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Developments in EU Industrial Policy and Implications for Japan

— The Importance of "Missions" in Industrial Policy and Lessons for Competing with China —

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〈Summary〉

◆ Despite leading global decarbonization efforts, Europe faces manufacturing stagnation and the threat of industrial hollowing-out due to persistently high energy costs and fierce competition from Chinese firms. In response, the EU is rapidly advancing a new industrial policy agenda based on the Draghi Report. In the Competitiveness Compass presented in 2025, the European Commission identified three transformational imperatives necessary to improve competitiveness: closing the innovation gap with the US and China, a joint roadmap for decarbonization and competitiveness, and reducing excessive dependencies and increasing security. Through the Clean Industrial Deal (CID), it then outlined a policy of enhancing industrial competitiveness while advancing decarbonization by providing financial support for low-carbon and net-zero technologies. By establishing an Industrial Decarbonization Bank and leveraging InvestEU, the CID aims to stimulate private capital while limiting pressure on public finances, accelerating efforts to simultaneously solve societal challenges and achieve economic growth.

◆ The proposed Industrial Accelerator Act (IAA), a central component of the CID, sets out major institutional reforms that go beyond mere financial support. It consists of three pillars: accelerating administrative permitting procedures, a longtime barrier to decarbonization efforts; creating lead markets using public procurement requirements that prioritize low-carbon and/or EU-origin ("Made in EU") products; and imposing conditions on inward foreign direct investment (FDI) to encourage the accumulation of technology within the region. The IAA reflects a particular awareness of Chinese firms offering low-cost, subsidized products or seeking to turn Europe into an assembly base, and aims to build autonomous supply chains by nurturing companies capable of competing with them.

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◆ The EU's approach offers valuable lessons for Japan, which faces similar challenges including financial constraints and competition from China. First, the primary objective of industrial policy should not simply be to promote specific industries. Public and private investment should instead be guided by clear "missions" such as decarbonization and economic security. Second, policy sustainability should be underpinned by emphasizing institutional reforms, such as faster permitting and market creation through public procurement, rather than excessive reliance on subsidies. Third, it is crucial to balance strategic autonomy and competitiveness by avoiding excessive protectionism that favors domestic interests and pursuing cooperation with like-minded countries. These institutional frameworks are likely to serve as a useful model for Japan's future policy efforts.

● **This is an English version of "欧州産業政策の進展と日本への含意 ―産業政策における「ミッション」の重要性と対中競争へのヒント―" in Research Focus (The original version is available at https://www.jri.co.jp/MediaLibrary/file/report/researchfocus/pdf/17076.pdf)**

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1. Introduction

Industrial policy is gaining renewed attention worldwide as the COVID-19 pandemic and geopolitical tensions have exposed supply chain vulnerabilities, underscoring the need to secure reliable access to critical goods and technologies. The imperative to address societal challenges such as climate change, which the private sector cannot tackle alone, is also reinforcing the importance of active government support for industry in advanced and emerging economies alike.

While Europe has notably led global decarbonization efforts, persistently high energy costs and fierce competition from Chinese companies have left its manufacturing sector struggling, particularly in Germany, raising concerns about industrial hollowing-out. The EU is now significantly shifting its industrial policy in an effort to turn the situation around. While Japan and the US have pursued industrial policies utilizing massive subsidies to support various businesses, the EU's approach is characterized by the existence of clear policy "missions" such as decarbonization, and innovative policy measures aimed at achieving these missions without relying solely on subsidies.

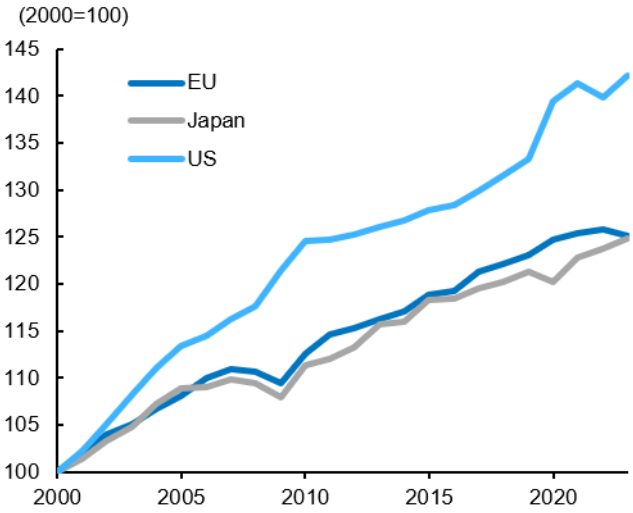
Section 2 of this paper explains the evolution of EU industrial policy in detail, focusing particularly on the major changes following the release of the Draghi Report. These moves reflect concerns about Chinese companies in particular, and Section 3 examines how these policies could enable European firms to compete with their Chinese counterparts. For Japan, which faces similar problems, the EU's initiatives should serve as a useful reference case for promoting industrial policy. Section 4 identifies the key areas of EU industrial policy to watch and considers policy recommendations for Japan.

