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Imagining Structures, Negotiating Transitions: Body, State, and Meaning in a Shifting World

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The Political Economy of Industrial Policy Legitimacy: Reconciling State Intervention with Dynamic Competition

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Abstract

In recent years, both the EU and the US have revived industrial policy amid challenges like digital dominance, the green transition, and shifting geopolitical dynamics. This paper uses a comparative historical approach to examine the legitimacy of industrial policy across post-WWII development, Cold War tech strategies, globalization, and current initiatives like the CHIPS Act, the EU Green Deal, and the Inflation Reduction Act.

The study finds a move from static to Schumpeterian competition models, reframing legitimacy debates. While concerns about rent-seeking persist, proponents emphasize innovation, externalities, and security. "Hybrid regimes"—industrial alliances and public–private missions—now blend industrial strategy and competition policy.

In the EU, "open strategic autonomy" and new state-aid rules aim to align market logic with strategic needs. In the US, bipartisan support has driven federal reinvestment in critical sectors. The paper argues that legitimacy depends on clear goals, R&D targeting, and institutional reforms that blend expertise with democratic oversight.

Ultimately, it proposes a new framework: industrial policy as "dynamic competition strategy" tied to ecological and security objectives and embedded in multi-level governance.

Keywords: Industrial policy; Competition; Legitimacy; Innovation; Strategic autonomy

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1. Introduction

Industrial policy–government efforts to direct resources or influence the structure of the economy–has long been a contentious issue in economics and political economy. Advocates argue that strategic state intervention can correct market failures, support infant industries, and catalyze technological change, while critics counter that it invites rent-seeking, government failure, and distortion of competition. In the post-war era, both the United States and Europe engaged in extensive industrial initiatives (e.g. defense R&D, space programs, Marshall Plan in Europe, or the indicative planning of postwar France and Italy), but by the late 20th century the dominant view was skeptical of selective intervention. The EU (and its members) favored horizontal policies and strong competition rules, and the US largely retreated from overt industrial direction outside of defense (e.g. NASA, DARPA). Yet the 21st century has witnessed a renewed turn to active industrial strategy on both sides of the Atlantic, motivated by concerns over globalization, technological leadership, climate change, and geopolitical competition. As Diane Coyle (2024) observes, "there is a clear revival of active industrial policy in many OECD economies" alongside renewed activism in competition policy to address digital and green challenges.

This paper investigates the legitimacy of modern industrial policy in light of evolving theories of competition, innovation, and capitalism. Legitimacy here refers to the normative and political acceptability of state intervention: whether the public and stakeholders view it as justifiable, the rules of law permit it, and it is effective. I ask: Under what theoretical and historical circumstances has state-led industrial strategy been seen as warranted or troubling? How do dynamic competition arguments (competition for the market via innovation) reshape the industrial policy debate? And how have institutional frameworks (EU single market rules, US federalism and antitrust, global trade law) adapted to reconcile state aid with competition?

The paper proceeds as follows. After reviewing the relevant literature (Section 2), I develop a theoretical framework that integrates classical and modern views of competition, innovation, and the state. I then survey the historical context (Section 4), from the post-WWII developmental states and Cold-War science policy, through the globalization era of the 1990s–2000s, to today's crises. In Section 5 I analyze contemporary industrial policy in the EU and US, focusing on cases such as green energy initiatives, digital sovereignty projects, and high-tech subsidies (e.g. CHIPS Act, European Green Deal, US Inflation Reduction Act). I discuss how these policies fit into broader economic and political goals (climate neutrality, supply-chain resilience, technological leadership) and how they are justified against competition norms. Section 6 synthesizes the discussion and assesses drivers of legitimacy (economic rationale, political coalition, institutional design). Section 7 concludes with recommendations for aligning industrial policy with dynamic competition objectives while maintaining legitimacy.

