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## Converging trajectories? Reassessing EU Cohesion Policy in times of new industrial policy

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# Converging trajectories? Reassessing EU Cohesion Policy in times of new industrial policy

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## Abstract

The paper presents a critical assessment of EU Cohesion Policy's rationale and specific features through the lenses of theories loosely referred to as 'new industrial policy'. Theoretical work in this area is important in order to clarify the role of Cohesion Policy in the context of the current revival of industrial policies and their growing importance for Europe's economic, geopolitical, technological and climate ambitions. The paper explores the main challenges Cohesion Policy should address in order to fully embrace the experimentalism and directionality entailed in new industrial policy, going beyond the limitations of Smart Specialisation Strategies in reflecting this perspective. At the same time, a set of arguments is presented in support to the idea that the new industrial policy paradigm can help Cohesion Policy refocus its limping rationale and regain political prominence.

*Keywords:* Cohesion Policy; European Union; Smart Specialisation Strategy; Industrial Policy

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# I. Introduction

Recent years have seen a comeback of industrial policies owing to a combination of economic, geopolitical and technological factors (Aiginger and Rodrik, 2020). The trend has been accompanied by fresh scholarly interest after a long period of neglect reflecting the marginal role played by industrial policies in Western economies throughout the 80s and the 90s (Chang and Andreoni, 2020). Conversely, since the 2000s, and all the more after the Great Recession undermined the dominance of pro-market theories (Aiginger, 2104), an emerging stream of studies has sought to breathe new life into industrial policy thinking (e.g.: Hausmann and Rodrik, 2003; Rodrik, 2008; Aghion et al., 2011). This body of research has worked towards developing a novel perspective (henceforth loosely referred to as “new industrial policy”) differing in many fundamental aspects from the old-fashioned industrial policy model in fashion until the 70s. A key concern driving these theoretical efforts has been precisely to avert the well-known shortcomings of traditional top-down industrial policy. In this sense, one defining aspect of these new theories is the attempt to go beyond the dichotomy between state-oriented and market-oriented approaches to industrial development (Pellegrin et al., 2019).

This paper presents a critical assessment of EU Cohesion Policy’s rationale and specific features through the lens of new industrial policy. From a policy-making perspective, the relevance of this analysis is that it seeks to clarify the role of Cohesion Policy in the context of the current industrial policy comeback. EU Cohesion Policy is the world’s largest regional development programme (McCann, 2021): its main goals are tackling territorial disparities and promoting regional competitiveness across Europe. Since its early stages, Cohesion Policy has been supporting industrial development or modernisation (Brunazzo, 2016). More recently, the policy has become a testing ground for the new paradigm of industrial policies (Benner, 2022), notably by means of the Smart Specialisation Strategies (S3s) (Foray et al., 2009). These are innovation strategies designed to prioritise areas or economic activities where regions or countries have a competitive advantage or the potential to develop it (Foray and Goenaga, 2013). Their adoption is a pre-condition for accessing Cohesion Policy funds. To date, Smart Specialisation Strategies remain nevertheless an incomplete incarnation of new industrial policies due to conceptual, design and implementing limitations (Radošević, 2017). Key features of the new perspective have found only a partial application in the context of S3s. One notable example is that the so-called Entrepreneurial Discovery Process (EDP) has fallen short of producing the kind of flexible and structured public-private collaboration conceptualised by new industrial policy (Laranja, 2022). Another case in point is the weak directionality of S3s. Thus, additional conceptual work is needed to refocus the Smart Specialisation approach in such a way to fully reflect the new industrial policy paradigm.

In the following sections the paper provides a dual perspective. The first one explores a series of challenges Cohesion Policy should tackle in order to become an effective framework for actual transformative and directional industrial agendas fully anchored in the new industrial policy perspective. In approaching this topic the literature has often restricted its focus to the role of Smart Specialisation Strategies. Less often scholars have taken a broader perspective considering Cohesion Policy as a whole. Such theoretical endeavour is very much needed for various reasons. The most obvious one is that Cohesion Policy provides the primary institutional, legal, operational and financial framework through which the Smart Specialisation approach is implemented: this cannot be neglected even if S3s are intended to operate as comprehensive regional innovation and industrial strategies beyond the scope of Cohesion Policy. A number of challenges faced by S3s can be ultimately ascribed to Cohesion Policy's intrinsic flaws and need therefore to be discussed from the standpoint of Cohesion Policy. For instance, scholars have noted that the rigidity of Cohesion Policy provisions has significantly restricted the room for experimentalism in S3s (Rahult and Humer, 2020). A second reason is that S3s have a too narrow focus on R&I whereas industrial policies require a broader set of interventions pertaining to other Cohesion Policy funding priorities (e.g. in terms of education or infrastructure provision). This is all the more true taking into account two essential theoretical propositions of new industrial policy. First, new industrial policy should be systemic, meaning that it cannot operate in isolation, but needs to be strictly integrated with other policies (Aiginger, 2014). Second, directionality policies, being targeted at complex challenges, entail a cross-policy focus which the design of S3s is currently missing (Pontikakis et al., 2020a). In this sense, the paper represents an attempt to connect the theoretical reflection on the future evolution of Cohesion Policy (European Commission, 2022; Hunter, 2023), with the broader debate on Europe's industrial agenda as well as discussions over new paradigms in regional innovation policies, including in view of further developing the Smart Specialisation concept (Soete and McCann, 2020).