2. Developments in EU Industrial Policy

(1) EU Industrial Policy Transformed by the Draghi Report

Growth in Europe has remained stagnant amid persistently low R&D spending, high costs, and a lack of policy coordination among member states. In recent years, rising geopolitical risks have increasingly become a major headwind, alongside fierce competition from foreign firms. Income and labor productivity growth in Europe have stagnated, and the gap with the US has widened notably (Figure 1). Furthermore, China's industrial technology has advanced rapidly, and Chinese firms are now able to manufacture high-tech, green products at low cost, putting many European and US manufacturers under pressure (Kynge [2026]).

Figure 1. Labour Productivity at Constant Prices



Source: JRI based on OECD
Note: GDP per hour worked.

Against this backdrop, former ECB President Mario Draghi published a report titled *The future of European competitiveness* (hereafter, the Draghi Report) in September 2024. The report recommended that the EU coordinate to promote home-grown innovation while removing barriers to the commercialization of new technologies, triggering a significant shift in EU industrial policy (Draghi [2024], Figure 2).

Figure 2. The Draghi Report's Key Proposals

Category	Core objective	Examples of policies proposed
Innovation	Close the innovation gap with the US and China	Boost EU R&D funding; expand VC markets to retain tech scale-ups
Decarbonization with competitiveness	Lower industrial energy prices and build clean manufacturing	Decouple clean energy prices from fossil fuels; subsidize clean-tech manufacturing
Strategic security	Reduce supply chain dependencies and strenghten defence readiness	Implement joint EU defense procurement; build strategic stockpiles of critical raw materials
Investment	Mobilize €750B–€800B annually in new public and private capital	Deepen the Capital Markets Union; regularly issue common safe assets (EU debt)
Governance	Streamline EU-level decision-making and reduce red tape	Curb the use of unanimity voting in EU Council decisions; streamline business regulations

Source: JRI based on Draghi [2024]

Although policies to support industry had been implemented in Europe previously, their effectiveness remained limited. This was due in part to the inability of EU member states to mount a strong, coordinated response, as well as inadequate funding systems and mechanisms to utilize available funds effectively. However, economists such as Mariana Mazzucato have advocated a modern approach to industrial policy in recent years. Reflecting this trend, the publication of the Draghi Report has accelerated the promotion of a new industrial policy in Europe that is conscious of missions and problem setting (Appendix 1).

In January 2025, the European Commission published the Competitiveness Compass and established three "transformational imperatives" necessary to improving competitiveness. These are: 1) Closing the Innovation Gap, 2) A Joint Roadmap for Decarbonization and Competitiveness, and 3) Reducing Excessive Dependencies and Increasing Security. Based on these imperatives, it has designated artificial intelligence (AI), quantum, biotechnology, advanced materials, space, low-carbon manufacturing, and net-zero manufacturing as priority

sectors.

This series of policy directives based on the Competitiveness Compass aims to elevate the goal of decarbonization beyond mere environmental regulation into a growth area with a strong business case. Combined with measures designed to mobilize private capital, including through the Savings and Investment Union (Appendix 2), it seeks to accelerate industrial growth and strengthen economic security under clear missions. The Competitiveness Compass serves as the axis for advancing the specific measures detailed below.

(2) Clean Industrial Deal (CID): Six Pillars and a New Funding Framework

In February 2025, the European Commission announced the "Clean Industrial Deal" (CID). The CID is a comprehensive policy proposal designed to enhance the competitiveness and resilience of European industries globally while advancing decarbonization. Specifically, it establishes six pillars that support business: 1) Affordable energy, 2) Boosting demand for clean products, 3) Financing the clean transition, 4) Circularity and access to materials, 5) Acting on a global scale, and 6) Skills and quality jobs. It aims to create an environment where companies can actively invest and expand their businesses (Figure 3). It also emphasizes the cross-cutting enablers of a competitive economy such as deregulation, promoting digitalization, improving policy coordination between the EU and member states, and fuller integration of the single market to harness its scale.

Figure 3. The EU Clean Industrial Deal (CID)

Pillar	Core objective	Examples of policies announced
(1) Affordable energy	Lower energy prices and promote the green transition	Streamline permitting for clean energy projects; decouple electricity prices from spot gas prices
(2) Boosting demand for clean products	Boost demand for low-carbon products made in the EU	Use non-price criteria in public procurement; accelerate low-carbon hydrogen deployment
(3) Financing the clean transition	Mobilize investment for green projects	Expand EU-level funding, reform InvestEU to mobilize investment; streamline State Aid rules
(4) Circularity and access to materials	Secure critical raw materials and reduce import dependencies	Help companies jointly buy critical raw materials; expand domestic recycling
(5) Acting on a global scale	Protect against unfair foreign competition and build partnerships	Toughen screening of FDI in clean tech; form Clean Trade and Investment Partnerships with third countries
(6) Skills and quality jobs	Equip workers for the green transition	Improve access to skills; improve monitoring of the impacts of the green transition on workers

Source: JRI based on European Commission [2025a]

A central feature of the CID is its emphasis on new funding frameworks aimed at supporting industrial structural transformation and the development and deployment of technologies (Figure 4). It provides financing options that reduce investment risk for companies expanding and scaling their operations in low-carbon and net-zero sectors. In the short term, it will supply over €100 billion through a new Industrial Decarbonization Bank, which will draw funds from the existing Innovation Fund and Emissions Trading System (ETS) revenues. Additionally, it aims to mobilize up to €50 billion of additional public and private investment in clean technology manufacturing and infrastructure deployment by leveraging InvestEU. In the long term, public support could expand significantly through the "European Competitiveness Fund," slated for creation under the next EU long-term budget starting in 2028.