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Throughout, I draw on key texts in development economics, competition law, and political economy (e.g. Hirschman on linkages, List on national systems, Schumpeter on creative destruction, Rodrik and Chang on industrial policy, and recent work on competition policy's role). I incorporate empirical evidence from both historical studies and current policy analyses. In so doing, I aim to provide a nuanced, academically rigorous account of how advanced economies are reconciling state-led strategies with market competition in an era of rapid change.

2. Conceptual Foundations: Industrial Policy, Competition, and Legitimacy

2.1 Industrial Policy, Competition, and Legitimacy: Conceptual Foundations

Industrial policy aims to promote long-term economic development and structural transformation by optimizing resource allocation and driving technological progress. While traditional views consider market competition a primary mechanism for efficiency, market forces alone often fail to guide innovation and upgrading in complex, imperfect environments. The dynamic competition perspective reorients attention toward innovation-driven rivalry and continual transformation. Unlike static competition, which emphasizes allocative efficiency at a given point in time, dynamic competition concerns the process of innovation, entry, and technological evolution over time (Schumpeter, 1942; Petit et al., 2024). It provides a renewed framework wherein government intervention is not merely a response to market failures, but an active effort to create the conditions for sustained innovation and industrial evolution.

However, such interventions raise questions of legitimacy. Industrial policy often redistributes resources and affects powerful stakeholders, making transparency and institutional safeguards essential to avoid rent-seeking (Stigler, 1946; Buchanan, 1980). As such, examining the relationship between competition and industrial policy requires not only an economic lens but also a political economy perspective—concerned with how policy gains public acceptance and institutional credibility (Rodrik, 2004; Coyle, 2024).

2.2 Development Economics, Endogenous Growth, and Competition Theory through a Dynamic Lens

Development economics has long emphasized structural transformation and state coordination. Early theorists like Kaldor (1957) argued that industrial output was central to productivity growth. Hirschman (1958) introduced the concept of forward and backward linkages—arguing that targeted investments (e.g., in steel or infrastructure) generate ripple effects across the economy. Gerschenkron (1962) emphasized the role of the state in late-developing countries, observing that strategic public investments were crucial for catching

up—seen later in East Asian economies. Chang (2003, 2014) further argued that today's developed countries historically used infant-industry protection and industrial coordination to build competitive capacity, challenging the narrative that such policies are inherently distortionary.

Endogenous growth theory, as developed by Romer (1990), Aghion and Howitt (1992), and others, shifted the focus to innovation, R&D, and human capital. These models underscore how knowledge spillovers and cumulative innovation processes drive long-term growth. From this standpoint, competition is not merely a price game—it is a race to innovate. The relationship between competition and innovation has been shown to follow an inverted-U curve: moderate competition fosters innovation, while excessive rivalry may reduce firms' R&D incentives (Aghion et al., 2005).

Schumpeter (1942) famously described capitalism as a process of "creative destruction," wherein new entrants challenge incumbents through disruptive innovation. This insight underpins a more dynamic theory of market competition. Modern industrial organization theory has expanded to include firm entry/exit, technology diffusion, and product cycles. These models redefine competition as an evolutionary process shaped by innovation capacity, not static market shares.

Bringing these theories together, dynamic competition provides a conceptual bridge: industrial policy should foster innovation incentives, lower barriers to entry, and support technological upgrading. R&D subsidies, public procurement, and targeted investment can help correct coordination failures and accelerate transition to higher value-added sectors (Petit et al., 2024; Mazzucato, 2013).

2.3 Political Economy and the Legitimacy of Industrial Policy

The political economy literature highlights that industrial policy is shaped by institutional capacity, political coalitions, and public expectations. Cold War-era theorists (e.g., List, 1841; Gerschenkron, 1962) saw state-led industrialization as a strategy to overcome colonial dependency or structural backwardness. More recent work by Rodrik (2004, 2014) explores the institutional prerequisites for "good" industrial policy: accountability, embedded autonomy, and learning mechanisms. Chang (2010) critiques ideological polarization in the debate and instead urges an empirical approach comparing successes (e.g., South Korea) and failures (e.g., Latin America in the 1970s).