The second perspective of the paper discusses how new industrial policy can be instrumental in bringing more theoretical salience and political prominence to Cohesion Policy. The EU and its Member States are implementing or planning more assertive industrial agendas out of concerns over their shrinking industrial base, foreign dependencies on critical inputs and technological gaps or insufficient capacity in emerging industries; generally speaking, proactive industrial policies are deemed increasingly necessary in Europe to achieve leadership in the digital and green transition (Guarascio et al., 2023). This urge can in principle open positive avenues for Cohesion Policy which require a proper identification and conceptualisation so that they can be understood by policy-makers.

The paper is structured as follows. The first part (Section II) takes a look at the main factors behind the revival of industrial policies. It also provides a brief overview of the EU approach to industrial policy and its main challenges, such as balancing a more proactive course with the long-standing goals

of the single market. Section III provides an overview of the main theoretical elements of the new industrial policy paradigm. It also offers a brief historical account of how Cohesion Policy has supported industrial policies over the years by means of different approaches. Then, the paper presents a critical assessment of the Smart Specialisation approach in relation to the new industrial policy paradigm. Section III discusses two sets of challenges Cohesion Policy should address in order to operate as an actual enabler of new industrial policies. It also focuses on positive pathways that could open for Cohesion Policy in the context of the current revival of industrial policies.

## **II. The revival of industrial policies: A European perspective**

### **2.1 Why industrial policy is back in fashion**

There are at least three intertwined dimensions behind the current “rebirth” of industrial policy: economic, geopolitical, and technological. The first one is primarily associated with the effects of the financial crisis and its consequences. Generally speaking, the Great Recession led to questioning the virtues of market-oriented policies and re-evaluating state intervention (Chang and Andreoni, 2020). In Europe, the scars of the crisis were particularly long-lasting, exacerbating low growth trends and labour market issues, especially in parts of the Eurozone. Evidence suggests that Member States in Southern Europe suffered the longest also owing to their falling industrial base (Aiginger, 2014). The crisis halted territorial convergence in Europe aggravating social and regional disparities in many parts of the continent (Monfort, 2020). All of this led to growing demand for a more proactive role of the state in supporting and diversifying the economy (Aiginger and Rodrik, 2020).

Competitive pressure from emerging economies, chief among them China, is another leading cause for the revival of industrial policy. Advanced countries have been constantly losing shares of their manufacturing base amid globalisation and trade integration at global scale (Andreoni and Gregory, 2013). In Europe, this trend has an additional facet, in that industrial decline in a number of Western European regions has also been accelerated by increasing manufacturing concentration in labor-cheap Central and Eastern Europe economies (Stehrer and Stöllinger, 2015), and is partially responsible for regional development traps (Diemer et al., 2022).

Concerns with China’s ever-expanding industrial base, including on technologically advanced sectors (Warwick, 2013), have in turn prompted the US to develop a more assertive industrial policy, which is acquiring salience also for security reasons. The economic, technological, and geopolitical race between the US and China presents significant challenges to Europe. The US and China industrial strategies have been increasingly based on a mix of interventionism and protectionism in order to

reinforce their productive capacity and reduce import dependency (Guarascio et al., 2023). The risk that Europe finds itself “squeezed” in-between, causing further de-industrialisation, has become a key matter for debate for EU policy-makers (Garcia Herrero, 2019).

The events of the past years (e.g.: supply chain disruptions in the wake of Covid-19; consequences of Russia’s invasion of Ukraine; Inflation Reduction Act; etc.) have drawn attention on the potential flaws of Europe’s traditional growth model. They have laid bare the continent’s structural vulnerabilities due to its technological gap in some key technologies (e.g. clean tech), import dependency, over-reliance on exports, and limited margin on strategic inputs (European Commission, 2022a). Renewed interest in industrial policy is also propelled by profound technological changes (the third dimension), particularly in the field of digital and green technologies, and their implications for long-term competitiveness. Europe’s technological gap and production dependency on strategic areas vis-à-vis the US and China has prompted wide-spread concern. Against this background, calls for a stronger industrial agenda in Europe have intensified alongside mounting political narratives on open strategic autonomy or de-risking trade relations.