Figure 4. Main CID Funding Measures

CID Pillar	Program	Amount	Type	Parent	Description
(1) **Affordable energy**	Corporate power purchase agreements	€500M	Counter-guarantees	EIB	Counter-guarantees for long-term electricity purchase agreements
	Grids manufacturing package	€1.5B	Counter-guarantees	EIB	Counter-guarantees for manufacturers of grid components
(3) **Financing**	Industrial Decarbonization Bank (IDB)	€100B	Production subsidies and grants	Competitiveness Fund	Aims to support industrial decarbonization. Financed through the Innovation Fund, additional revenues from the EU Emission Trading System and InvestEU regulation amendment
	Innovation Fund 2025 commitment	€6B	Production subsidies and grants	Innovation Fund	Aims to support clean-tech manufacturing, renewable hydrogen and industrial decarbonization
	Horizon Europe 2026-2027 call	€600M	Grants	Horizon Europe	Grants for fit-for-deployment clean technologies
	InvestEU regulation amendment	€1B	Budgetary guarantees	InvestEU	Increase InvestEU's risk bearing capacity to mobilize €50B of additional public and private investment

Source: JRI based on European Commission [2025a]
Note: Funding measures as announced in February 2025. Part of the €6B Innovation Fund 2025 commitment is expected to count towards the IDB's €100B funding once it is established.

Even as the EU aims to expand funding through funds and other channels, a key characteristic of its industrial policy is that it does not rely solely on direct subsidies. While the scope for fiscal expansion, such joint debt issuance, is being explored, guarantees, investments, and loans have taken precedence over subsidies (Appendix 3). The CID incorporates measures that enhance the effectiveness of policy support without sharply increasing pressure on public finances. Central to this approach is deeper single-market integration, aiming at harnessing the strengths of the massive EU single market.

(3) Industrial Accelerator Act (IAA): Three Major Institutional Reforms

The policies of the CID include mechanisms that boost the competitiveness of companies through institutional reform, going beyond mere financial assistance. The core of this is the Industrial Accelerator Act (IAA). The IAA sets out institutional reforms in three areas: faster permitting, lead markets, and foreign direct investment (FDI) conditionality (Figure 5). These reforms are focused on strategic sectors such as energy-intensive industries, automotive, and net-zero manufacturing.

Figure 5. Proposed Measures in the Industrial Accelerator Act (IAA)

Key target: Manufacturing industry = 20% of EU GDP by 2035					
Pillars	**Faster permitting**			**Lead markets**	**FDI conditionality**
Specific policies	Single access points at the national level for permitting	Stricter deadlines for permit granting	Designate "industrial acceleration areas" with streamlined permitting and other support	Apply low-carbon and/or "made in EU" requirements to certain products in public procurement and support schemes	Conditions trigger when the following criteria are met: 1. investment amount >€100 million 2. investment originates from a country which holds >40% of global manufacturing capacity 3. investment in batteries, EVs, solar panels, or critical raw materials

Source: JRI based on European Commission [2026a]

On the first point, administrative permitting procedures have historically presented a major barrier to the EU industrial sector's efforts to decarbonize. Approvals for plant upgrades, the adoption of new technologies and connections to energy infrastructure have often taken several years, creating the risk that projects would be

frozen or abandoned during that time. In response to this, the IAA proposes requiring one-stop administrative procedures, online digital applications, and clear deadlines for the permitting process.

The second point, the creation of lead markets, aims to intentionally stimulate demand by utilizing public procurement and institutional support. The aim is to encourage the adoption of products from targeted industries, particularly where low-carbon goods struggle to differentiate from high-carbon counterparts, so eligibility requires compliance with low-carbon and/or EU-origin ("Made in EU") requirements, depending on the specific product. It sets out low-carbon requirements for a specified share of steel, and low-carbon and EU-origin requirements for specified shares of concrete, mortar and aluminium used in public construction and large-scale infrastructure projects. By having national and local governments take the lead in prioritizing the purchase of low-carbon, EU-produced materials, it becomes possible to differentiate them from products whose prices have been unfairly driven down by subsidies and other means.

