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Aid and Abet? The Role of State Aid in Shaping EU Industrial Policy (And its Limits)

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Recently, the European Union's industrial policy has undergone a renaissance. Faced with mounting geopolitical uncertainties, increased global competition, and the urgency of "twin transitions" (digital and green), the EU has identified a pressing need to bolster strategic sectors, accelerate innovation, and ensure resilience within the internal market. The Letta and Draghi Reports can vouch for that.

At the same time, State aid control, a cornerstone of EU competition policy, has undergone a remarkable evolution as well. Traditionally aimed at preventing market distortions through Member State subsidies, the EU's State aid regime has shifted from a rigid prohibition-based approach to a more flexible compatibility model. This shift has positioned State aid to accommodate the EU's industrial-policy ambitions. By leveraging compatibility instruments such as the General Block Exemption Regulation (GBER), Important Projects of Common European Interest (IPCEIs), and a succession of temporary crisis frameworks, the European Commission now helps direct national subsidies into areas of strategic interest. This shift reveals how State aid rules are evolving into a deliberate coordination framework for industrial policy priorities, even as it raises questions about market fairness, the balance of power between the EU and Member States, and the practical and legal limits of the EU's approach.

Below is an overview of this evolution, focusing on what industrial policy entails at the European level, how State aid law has shifted toward an "authorization model," and what the implications are for market integrity, national autonomy, and the future of EU industrial strategy. More in-depth analysis can be found in a working paper (here).

EU Industrial Policy: where to start and where to close?

Within the EU, industrial policy straddles a difficult line between supranational and national competences. The EU has a long history of industrial policy ambitions, stretching back to at least the 1970s with the Colonna Memorandum. The formal inclusion of an industrial policy title in the Treaty of Maastricht codified the EU's role, but real momentum accelerated with the 2005 Communication "Implementing the Community Lisbon Programme," then the Europe 2020 Strategy, and more recent frameworks, such as the 2020 "New Industrial Strategy for Europe" and

its updates. These policy papers consistently stress the importance of, e.g., environmental and energy transitions, digital transformation, R&D&I, or strategic autonomy and resilience.

Despite these aims, EU industrial policy remains somewhat fragmented, consisting of multiple overlapping instruments and communications rather than a single, unified strategy. Currently, industrial policy lacks a single, legally binding framework. Article 173 TFEU would provide a legal basis for a common industrial policy, aiming to speed up structural adjustments, foster innovation, and improve competitiveness across Member States. However, it also makes plain that any EU-level industrial policy should not introduce measures that unduly distort competition. This tension – promoting EU-wide industrial aims while preserving a level playing field – lies at the heart of how State aid control now operates.

How the transformation of EU State aid control led to include industrial policy aims

Since its outset, State aid law and policy has shifted considerably. One the one hand, case law from the EU courts has consistently applied a functional, wide-ranging interpretation of what counts as "aid". On the other hand, this development coincides with a shift in the compatibility assessment of aid. In particular, State aid policy has shifted towards enabling certain types of aid in pursuit of broader EU objectives or priorities. The State aid treaty compatibility criteria are often viewed through secondary legislation and "soft law" instruments. Through these instruments, the Commission can delineate "good aid" that aligns with broader EU goals. The detailed rules for environmental protection and energy (CEEAG), R&D&I, broadband networks, for example, define how aid can be assessed to ensure it addresses clearly stated public objectives, to just name a few examples.

In that sense, state aid compatibility control now increasingly functions as a quasi-industrial policy tool, directing national subsidies toward EU priorities, in the absence of other proper industrial policy measures. By identifying which types of subsidies qualify for simplified or pre-approved procedures, the Commission effectively incentivizes Member States to direct their industrial-policy funds toward those areas deemed priorities at the EU level. IPCEIs perfectly illustrate this dynamic. As large-scale projects requiring at least four Member States, IPCEIs address strategic areas (e.g., batteries, hydrogen, semiconductors) where investments are risky, costly, and require cooperation across borders. When such projects align with common priorities, the Commission's IPCEI Communication sets out criteria ensuring that any granted subsidies bring benefits extending well beyond national boundaries. While they distort competition to some degree, the Commission balances this distortion against the broader economic, technological, and societal gains.

Up and downsides of such an approach

Obviously, some advantages come with doing industrial policy via the State aid tool. A key reason why State aid has become central to EU industrial policy is the Union's limited budgetary clout. Although programs like Horizon Europe, InvestEU, and the Recovery and Resilience Facility offer important funding, they cannot individually match the scale of national spending. Member States, however, can deploy significant resources. In 2023 alone, compatible or exempted aid represented about 1.4% of the EU's GDP—substantially surpassing the direct EU budget for similar goals. Consequently, using the State aid framework enables the Commission to guide national spending

toward shared EU objectives. By structuring the conditions under which subsidies become permissible, the Commission creates a form of "soft coordination" that knits national budgets into a broader EU-level effort. Furthermore, the State aid framework incentivizes private co-financing, ensuring that EU industrial policy is not solely dependent on public funds. Besides financial incentives, via State aid policy the EU can align national efforts to contribute to a shared EU strategy while still giving Member States leeway in their actual roll out.

At the heart of every State aid compatibility assessment is a balancing test. On one side are the positive outcomes—like fostering innovation, boosting strategic sectors, or accelerating green technologies. On the other side are the negative effects on competition, Member State imbalances, and potential fragmentation of the Internal Market. This side of the coin should not be underestimated when using State aid policy for industrial strategies. One should not forget the intended role of State aid policy: the level playing field and undistorted competition on the internal market. Let us not forget; Article 173 TFEU explicitly prohibits measures that distort competition. By using state aid as a prime tool in the industrial strategy, unequal subsidy capacities (i.e., wealthier Member States who can afford larger subsidies, as demonstrated through COVID-19 subsidy races) and a fragmentation of the internal market could be at stake.

Some recommendations to close

First of all: there needs to be further alignment of State aid policy with the need for an increased EU industrial policy. To prevent distortions, the Commission may consider stricter ex ante coordination for large aid projects, more rigorous ex post evaluations of outcomes, or even overall State aid caps. If strong oversight mechanisms are formalized, it will help ensure Member States deploy subsidies in ways that complement, rather than compete with, each other. The objective is to preserve the Internal Market's integrity while pursuing pressing socio-economic transformations.

Second of all: there should be a proper own EU industrial policy. While State aid can and should support industrial policy, it should not be the only or main instrument. A stronger EU fiscal capacity is needed to ensure that industrial policy is not entirely dependent on Member State subsidies (e.g., through a permanent EU industrial policy fund). Moreover, EU industrial policy should go beyond mere strategy communications. The EU should establish a dedicated EU industrial policy framework that integrates State aid control with broader economic governance.

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