## **2.2 Putting EU industrial policy in perspective**

The industrial policy of the EU has been going through different stages over the decades. In the early days of the EU project, the focus was mostly on preventing national industrial policies from undermining the building of the common market. Early attempts at coordinating Member States’ industrial agendas in the 70s failed owing to disagreements and reluctance to relinquish national prerogatives. In the 80s and 90s, the prevalent market-oriented vision alongside the Delorsian impetus towards completing the single market relegated industrial policy to the margins of the EU agenda. A timid interest in industrial policy re-emerged in the context of the Lisbon Agenda, whose goal to turn Europe into the most dynamic knowledge-based economy entailed a strong emphasis on R&D and technological knowledge to boost the competitiveness of future-oriented industries. The EU’s first joint approach to industrial policy was subsequently presented in 2005 (European Commission, 2005). Prior to that, the EU’s research policy, most notably via the Framework Programme (now Horizon), had acted for many years as a sort of substitute for a more complete EU industrial policy: its funding played a non-negligible role in spurring industrial innovation (Peterson and Sharp, 1998) though the focus was limited to pre-competitive research.

After the crisis of 2008, concerns about industrial decline and technological laggardness led to a growing number of initiatives at EU level, at first in the framework of the Strategy Europe 2020. In 2014, the adoption of an EU strategy for the “industrial renaissance” set out the target to increase



the proportion of GDP generated by manufacturing to 20% by 2020<sup>1</sup>. Scholars have noted that these endeavours yielded little results (Renda, 2021) while remaining mostly driven by a horizontal and market-led approach (Pellegrini et al., 2019) essentially directed at building a favourable environment for industrial development through regulatory measures, infrastructure provision, access to financing (Pianta, 2009). This was after all consistent with the neutral philosophy underpinning article 173 of the Treaty on the functioning of the European Union, which spells out the main goals of EU industrial policy (Wigger, 2023). Nonetheless, elements of a vertical logic started to percolate into the EU industrial policy, notably with the operationalisation of the Smart Specialisation approach into Cohesion Policy (Foray and Goenaga, 2013). This direction has become even more apparent in the latest EU initiatives such as the New Industrial Strategy for Europe, the Net Zero Industry Act (NZIA), the Strategic Technologies for Europe Platform (STEP).

The current debate is focusing on various aspects. One prominent one is how to best combine the need for a more vertical approach with the default horizontal one which has largely guided the EU industrial policy so far. A second and related matter for debate is how the EU commitment to the single market and trade openness can be reconciled with a more proactive industrial policy. To this end, scholars argue that the EU should exert a stronger stewardship in the coordination of industrial policies, which remain otherwise a national prerogative (Tagliapietra et al., 2023). A necessary (though not sufficient) condition for the EU to fulfil this task is to equip itself with adequate financial means (Zuleeg and Lausberg, 2023). This is all the more important when looking at the role played by EU funding instruments such as the structural funds in fostering coordination among national R&I policies (Barré et al., 2013). More recently, the establishment of the NextGenerationEU, with its “transformative” orientation and central role of the Commission in the decision-making, has marked a further step in this direction (Criscuolo et al., 2022).

### **III. Cohesion Policy in the new paradigm of industrial policy**

#### **3.1 Conceptualising the new industrial policy**

There is no common definition of industrial policy. The understanding of its scope and objectives varies widely among scholars and policy-makers. One possible explanation is that the policy has a somewhat “elusive” nature, lacking the defining features that can be attributed to other areas such as trade or monetary policy (Riess and Vålilä, 2006). This notwithstanding, there exists a common

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<sup>1</sup> For an overview of the EU initiatives on industrial policy since the early 2000s see: <https://www.europarl.europa.eu/factsheets/en/sheet/61/general-principles-of-eu-industrial-policy>

denominator upon which all economists agree: an industrial policy entails a role of some sort for the state in determining the productive structure of the economy.

In the past years the academic debate has focused on how to re-conceptualise industrial policy in the face of its gradual comeback. A primary preoccupation of this new perspective, as explained above, is to tackle the failures of preceding models. For a start, the new industrial policy perspective is intent on tackling information imperfections that constrain both the traditional top-down approach to industrial policy and its market-led opposite dominating between the 80s and the 2000s (Stiglitz and Greenwald, 2014). Policy-makers may have a sub-optimal level of knowledge, and need therefore to complement it by accessing and leveraging information scattered across the private sector. Thus, the new model of industrial policy requires a high degree of interaction between government officials and businesses by means of a structured, open and perpetual collaboration aimed at identifying barriers and opportunities (Rodrik, 2014; Meadowcroft 2011; Crafts and Hughes, 2013). Such cooperation is understood as a learning and (self)discovery process through which both the public and private sectors develop the adequate competences (Hausmann and Rodrik, 2003). It should not be limited to government and businesses, but should include a third critical actor represented by the civil society (Rodrik, 2004). There is an inevitable dimension of experimentalism in this dynamic in order to navigate the high level of uncertainty and dynamism that marks competitive markets, especially in emerging technologies. This also means that new industrial policy should embrace a trial-and-error approach, using incremental information emerging from the discovery process to adjust its trajectory.