In liberal democracies, legitimacy depends on whether policy aligns with widely accepted goals—such as innovation, employment, or national security—and whether it is administered through transparent, rule-based processes. Diane Coyle (2024) argues that modern regulators must make normative judgments about strategic economic direction, blurring the line between technical governance and political choice. Wambach (2025) reflects on Germany's shift from marginalizing industrial policy to openly embracing it as a tool for innovation and climate policy. These shifts have reopened legitimacy debates: while critics warn of past policy failures (e.g., UK automobile bailouts),

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supporters highlight innovation externalities and strategic resilience—especially in light of recent global shocks.

2.4 Institutional Evolution and Empirical Lessons

The design and effectiveness of industrial policy are deeply shaped by institutional conditions. Legal frameworks, property rights, education systems, and innovation ecosystems all affect how competition and policy interact. A robust institutional environment supports both private innovation and public accountability—essential for sustaining dynamic competition.

Empirical studies present a mixed record. Hufbauer and Jung (2021), in a review of 18 U.S. industrial policy episodes (1970–2020), found that broad-based policies such as funding basic research often perform well, while narrow protectionist measures generally fail. Their conclusion is clear: "In most cases, import protection does not create a competitive US industry, and it imposes extreme costs… DARPA has the outstanding record." Similarly, Operation Warp Speed is often cited as an example of success through competitive, collaborative R&D efforts.

In Europe, experiences with aerospace, energy, and computing policies suggest mixed outcomes—frequent misallocations coexisted with some notable successes, such as the Airbus consortium and the EUREKA R&D network. The European Union's 2020 Industrial Strategy frames initiatives (e.g., semiconductor alliances) as compliant with competition law, and recent OECD discussions emphasize "pro-competitive industrial policy" that maintains transparency and legal certainty.

The overall lesson is that industrial policy is not inherently legitimate or illegitimate—it depends on context, design, and institutional architecture. Dynamic competition theory, combined with evolving geopolitical realities, provides a timely lens for rethinking legitimacy. Policies that support innovation, emphasize human capital, and are embedded in accountable institutions have the strongest track record. The next section develops a conceptual framework to analyze historical and contemporary cases accordingly.

3. Theoretical Tensions: Reconciling Intervention and Competition

To analyze industrial policy legitimacy, I integrate economic and political theory. I distinguish between static competition (traditional market competition in established industries) and dynamic competition (innovation-driven competition over time) and consider how state interventions interact with each. I also consider legitimacy along multiple dimensions: economic legitimacy (justification by market failure or strategic necessity), legal legitimacy (consistency with rules), and political legitimacy (public support and accountability).

3.1 Market failures and government justification

In neoclassical economics, market failures provide the classic rationale for government action: public goods (R&D spillovers, basic infrastructure), externalities (pollution, R&D spillovers), information asymmetries (e.g. financing of new firms), and coordination failures (supply chain investments). Early trade theory even offers a ground for strategic interventions: a classic example is the infant industry argument (List 1841; Prebisch–Singer), where protection or subsidies are justified to allow a nascent industry to grow until it can compete globally. Modern writers (Krugman, Bhagwati) emphasize how industrial policy is essentially about altering allocative outcomes for growth or security. But any industrial policy introduces "distortions" by design: it privileges certain industries or firms. Thus the legitimacy of intervention depends on demonstrating that it yields greater net welfare than leaving markets alone.

One aspect of our framework is the evolution of competitiveness. Traditional competition policy views markets as if they were "perfect competition" in the long run, ignoring innovation. The dynamic competition literature rejects static efficiency as the sole goal. It emphasizes that intense rivalry and creative destruction drive technological leadership. In dynamic competition, short-term market dominance might be temporary if firms continually innovate. Government policy may thus be justified if it accelerates innovation cycles, either by providing targeted R&D or by crafting conducive environments (patent systems, clusters, skills). Schumpeter himself warned that perfect competition (many small firms) is not realistic for innovation-led industries; rather, the process of "gale of creative destruction" often involves large firms eventually replaced by newcomers. This suggests that antitrust and industrial policy must be coordinated: for example, tolerating a temporary monopoly in a new technology market might be fine if entry is fostered through R&D subsidies or standards that lower barriers.