Finally, setting conditions on inward FDI addresses the risk that the EU becomes little more than an assembly base in emerging and strategic sectors such as electric vehicles (EVs) and batteries, without accumulating the associated technological capabilities. Strict measures apply when the investment size exceeds 100 million euros, the business involves batteries, EVs, solar panels or critical raw materials, and the investment originates from a country which holds more than 40% of the global manufacturing capacity in that sector. Such investments may proceed only if they meet at least four of the six specified screening criteria (Figure 6).

As such, the policy proposals incorporated into the IAA bill strongly emphasize institutional reform – the creation and protection of domestic markets and investment conditionality – rather than simply relying on investment incentives like subsidies. However, the IAA is still in the deliberation stage, and key details remain uncertain, such as how far to include trusted partner countries outside the EU in the "Made in EU" requirement. Furthermore, both the CID and the IAA are policies that primarily advance the second pillar of the Competitiveness Compass, the joint roadmap for decarbonization and competitiveness. Further policies will likely be rolled out to achieve the goals of closing the innovation gap (pillar 1) and reducing excessive dependencies and increasing security (pillar 3).

Figure 6. FDI Screening Criteria in the IAA

(1) Minority ownership	Foreign investors do not hold more than 49% of capital, voting rights, or other ownership interests.
(2) Joint venture	Foreign investor forms a joint venture with EU entities.
(3) IP licensing/ transfer	・Foreign investors shall enter agreements with the EU entity to share IP rights and know-how. ・The EU entity's IP and assets developed prior to the investment, without collaboration with the foreign investor, shall not transfer ownership. ・IP and assets developed as a result of collaboration with the foreign investor shall be jointly owned.
(4) R&D spending	The foreign investor spends at least 1% of the gross annual revenue of the EU asset on R&D in the EU.
(5) EU employment*	At least 50% of the workforce in the EU asset is made up of EU workers across all job functions.
(6) EU value chains	The foreign investor prepares and publishes a strategy for EU sourcing for manufacturing processes, striving for 30% local content in products sold on the EU market.

Source: JRI based on European Commission [2026a]
Note: *this condition is mandatory in all cases.

3. Competitiveness Against China

In the EU's latest industrial policy agenda, issues such as global overcapacities, unfair competitive environments, and trade dependencies are heavily discussed, with a particularly strong awareness of the declining competitiveness of European firms relative to Chinese firms. The strength of Chinese manufacturing

has now entered a new stage characterized by "competitiveness driven by advanced technology" rather than "cheap manufacturing," and European manufacturing is facing a phenomenon referred to as the "China Shock 2.0" (Nogimori [2025a]). Ironically, this impact is most pronounced in the green industries that the EU prioritizes most. In the global electric vehicle (EV) market, Chinese manufacturers are expanding their market share, leading to situations such as Germany's Volkswagen (VW), which continues to struggle in both the European and Chinese markets, being forced to close domestic factories for the first time since its founding (Nogimori [2025b]).

Indeed, the IAA highlights, with China in mind, that the EU's trade dependencies elevate the risk of trade weaponization by other countries. It also expresses alarm at China's extremely high share of global manufacturing capacity of green technology products, such as batteries and solar panels. In response to this situation, the EU has put forward two countermeasures within the IAA: “Made in EU” requirements and FDI conditionality.

The first measure, “Made in EU” requirements, is a strict local procurement rule for components used in manufacturing. This applies to (1) public procurement and (2) public support schemes. As already noted, the requirements form part of the institutional reforms designed to create lead markets. The former involves national and local governments prioritizing the purchase of compliant products, while the latter envisions providing subsidies and other support for the purchase of products that meet the conditions. It is a policy that simultaneously stimulates demand for EU-made products and revitalizes investment within the EU.

However, the scope of the “Made in EU” requirements is limited to specified net-zero technology products such as batteries, solar panels, vehicle components, and wind power, as well as concrete, mortar, and aluminum. For sectors like steel, where China's overcapacity is viewed as a problem, import restrictions such as tariffs are considered as options for addressing industrial competitiveness. This distinction underscores that the policy strongly emphasizes the mission of decarbonization.

Regarding conditional FDI, as previously indicated, this is a measure that applies strict regulations to foreign firms making investments exceeding €100 million. The IAA's Impact Assessment Report (European Commission [2026b]) presented forecasts for the battery industry indicating that while Chinese firms will account for 34% of the EU's battery cell manufacturing capacity by 2030, joint ventures (JVs) between European and Chinese firms will only account for 7% of total capacity, thereby expressing concern over the battery ecosystem. These concerns reflect an emphasis on strengthening autonomous supply chains led by European firms, rather than merely being satisfied with having factories located within the EU.

The “Made in EU” requirements and FDI restrictions are highly likely to act as strong countermeasures against competition from Chinese firms. China's Ministry of Commerce criticized the IAA in March 2026 as "constituting a severe investment barrier and institutional discrimination," and in April formally submitted a written opinion to the European Commission expressing its official stance and serious concerns. In May, the China Association of Automobile Manufacturers (CAAM) also expressed strong opposition, indicating growing concerns on the Chinese side over negative impacts.