The difference with the traditional top-down model is apparent, and can be summarised in the following points. First, the underlying philosophy of the new industrial policy is “probabilistic” rather than “deterministic” (Benner, 2019): the difficulty to anticipate the direction markets will take suggests to adopt a portfolio approach, promoting diverse entrepreneurial investments, some of which will inevitably fail whereas others will succeed. This model is somehow reminiscent of venture capital business. Second, the focus of industrial policy is therefore not on identifying the winners, for it would be difficult to recognize them *ex ante*, but gradually “letting losers go” (Rodrik, 2009). Thirdly, the role of government in industrial policies does not consist in imposing top-down decisions but in acting as a catalyst or enabler (Mazzucato, 2016). A forth, and critical aspect of the new paradigm is that industrial policy cannot only have strictly economic goals, but should strive to address societal challenges at large, such as climate change (Rodrik, 2014). The role of the state is of essence here. Markets are not “societally-conscious”, and may develop in ways that are not ideal from the point of view of societal problems. It is for the state to step in and set the direction of change “towards new “techno-economic paradigms”” (Mazzucato, 2016), i.e. leveraging industrial policy to steer markets towards bringing societal benefits. In the words of Mazzucato, the new industrial policy

should adopt a “market-shaping” approach rather than restraining itself to the traditional function of fixing market failures (Mazzucato, 2016). Linked to that, a specific focus on demand policies is also an element that some proponents of new industrial policy deems very important, highlighting a substantial neglect in past theories. Demand management, for instance by means of macro-economic policies, is important for ensuring resources commitment by firms in the face of high uncertainty in certain markets (Chang and Andreoni, 2020). Hence, the role of demand management in the specialisation or diversification of economies. This leads to the sixth feature of the new perspective: that is, industrial policy cannot be shaped in isolation from, let alone conflict with, other policies, but has to work in close alignment with them in a “systemic” way (Aiginger, 2012).

Finally, and perhaps most crucially, the new paradigm, as framed above, seeks to transcend the traditional dichotomy between state intervention and market-oriented approach (Tagliapietra and Veugelers, 2020). On the one hand, it recognises that the knowledge and inventive of the private sector should not be overlooked or constrained by the state, but rather “enabled”, “sowed”. This is confirmed by the idea that trade openness and in-sector competition are important ingredients for the success of new industrial policy (Aiginger, 2014; Altomonte and Veugelers, 2019). On the other hand, the state has a key role to play in setting the direction and ensuring that enough resources are mobilised, especially towards entrepreneurial investment that might not happen because of uncertainty or path-dependency. Ultimately, this “systemic” approach entailing public-private collaboration/coordination, policy experimentalism, market creation, and strategic directionality, blurs the lines between horizontal and vertical logic (Pellegrin et al., 2019). Finally, one additional aspect that has integrated the new industrial policy perspective is the importance of incorporating a place-based logic.

### **3.2 EU Regional Policy and industrial policies**

European Structural and Investment Funds (ESIF) have been traditionally playing a role in the delivery of industrial policy – regional policy being at its core an industrial policy –, albeit in different ways and to a different extent throughout the years. The Thomson report, which laid the foundations of EU regional policy, identified industrial development or modernisation as one of its major goals in order to address regional imbalances (European Commission, 1973). Accordingly, in its early days, the regional policy of the EU focused on infrastructural and productive investment in less well-off or de-industrialising areas (Dall’Erba, 2003). In this phase, its approach to industrial policy was consonant to traditional regional policy: sectoral, strongly top-down in its decision-making, and driven by national economy considerations (McCann and Ortega-Argilés, 2021).

The EU regional policy evolved significantly after its reform in 1988: under a new “EU Cohesion Policy” brand, it went from being little more than a set of intergovernmental transfers to becoming a full-fledged policy instrument for regional development supported by a consequential budget (Manzella and Mendez, 2009). Key aspects of the new policy framework were the introduction of a programme-based logic, replacing the previous project-led one, and a “multi-level” governance enabling the participation of sub-national actors in the decision-making (Hooghe, 1996). Shortly afterwards, the main goal of EU Cohesion Policy began to widen from regional convergence (of lagging areas) alone to economic competitiveness (of all regions) as well. Secondly, the initial focus on infrastructures and manufacturing gave way to an increasing emphasis on knowledge-based activities (Piattoni and Polverari, 2016). This shift took place against the background of a growing alignment of the policy with the market-oriented and post-industrial agenda of the EU (Mendez, 2011).