3.2 Horizontal vs. vertical policy

Our framework distinguishes horizontal policies (broad-based, technology-neutral measures like improved education, infrastructure, and general R&D tax credits) from vertical/targeted policies (subsidies to specific sectors, firms, or technologies). Neoclassical theory argues horizontal policies have less distortion (though they still involve large budget allocations, e.g. public R&D institutes). But structuralist and modern development perspectives emphasize that coordination failures and specific externalities may justify vertical actions. For instance, building a semiconductor fab without assurance of a cluster of suppliers and skilled workers might fail — a "big push" rationale. The EU's industrial strategy reflects both: it funds ecosystem development (digital hubs, battery alliances) without choosing single winners, attempting a compromise between horizontal and vertical emphasis.

3.3 Legitimacy and political economy

Industrial policy legitimacy also has a political side. I draw on theories of input and output legitimacy. Input

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legitimacy refers to how policies are made (transparency, democratic process); output legitimacy to their outcomes (economic growth, jobs). Legitimacy is higher if industrial policy is seen as addressing widely agreed societal goals (decarbonization, security) rather than benefiting narrow interests. Historical experience shows that policies packaged as national projects (e.g. Apollo program in the US, Airbus in Europe) can garner broad support. Conversely, policies that blatantly favor certain incumbents or redirect resources toward politically connected firms can generate cynicism and backlash. The EU has tried to build legitimacy by reconciling industrial policy with open-market rhetoric – for example by stipulating that alliances must be "fully compliant with competition rules". The US, less constrained by supranational rules, frames its interventions in bipartisan terms (national security, competition with China) to build consensus.

Our framework thus considers legitimacy as a function of justification, design, and context. Justification refers to the underlying arguments (market failure, innovation, security) and evidence. Design refers to implementation (targeting, evaluation, sunset provisions). Context includes institutional settings (EU law, WTO obligations, political pressures). Dynamic competition theory adds a layer: legitimate intervention should be seen as fostering long-run market rivalry, not static protectionism. In practice, this means (for example) ensuring subsidies are coupled with competition-enhancing features (phase-out, performance criteria) or that regulation (antitrust) allows for the emergence of new competitors.

Finally, I incorporate legitimacy-building mechanisms from development theory: networks, learning platforms, and consensus-building institutions. Public–private partnerships, multi-stakeholder councils, and independent impact assessments can lend credibility. Chang (2010) and Rodrik (2004) emphasize that effective industrial policy often comes with mechanisms to elicit private information and to be self-correcting (e.g. Israel's Yozma program with venture capital, Korea's Techno-Venture Fund). I will assess contemporary EU and US examples against these criteria.

4. Historical Evolution of Industrial Policy Legitimacy

4.1 Post-WWII to 1970s: Developmentalism and Cold War Imperatives

In the aftermath of World War II, industrial policy was widely regarded as legitimate across advanced economies. In the U.S., Cold War exigencies gave rise to the Military-Industrial Complex, with agencies like DARPA (founded in 1958) and programs such as Apollo justifying large-scale R&D spending under national security goals. These interventions were accepted due to both geopolitical necessity and their innovation spillovers (Rodrik, 2004). Meanwhile, Europe adopted developmentalist models: the Marshall Plan was coupled with state-led planning, national champions, and sectoral coordination—especially in France, Italy,

and the ECSC. Germany's ordoliberalism maintained a market-oriented rhetoric, but even there the state guided regional development.

By the 1960s, interventionist models were widespread. Japan and other East Asian economies demonstrated state-led industrial success, while in the West, legitimacy rested on full employment and reconstruction narratives. As Joseph Nester observed, "Every nation has industrial policy, whether they admit it or not," with even liberal regimes maintaining selective support for key sectors (e.g., U.S. steel tariffs, Boeing financing).