However, it must be noted that while this will deal a significant blow to Chinese firms, it will not necessarily yield immediate positive results for European firms. FDI restrictions, in particular, may lead to numerous problems such as increased costs, given that prominent European firms capable of replacing Chinese firms in many green sectors have not yet emerged. Among the various proposals presented by the EU Commission, 89% of EU industrial stakeholders agreed with the statement that "measures to stimulate demand for clean industrial products are essential to drive industrial decarbonization". While there is significant support for proactive measures to create and protect European lead markets for low-carbon products, the same cannot be said for conditional FDI. Only 55% agreed with the statement that "imposing certain conditions on FDI is useful from the perspective of the EU Single Market" (Figure 7).

Figure 7. Survey of Industrial Stakeholders: Summary of Responses

Barriers to industrial decarbonisation		% agreeing
	Lack of sufficient access to affordable and decarbonised energy	85%
	High operational costs	83%
	Permitting complexity and duration	82%
	High capital costs	80%
	High carbon abatement costs	80%
	Unfair international competition from non-EU countries	80%
	Decarbonisation technologies not yet widely available or deployed at scale	63%
	SMEs face greater decarbonisation barriers than larger companies	46%
Streamlining and speeding-up permitting procedures: Key issues related to permitting		% agreeing
	Decarbonising energy-intensive industries requires addressing cross-border challenges	85%
	Permitting challenges differ between Member States (national fragmentation)	71%
	Permitting challenges are widespread across Member States	69%
	Fragmented regulatory landscape & complexity identified as most significant issue	60%
Creation and protection of European lead markets for low-carbon products		% agreeing
	Demand-stimulation measures are essential to drive decarbonisation	89%
	Public procurement is a significant driver for lead markets	82%
	Lack of willingness among downstream sectors/consumers to pay a premium	81%
	Public procurement focuses too heavily on price over non-price criteria	78%
View on FDI conditions		% agreeing
	Valuable for bringing capital into Europe unavailable within the EU	63%
	Beneficial for transferring know-how on products/processes not available in EU	47%
	Enhances supply security by localising production closer to demand	38%
	Plays no role in advancing industrial decarbonisation investments	4%
	Useful to impose conditions on FDI from internal market perspective	55%

Source: JRI based on European Commission [2026b]
Note: The total number of responses was 314: 129 from business associations (41%), 120 from companies (38%), and 65 from other respondents, including public authorities (21%).

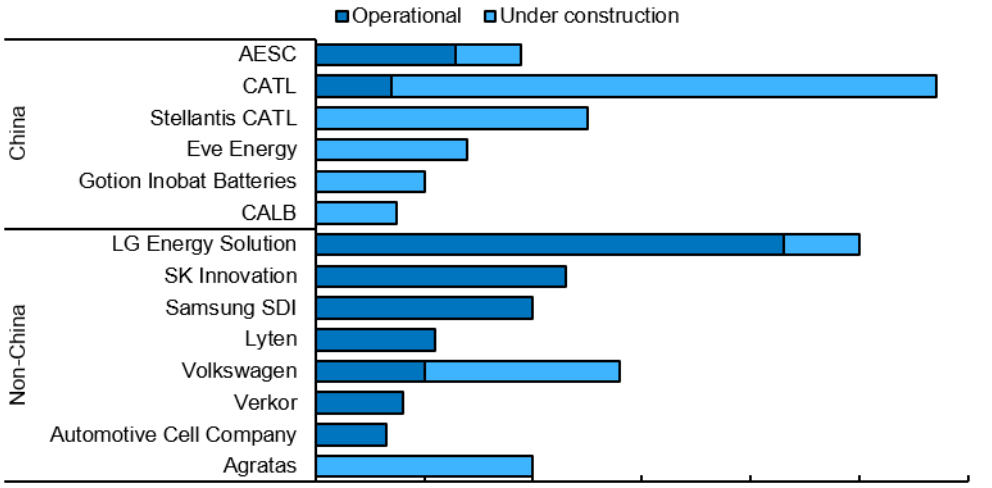
Furthermore, in response to the “Made in EU” concept envisioned by the IAA, García Bercero et al. [2026a] argue that international cooperation is more important than ever for the pursuit of European economic competitiveness and economic security, advocating for "Made with Europe" rather than "Made in Europe". This stems from concerns that the current IAA could strengthen restrictions not only against China but also against like-minded countries. Rather than rigidly relying on resources within Europe, cooperation with other countries where appropriate would likely make policies towards China more effective.

García Bercero et al. [2026b] also argue that, while economic security measures are necessary, the current proposal has become an excessively protectionist. They note side effects such as the price that European governments pay for solar panels more than doubling if Chinese solar cell imports are excluded. Furthermore, while they support stronger screening of FDI, they argue that investments generating added value within the EU must be accepted regardless of nationality. Given the reality that the EU heavily relies on non-EU firms for production capacity – with much of the operational battery cell capacity in Europe run by South Korean firms,

and Chinese firms accounting for the majority of capacity under construction (Figure 8) – significant negative economic impacts from policies that unilaterally exclude non-EU firms are inevitable.