Thus, the underlying logic in regards to industrial policy in this phase of Cohesion Policy (late 90s/2000s), if barely existent, was eminently horizontal. It aimed at facilitating the framework conditions for regional competitiveness, by fostering advanced knowledge, technological development, business competitiveness. The interplay of various factors such as the then dominant pro-market thinking, a strong focus on completing the single market, stringent state aid rules, strict requirements to finance only SMEs, and the neutral logic to industrial policies mandated by article 173 of the Treaty on the Functioning of the European Union, limited the scope for Cohesion Policy to support industrial policy. Above all, industrial policy was not considered key to promoting territorial cohesion: hence, it had de facto little or no role in Cohesion Policy reflecting a more general neglect at EU level (Budd, 2017).

### **3.3 Smart Specialisation Strategies as an incomplete case of new industrial policy**

The global financial crisis turned out to be a watershed. In its aftermath, the renascent debate around industrial policies, alongside growing attention on place-based policies as effective remedies to regional development challenges (Barca, 2009), ended up exerting a profound influence on the reform of Cohesion Policy in the period 2014-2020. Indeed, key elements of these discussions fed into the development and subsequent mainstreaming of the Smart Specialisation approach into Cohesion Policy (Foray et al., 2009; McCann and Ortega-Argilés, 2011), a cornerstone of said reform. At its core, the Smart Specialisation approach provides a bottom-up framework guiding the prioritization and support for innovative/technological areas at local/regional level where there exists potential to develop a competitive strength (McCann and Ortega-Argilés, 2015). Crucially, the Smart Specialisation approach combines aspects of regional and industrial policies in a novel way (McCann and Ortega-Argilés, 2021). Thus, the introduction of Smart Specialisation Strategies (S3) entails a

significant change in Cohesion Policy approach to industrial policy. First, industrial policy is again restored at the heart of Cohesion Policy. Second, Cohesion Policy becomes a dominant policy framework for enabling and supporting industrial strategies (Ahner and Landabaso, 2011). Thirdly, and perhaps more importantly, the Smart Specialisation approach (re-)introduces elements of vertical or selective industrial policy in Cohesion Policy, albeit on a new basis (Foray and Goenaga, 2013). This shift stems from the realisation that “generic” innovation, competitiveness and enterprise support policies have fallen short of producing the expected impacts, all the more in less developed regions (Foray, 2014), and appear therefore ill-suited to deliver the required industrial change, particularly in order to address societal challenges (Flanagan et al., 2021).

The Smart Specialisation approach is firmly grounded in the new paradigm of industrial policy, given its non-neutral, experimental, “directional” focus (Foray, 2018), amongst other things. Nevertheless, many defining features of new industrial policy have found only a partial or limited application in Smart Specialisation Strategies (Radošević, 2017). Overall, the place for experimentalism in S3s has turned out to be rather limited (Coenen and Morgan, 2020) due to a number of reasons, chief among them the notorious rigidity of Cohesion Policy rules and procedures (Rahult and Hulmer, 2020), its complex governance as well as lack of capacity in many managing authorities (Morisson and Doussineau, 2019). Second, the involvement of civil society, notably in the context of the Entrepreneurial Discovery Process (EDP), has been at best poor (Arangueren et al., 2019). Thirdly, the EDP has fallen in many cases short of producing the sort of structured collaboration between private and public sectors extolled by the new industrial policy perspective. Fourth, a selective and non-neutral approach is challenged by the choice of several S3s to adopt a wide set of priorities (Giannelle et al., 2019) or/and funding schemes with too broad a thematic scope (Foray, 2023). Fifth, the narrow focus on R&I has prevented (so far) S3s to incorporate a full-fledged transformative dimension targeting ecological, social and human challenges. Finally, S3s may even have promoted in some cases a traditional approach to industrial policy by protecting existing champions irrespective of their potential (Fedeli et al., 2017).

*Table 1: How the main features of the new industrial policy perspective have been reflected in Smart Specialisation Strategies*

<b>NEW INDUSTRIAL POLICY</b>	<b>SMART SPECIALISATION STRATEGIES</b>
<b>Experimentalism</b>	<b>Limited by Cohesion Policy rigid rules and complex governance</b>

<b>Trial and error approach</b>	<b>Severely limited by cost-efficiency logic of Cohesion Policy, as well as strict audit rules</b>
<b>Structured and open collaboration between public, private sector and civil society</b>	<b>Limited engagement between public and private actors over time through the European Discovery Process; scant involvement of civil society so far</b>
<b>Non-neutral/selective approach</b>	<b>Too many priorities identified in some S3s</b>
<b>Directionality</b>	<b>Hindered by narrow focus on R&amp;I</b>
<b>Avoiding incumbent captures/pick-the-winners approach</b>	<b>Some S3s have tended to support local champions</b>

On the whole, analyses have pointed out that S3s have often failed to act as comprehensive industrial agendas at local or regional level, having been implemented with a narrow focus on the R&I strand of the EU structural funds (Pontikakis et al., 2022). Finally, another key critique concerns the capacity of S3s to realistically tackle regional disparities (Madeira et al. 2021), as lagging or peripheral regions tend to lack the pre-conditions, in terms of industrial, innovation as well as institutional capacities, for the Smart Specialisation approach to deliver (Capello and Kroll, 2016; Di Cataldo et al., 2022). The theoretical work around the S4 (McCann and Soete, 2020) and Partnership for Regional Innovations concepts (Pontikakis et al., 2022b) is intent on re-focusing the Smart Specialisation approach to address the aforementioned shortcomings. This work needs to take into due account both the debate on the future of Cohesion Policy and the emerging EU industrial strategy.

