say renewable energy auctions. However, in practice, the new measures are unlikely to become a "Buy European clause" in disguise. Member states already had the option to introduce more stringent environmental or social criteria in public procurement systems before the arrival of the new act. They tend not to use it much for the obvious reason that it would make buying clean tech more expensive for taxpayers, hamper the deployment of clean technologies, and slow down the green transition. The NZIA will not force governments to change this.

Most importantly, it still allows member states to ignore resilience criteria if they result in disproportional costs, defined between 5% and 20%, depending on the scheme. In those sectors where Europe is currently lagging, such cost gaps are common. As a result, the NZIA criteria are unlikely to be applied much unless member states really want to change their approach.

Lacking Money

This brings us to the last point. The EU lacks the financial means to underwrite its industrial policy goals with actual money. The Commission initially planned the NZIA to work in tandem with a new European Sovereignty Fund. The idea always remained rather vague but should have offered direct EU-level support for strategic industries, coordinate investments across the continent, and prevent unfair subsidy races between member states. It never materialized mostly because the Commission quickly discovered member states' appetite for it was limited. National budgets were strained, member states did not come forward with concrete ideas for new projects, the Commission was unable to put a convincing price tag on its industrial policy ambitions, and there was still enough money around from the Recovery and Resilience Facility to cover the most pressing investment needs.

In a big climb-down from its initial plans, the Commission in the end proposed a small new Strategic Technology for Europe Platform (STEP), which largely rehashes funds from the existing EU budget and was shrunk even further in negotiations with the Parliament and the member states. The Commission wants the acronym of the platform to be read as a not-so-subtle-hint that it has not entirely given up on the idea of a real fund for the future. However, for now, the European level lacks the money to back up its industrial policy ambitions. This also means that any meaningful financial support for industries will come from national state aid with all the negative side-effects this has on the ability to scale and coordinate projects and on economic cohesion and fair competition in the single market.

High Time to Prioritize Industrial Policy

So, where does this leave us? The US Inflation Reduction Act and Chinese state subsidies challenge the EU's clean tech ambitions. With the Green Deal Industrial Plan and the NZIA, the EU had, at least on paper, decided to play ball. However, in practice, the initiatives have become a shadow of what was announced. The fact that the need for an industrial strategy is already turning into a campaign hit for the European elections shows that having an industrial policy in pretense will not suffice. The EU needs a more fundamental rethink on how it can build the analytical, governance, and financial preconditions to deal with the reality of a global return of industrial policy in a strategic, modern, and forward-looking way. The NZIA saga shows that solving this conundrum will not be easy, but it should rank high on the agenda of the next Commission.

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