As deliberations on the IAA have continued, the German and French governments reached an agreement on a policy proposal regarding criteria for EV subsidies related to the IAA on October 16, 2026. According to reports, the agreement's definition of the EU's internal market includes not only the 27 EU member states but also partner countries that were "part of the EU internal market on January 1, 2020"[3] such as the UK, Norway, and Iceland. If the proposal becomes EU law, these countries would be eligible for inclusion in "Made in EU" preference, subject to signing reciprocity agreements with the EU.

Figure 8. European Battery Cell Manufacturing Capacity by Company



Source: JRI based on García Bercero et al.[2026b]
Note: Only includes firms with over 10 GWh of capacity operational and/ or under construction.

4. Implications for Japan

The shift in EU industrial policy offers profound implications for Japan, which faces similar geopolitical risks, financial constraints, and competition with China. First, the starting point should be "clarifying missions and target setting" rather than treating promoting specific industries as an end in itself. The concept of inducing innovation through an approach that presents clear societal challenges, such as decarbonization and economic security, as missions, and encouraging the entry of firms aiming to contribute to their achievement or solve those challenges, is a point Japan should learn from. It has been pointed out that the 17 priority areas in Japan's growth strategy are somewhat too numerous compared to other countries, and clear missions can serve as criteria for reviewing which firms merit support and how they should be prioritized in light of their contribution to these challenges (Ishikawa [2026], Nogimori, Inoue, and Paterson [2026]).

Second, policy should focus on institutional reform to ensure the continuity of policy support given limited fiscal resources. Support that relies solely on subsidies risks pressuring public finances and undermining policy sustainability (Inoue and Nogimori [2026]). The core of support policies should be improving the market environment, for instance by accelerating permitting, creating demand through public procurement (lead markets), and standardizing specifications. By combining institutional reforms with financial mechanisms that

[3] "France, Germany strike deal on car emissions and UK special status", Reuters, October 16, 2026. https://www.reuters.com/business/france-germany-agree-deal-car-emissions-uk-special-status-2026-10-16/

effectively crowd in private capital, it becomes possible to promote industries sustainably while keeping the burden on public finances in check. It is also important to concurrently verify the inducement effect on private investment and review the scale, methods, and viability of continuing support (Inoue [2026]).

Finally, the approach to setting conditions with an eye on industrial competition with China is also noteworthy. Much like the "Made in EU" requirements and strict FDI conditionality, a certain degree of discipline is required to encourage the domestic accumulation of technology and added value and to build autonomous supply chains. In doing so, policymakers must carefully assess the risk that excessive domestic preference could harm domestic industries, for instance by fragmenting supply chains and raising costs. Cooperation with like-minded countries, where appropriate, will be essential to strengthening competitiveness while preserving strategic autonomy, pursuing both technological leadership and an indispensable role in global supply chains.

5. Conclusion

Amid the global revival of industrial policy, the EU's innovative initiatives highlight both the limits of traditional, subsidy-reliant industrial support and the potential for new types of policy support.

As Japan builds its future industrial policy, the EU's efforts to create markets through institutional reforms and develop financial frameworks that use public funds as leverage to encourage a self-sustaining cycle of private investment serve as highly valuable reference models. It will be essential to clarify missions prior to industry selection and ensure the continuity of policy support given resource constraints. Even as competition from Chinese firms poses a major challenge, the key to the success of Japan's industrial policy will lie not simply in the scale of subsidies, but in how effectively it can translate societal challenges into policy objectives and build mechanisms to guide public and private investment towards them.

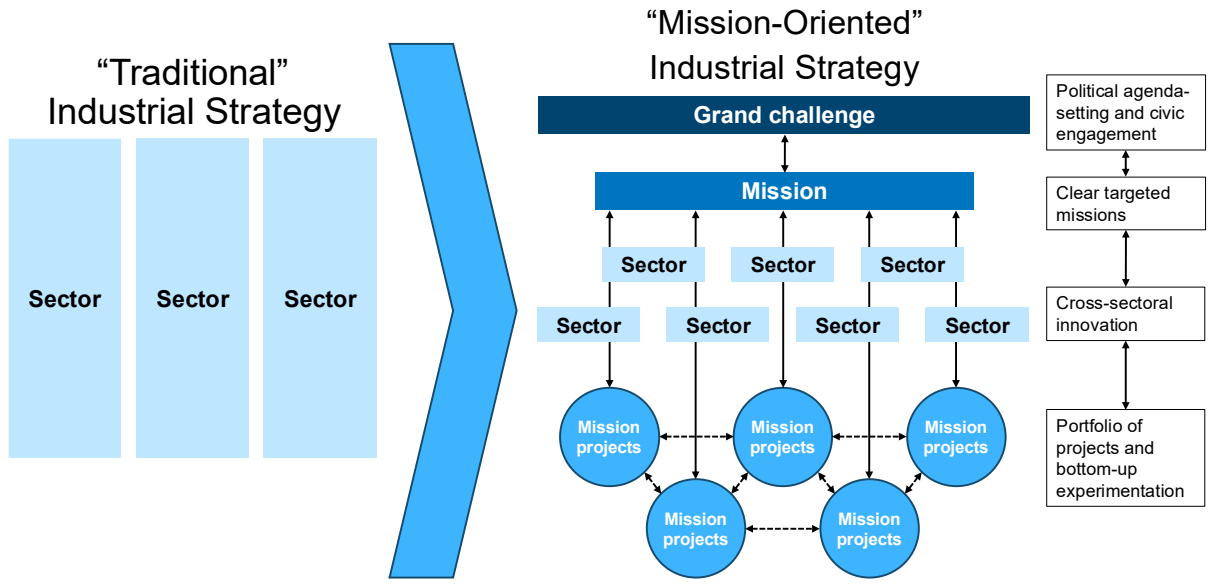
Appendix 1: The Importance of Missions and Targets in Industrial Policy as Highlighted by Mazzucato and Draghi