## IV. Challenges and positive pathways

Cohesion Policy is at a critical juncture. Questions over its identity, effectiveness, place in the context of a fast-evolving EU agenda, are as pressing as ever (Hunter, 2023). There is consensus that the policy will need to evolve to tackle a combination of traditional and emerging challenges (European Commission, 2022b). The discussion cannot neglect both the trajectory of new industrial agendas and its underlying theories. Since its inception, Cohesion Policy has represented a key policy and funding framework to pursue innovation and industrial policies. Smart Specialisation Strategies have rendered Cohesion Policy a major component of EU industrial policy (Benner, 2022). But this role is not granted in the future. The establishment of the Recovery and Resilience Facility, with its “transformative” orientation (Criscuolo et al., 2022), challenges the role of Cohesion Policy as the dominant investment instrument of the EU (Bachtler et al., 2020; Conte and Molica, 2022). At the same time, the recent initiatives adopted under the new EU industrial strategy, while emphasising the importance of place-based solutions and regional cohesion, may result in a more top-down governance or less place sensitive approach. It is important to discuss what challenges need to be addressed and what opportunities should be exploited for Cohesion Policy to establish itself as a prominent instrument for new industrial policy and become central to EU and its member states’ industrial strategies.

### 4.1 Challenges

There are two different sets of challenges that Cohesion Policy should navigate in the context of new industrial policy. The first pertains to its rationale and role whereas the second regards the suitability of its rules and mechanisms.

*Rationale and role:* Regional policy and industrial policy are two distinct policy areas, with different rationales as the goal of steering industrial change does not necessarily coincide with that of fixing regional imbalances (Pierre, 1995). However, the two policies have often overlapped or conflicted in absence of a clear separation of tasks or coordination (Aiginger and Rodrik, 2020). A strong alignment (and, ideally, integration) between Cohesion Policy (as regional policy) and industrial policy is essential from the new industrial policy perspective (Aiginger, 2014). In fact, this is also a pre-condition for Cohesion Policy to play a meaningful role in future industrial policies. At the very least, more proactive industrial agendas must not come to clash with the very goals of EU Cohesion Policy or end up distorting them. In this sense, two issues require attention.

- The first one is how to best reconcile the strategic directionality required by the new industrial policy paradigm with both the place-based and multi-level focus of Cohesion

Policy (without diluting it). There is a risk that Member States resort to a *dirigiste* attitude in their renewed industrial policy efforts; the new EU industrial agenda does not appear immune from this danger either. Even if this scenario does not materialise, there is little doubt that the new paradigm of industrial policy entails a stronger central steering to orchestrate industrial development or transformation towards the desired direction (Bugge et al., 2018). This does not necessarily mean going back to a traditional highly centralised model, which should not even be viable in a number of Member States where responsibility for industrial policies are devolved to regional/local authorities. Moreover, several scholars have stressed that multi-level governance, alongside stakeholders coordination, is important for addressing directionality (Haddad and Bergek, 2023). They suggest the need for combining top-down and bottom-up approaches, for instance in relation to missions (Kattel and Mazzucato, 2018; Mazzucato, 2018; Foray, 2018). But it remains to be seen whether and how this could work in practice (Cappellano et al., 2023). Assuming a degree of central steering is inevitable in the context of the new paradigm, Cohesion Policy might have to face more trade-offs between top-down and place-based/bottom-up logic if it is to make a significant contribution to future industrial agendas. But the opposite is also true. An emerging stream of studies is starting to look into the institutional and spatial implications – and tensions – arising from the practical implementation of policies with strong directionality such as mission-oriented ones (e.g. Uyarra et al., 2023). These works show that balancing directionality and bottom-up logic/subsidiarity is a challenge to which the new industrial policy is inherently confronted, irrespective of Cohesion Policy. But Cohesion Policy can be instrumental in fostering the sort of optimal horizontal and vertical coordination needed to effectively address this challenges, notably by leveraging on existing mechanisms, such as multi-governance, partnership principle and the smart specialisation approach. This could boost the importance of Cohesion Policy as a key framework to implement new industrial policies in the future (Grillitsch et al., 2023).

- The second issue pertains to how to best balance efficiency and equity considerations. Cohesion Policy is already grappling with evident (yet, neglected) trade-offs between promoting regional convergence and economic growth, as the latter may entail accepting more economic concentration in best endowed regions thereby widening regional disparities (Farole et al. 2011). In other words, the two distinct goals of the policy, regional convergence and regional competitiveness, may be conflicting (Begg, 2010). A case in point is represented by Central and Eastern European countries, where Cohesion Policy has largely contributed to strong economic growth which has produced more in-country disparities (Gorzalek, 2017). There is a specular discourse on the side of industrial policy, in that it may either reinforce existing agglomerations or, if specifically directed towards less developed areas in



the form of regional policies, may not bring particular gains from a national economic perspective (Glaeser and Gottlieb, 2008). In fact, industrial policies targeted at less developed areas were in many instances not as effective as expected, as it is the case for Italy's Mezzogiorno or France (Iammarino et al. 2019). Crucially, the experience of S3 shows that less developed regions may not have the right conditions in place to properly implement transformative agendas in the sense of new industrial policy (Capello and Kroll, 2016). Acknowledging the existence of equity-efficiency trade-offs, an issue policy-makers have seemed to avoid in approaching the debate on Cohesion Policy, is therefore important. A reflection is needed as to where the balance should lie.

*Rules and mechanisms:* Questions should be also raised as to whether the current provisions and mechanisms of Cohesion Policy allow for effectively supporting new industrial policy. The literature on S3 has provided important insights in this sense. But the problem merits to be discussed from the broader perspective of Cohesion Policy. To this end, four aspects, amongst others, would require a critical assessment.

- The first one is that the administrative rigidity and cost-efficient logic of Cohesion Policy heavily restricts the scope for experimentalism entailed in new industrial policy and the smart specialisation approach (Radosevic, 2017). It certainly hinders the possibility to: i) engage in an open and flexible way with stakeholders; ii) adjust on a regular basis investment decisions in the context of a constant learning process; iii) and, more importantly, embed an inevitable degree of risk, and thus failure in selecting and supporting projects. By contrast, a conservative and risk-averse attitude in funding decisions within the policy appears to be encouraged by growing emphasis on audit (Mendez and Bachtler, 2011), monitoring and evaluation requirements (Rauhut and Humer, 2020), performance-orientation, and ultimately the strong pressure for absorption (Cunico et al., 2022).
- The second aspect regards state aid rules (and aid to large enterprises). Historically, reconciling strict EU competition requirements with regional policy goals has been both theoretically and operationally difficult (Wishlade and Michie, 2009) even if less developed areas benefit from significant exceptions in accordance with article 107 TFEU. In the current context, however, additional flexibility in state aid rules, including in the framework of Cohesion Policy, appears to be necessary to best serve the goal of developing innovative industrial capacity in the EU. Recent measures adopted by the EU go in this direction (European Commission, 2023), mostly as part of a temporary relaxing of the overall EU competition framework since Covid-19. In the long run, it remains an open question how to settle the potential conflict between the need for a loosen state aid framework required by a more assertive industrial policy and the commitment to protecting the single market. It

should be noted that the latter objective sees also a potential indirect role for Cohesion Policy: in a scenario of even laxer state aid rules, which would be seized by big Member States to finance massive industrial programmes<sup>2</sup>, cohesion funds would contribute to maintaining the level playing field by supporting industrial investment in states that have a smaller fiscal capacity. Similarly, there is a need to re-assess Cohesion Policy longstanding restrictions to support large enterprises.

- The third element regards the role of financial instruments. Their uptake in the frame of Cohesion Policy has been expanding. But it remains limited (about 6% of the overall ESIF funds in the 2014-2020 period) owing to various reasons, such as lack of administrative capacity or demand in certain areas (Wishlade and Michie, 2017). The current phase of industrial transformation requires major public investment to attract the private sector and leverage its funds towards risky or emerging markets. The use of financial instruments, including in innovative forms and in combination with grants, is critical, especially for public powers to operate as investors of “first resort” (Mazzucato and Penna, 2016) vis-à-vis growing budgetary constraints. Re-assessing the place and use of financial instruments in Cohesion Policy, in particular drawing on national development banks and European Investment Bank, appears to be a necessary step.
- The fourth, and final aspect relates to the ample range of funding instruments and policy frameworks devoted to innovation and industrial policies, of which Cohesion Policy is only a part, and their insufficient coordination and integration. This has been identified as a notorious weakness in the implementation of smart specialisation strategies, whereas lack of coordination and poor synergies with other funding instruments is also limiting Cohesion Policy impact. There is an increasingly growing rationale for holistic coordination and systemic approaches in delivering innovation and industrial policies (Larrue, 2017). In concrete policy terms, this means that Cohesion Policy, through the S3, needs to offer a comprehensive framework for pooling scattered resources and initiatives as well as promoting vertical and horizontal coordination.