Mariana Mazzucato argues that governments should not just use industrial policy, but "mission-oriented industrial strategy" (Mazzucato et al. [2024]). Being "mission-oriented" means not striving for economic growth alone as the end goal, but seeking to shape the direction of growth towards tackling societal "grand challenges" such as climate change, and combining this with an industrial strategy—which refers to "a set of industrial policy measures deployed together in a coordinated way to achieve objectives." This effort should be guided by "missions," specific government-set targets which relate to these challenges. An example mission would be "creating ten carbon-free cities by 2035". Economic growth is then seen as a by-product of achieving these missions.

Mazzucato is critical of older models of industrial strategy that focus on promoting specific sectors as their end-goal. She instead calls for governments to set missions that target specific problems and support public and private actors from across the economy who are willing to contribute (Mazzucato [2018a]) (Figure 9). In short, she calls for "picking the willing" rather than "picking winners". It should be noted that this does not mean the government should support all sectors equally, but investment in various sectors should contribute to the

government's missions (Mazzucato [2025]).

Figure 9. "Traditional" Industrial Strategy and "Mission-Oriented" Industrial Strategy



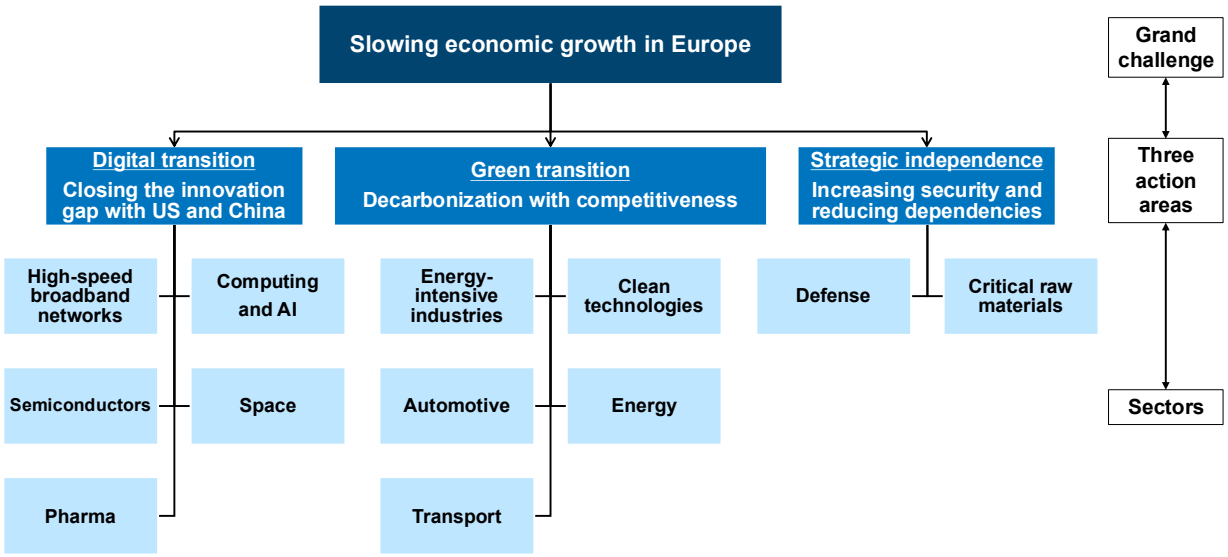
Source: JRI based on Mazzucato et al. [2024]

In addition to being cross-sectoral, good missions should have clearly measurable/quantifiable targets and defined time frames, which she argues are critical for measuring progress and ultimately determining mission success or failure. These ideas are directly referenced in the mission design of Horizon Europe, the EU's support program for promoting research and innovation (Mazzucato [2018b]). Mazzucato and Penna [2020] cite Chile's 2016 strategy for the solar energy sector as an example. This set quantifiable goals to be met by 2025 including establishing 100 Chilean companies in the solar value chain and reducing the cost of solar PV energy to US$25/MWh.