## 4.2 Positive avenues

Despite representing one third of the EU overall budget, Cohesion Policy has been facing increasing scrutiny in relation to its role, relevance, and ultimately impact. The reasons are multiple: confusion about its objectives (Begg, 2010), a diminishing focus on convergence (Mancha-Navarro and Garrido-Yserte, 2008), inconclusive evidence about its effects (Bachtrögler et al., 2020), emergence

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<sup>2</sup> This is already happening: “Ukraine war and green transition keep EU state aid near record level”, Financial Times, 19/07/2023

of new funding instruments (Conte and Molica, 2022). Crucially, the rationale of Cohesion Policy has been sapped by the growing prevalence of a sectoral logic in articulating its goals (Mendez, 2013), its gradual subordination to the macroeconomic objectives of the EU economic governance, and the need to prioritise short-term demand policies over regional policies in the face of ever-intensifying economic downturns since 2008 (Camagli and Capello, 2017). Renewed interest in industrial policies, however, offers positive avenues for reversing this situation and restoring theoretical salience and political prominence to Cohesion Policy.

First of all, Cohesion Policy is grounded in a model of capitalism which, to various degrees, contemplates a pro-active role for public authorities in the economy (Hooghe, 1998), and it is itself very instrumental in delivering such model. This notion, which is in-built in the conceptual foundations of Cohesion Policy, resonates in the new industrial policy's framing of the state as a prime actor in orchestrating industrial change. In this sense, the re-evaluation of public intervention underpinning the revival of industrial policies provides a strong conceptual and political justification for Cohesion Policy.

An additional argument pertains to the very mechanics of Cohesion Policy. Theorists of new industrial policy stress the importance of private-public collaboration and coordination to prevent information gaps and private capture. It has been discussed in the previous sections that the Smart Specialisation approach draws extensively on this idea, notably by means of mechanisms such as the entrepreneurial discovery process. Perhaps more importantly, this idea is embryonically ingrained in the design of Cohesion Policy since its inception, mirrored as it is in key aspects such as the partnership principle. In the words of Hooghe, the policy aims to “upgrade the potential for indigenous economic growth in lagging regions by inducing public and private actors to create and share collective goods” in that “collaboration among public and private actors is likely to [...] enhance mutual learning” (Hooghe, 1998; pag. 459). From this perspective, Cohesion Policy can thus offer an optimal framework for enabling new industrial policies.

There is a third indirect reason why Cohesion Policy remains central to new industrial policy. The pace of industrial transformation Europe will face in order to achieve the twin transition is going to have heterogenous impacts across its regions, benefitting some territories while putting others under stress (Soete and Stierna, 2023). One should not forget that one of the economic rationales of the policy has been since the onset to support regions adversely affected by the completion of single market and/or experiencing industrial decline. Likewise, the idea that Cohesion Policy should step in to support those territories most impacted by the current systemic transformation of the industrial landscape provides a strong justification to it.

## V. Conclusion

The 2021-2027 programming period of Cohesion Policy has kicked-off under unprecedented circumstances. The policy has come under increasing pressure to support a widening range of priorities and policies, including short-term ones, in the context of the current “polycrisis”. There is consensus about the fact that Cohesion Policy should evolve in the future to address a more complex geography of regional disparities whilst supporting investments towards the EU priorities of building resilience and delivering the twin transition (European Commission, 2022b). A reflection as to the future shape of the policy is currently underway. Unquestionably, this discussion cannot neglect the role of Cohesion Policy in supporting industrial transformation to meet the EU priorities in terms of open strategic autonomy, decarbonisation and twin transition.

In this paper we have argued that, in order to fully embed the vision of the new industrial policy and become one of its central enabler, Cohesion Policy needs to go through an honest reassessment of its rationale and of its mechanisms and rules. It should in particular tackle two sets of challenges. The first is about ensuring a strong integration between Cohesion Policy and industrial policies: achieving this goal would imply accepting trade-offs, and thus striking a delicate balance, between top-down directionality and place-based logic as well as efficiency and equity considerations. The second challenge pertains to the rules and mechanisms of Cohesion Policy: that is, how to make them more suited to support the new perspective of industrial policy. For instance, there is no doubt that stringent management and audit requirements and an entrenched cost-efficient logic hamper a sufficient degree of experimentalism in the use of funds. At the same time, the paper has also highlighted that the new industrial policy paradigm can contribute to restoring theoretical salience and political prominence to Cohesion Policy. The important role of the state in “nudging” markets and coordination between public and private sector advocated by the new industrial perspective are equally rooted in the vision on which rests Cohesion Policy since its inception.

While it is difficult at this stage to formulate recommendations, it seems reasonable that one of the ingredients to ensure Cohesion Policy has a key role in delivering industrial agendas is allowing more bottom-up experimentalism by means of flexible and simplified rules. A crucial aspect of this reflection is what would be role of S3, and how it should evolve building on the experience of the 2014-2020 period and taking into account existing critiques.

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