While Mario Draghi does not emphasize the word "missions," his focus on specific problems and areas for action guiding industrial policy reflects an approach which in practice bears similarity to "mission-oriented industrial strategy". He argues that, amid sluggish economic growth, it will be difficult for Europe to simultaneously achieve the digital transition, the green transition, and strategic independence, and sustainable growth will be necessary to achieve all three goals. Within this framework, he outlines three specific areas for action: closing the innovation gap with the US and China, a joint plan for decarbonization and competitiveness, and increasing security and reducing dependencies (Figure 10). These are intended to support sustainable economic growth, with the selection of industries to support tied to these priorities. For instance, increasing security and reducing dependencies are considered essential for growth because geopolitical risks can deter investment and trade shocks can disrupt growth. Each action area includes several sectors needing support.

However, Draghi's approach differs from Mazzucato [2024], who specifically criticizes policymakers who treat economic growth itself as a mission. This difference is clear with regard to decarbonization. While Mazzucato would frame this as the end-goal of a mission and economic growth a by-product of the mission, Draghi instead frames decarbonization as a means fostering sustainable growth by bringing about productivity improvements and cost reductions.

Figure 10. Draghi's Proposed Industrial Strategy for the EU



Source: JRI based on Draghi [2024]
Note: "Energy-intensive industries" refers to sectors such as chemicals, basic metals and plastics. Industries linked by Draghi to multiple action areas are listed only under the action area they are most relevant to.

Appendix 2: Initiatives to Utilize Household Funds for Industrial Policy

The EU is also attempting to build a better pipeline from individual investors to firms in need of capital. EU capital markets currently face two key problems: regional fragmentation and low household participation in capital markets. The EU proposes a series of capital market reforms collectively called the Savings and Investment Union (SIU), aiming to harmonize regulations such that asset managers, financial institutions, and firms can easily operate between markets. With reforms under the SIU, such as the Market Integration and Supervision Package, the EU assumes a larger regulatory and oversight role (European Commission [2025b]). This allows it to consistently apply standards across member states and create a more predictable financial environment for firms.

The SIU aims to create an environment that allows financial institutions to more easily offer investment products, such as equities, bonds, and investment trusts, to a wider array of customers. Retail investors can also easily invest their funds in equities and investment trusts through joint Savings and Investment Accounts with simplified tax systems and procedures. Collectively, these reforms and financial products should make it easier for firms to raise capital regardless of where they are based or listed. These reforms reduce some of the intra-market friction that hinders new business and aim to expand the supply of private capital to areas such as clean technologies.

Appendix 3: Financial Resources Supporting EU Industrial Support and the Division of Roles Between the Public and Private Sectors

While market integration is advancing in the EU, fiscal management remains primarily the responsibility of individual member states, making the burden of cross-border investment costs a challenge (Draghi [2024]). For example, if cross-border power grids are developed, it becomes easier for multiple countries to share

electricity. However, if each country makes decisions based solely on its own costs and benefits, the necessary investments for the EU as a whole may not proceed. In the EU, where markets and supply chains expand across borders, mechanisms to jointly support such investments are vital.

Differences in the fiscal capacity of member states also constrain the promotion of a common industrial policy. Countries with tight finances must balance new support with fiscal consolidation. On the other hand, if countries with ample fiscal space increase subsidies to their domestic companies, the competitive conditions for companies could be dictated by the government's financial strength. The Letta Report points out the risk that differences in fiscal capacity among member states could undermine fair competition in the single market (Letta [2024]).

Since the EU's common budget is also limited, it is important to devise ways to crowd in private investment with public support. The Draghi Report noted that the EU's annual budget is small, at just over 1% of regional GDP, with much of it allocated to agriculture and correcting regional disparities. The Clean Industrial Deal (CID) utilizes guarantees, investments, and loans in addition to subsidies (European Commission [2025a], Figure 4). For example, under the InvestEU investment support scheme, the EU provides guarantees backed by its budget, bearing a portion of the loss risk associated with loans and investments by institutions like the European Investment Bank (European Parliament and Council of the European Union [2021]). This is a mechanism where the public sector shares the risk, making it easier for private financial institutions and investors to provide funding. However, a budget is still required to prepare for losses associated with guarantees and to pay out subsidies; utilizing private funds does not eliminate the public burden.

The issuance of "joint bonds" by the EU has also been proposed as a means of raising funds to support common investments. Building on the precedent of the EU borrowing to support recovery from the COVID-19 crisis, the Draghi Report proposes borrowing to support joint investments in advanced technology research and cross-border power grids. The idea is to jointly support projects that bring benefits to multiple countries, rather than simply filling the deficits of individual countries.

Joint debt issuance, however, does not eliminate the future repayment burden. It is necessary to agree on which projects to support and how to share the costs, and to secure financial resources to support repayment. The Draghi Report also calls for limiting the use of funds to specific policy objectives or projects and strengthening the fiscal discipline of each country. The EU should therefore use public support to catalyze private investment while securing the revenue needed both to sustain that support and to repay jointly issued debt.

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