4.2 1980s – 1990s: Liberalization, Globalization, and Horizontalism

The late 1970s brought a shift: stagflation and the decline of the Keynesian consensus eroded confidence in industrial planning. In the Reagan-Thatcher era, deregulation and market liberalization became dominant. Europe moved toward the Single Market (1985), privatizing utilities and focusing on horizontal instruments like the Framework Programmes and the Eureka initiative. The EU institutionalized competition through state aid rules (Article 107 TFEU), emphasizing neutrality and efficiency.

In the U.S., industrial policy took the form of trade defense (e.g., Section 301), while subsidies were largely confined to defense sectors. Policymakers embraced innovation as a competitiveness strategy—framed through National Innovation Systems (Freeman, 1987; Lundvall, 1992) and Varieties of Capitalism (Hall & Soskice, 2001)—rather than explicit sectoral favoritism. Nevertheless, industrial policy remained present, albeit under new labels and justifications.

4.3 2000s – 2010s: Crisis, Restructuring, and Policy Resurgence

The 2008 financial crisis marked a turning point. Emergency bailouts and stimulus programs revived selective intervention, including the U.S. TARP, the ARRA's clean energy support, and EU state aid for banks and industries. Scholars and policymakers reconsidered the legitimacy of industrial policy in light of systemic risks and global competition (Rodrik, 2014; Aiginger, 2006; Chang, 2010).

In the 2010s, Europe launched IPCEIs and national industrial alliances (e.g., on batteries, hydrogen), while the Commission repositioned industrial strategy as essential for growth and resilience. Innovation ecosystems and "mission-oriented" approaches (Mazzucato, 2013) replaced traditional national champion rhetoric, aiming to reconcile state involvement with competition norms. Populist discontent with globalization (e.g., Brexit) added urgency to protect jobs and strategic sectors.

In the U.S., industrial policy re-emerged with nationalist overtones under the Trump administration, including tariffs, reshoring efforts, and early CHIPS legislation. Although controversial, these moves reflected a bipartisan recognition that strategic sectors like semiconductors and clean energy required active state support, especially in response to China's "Made

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in China 2025" initiative.

5. The Resurgence of Industrial Policy in the US and EU: A Contemporary Analysis

5.1 European Union: From Open Markets to Strategic Autonomy

In the EU, recent industrial policy is shaped by the twin transitions to a digital and green economy, and by concerns over open strategic autonomy – ensuring that Europe can act independently on the world stage. The European Green Deal (2019) declared climate neutrality by 2050 a binding goal, implying massive industrial mobilization (renewables, batteries, hydrogen, etc.). At the same time, the Digital Strategy and Industrial Alliances aim to reduce dependence on non-EU technologies (for example, cloud platforms and semiconductors) and to build EU champions in emerging sectors.

In practice, this has meant a flurry of policy initiatives in 2020–2025:

- Climate and Energy: The European Green Deal Investment Plan (also known as the Sustainable Europe Investment Plan) mobilizes at least €1 trillion over 2021-2030 for decarbonization. Notably, the EU is adjusting its state aid framework: the Climate, Energy and Environmental Aid Guidelines allow more direct subsidies for green projects. The Net-Zero Industry Act (2023) commits the EU to produce 40% of its net-zero tech needs by 2030, which (as Wambach notes) requires altering state aid rules and possibly easing merger control for "innovation or sustainability". The Carbon Border Adjustment Mechanism (CBAM) is a tool to counteract any disadvantage from strict EU climate policy by levying import charges on high-emission goods. These measures are pitched as necessary market interventions to fight the externality of climate change, a broadly accepted rationale.
- Digital and Tech Sovereignty: The Commission has launched Important Projects of Common European Interest (IPCEI) for microelectronics, communication technologies, batteries, and hydrogen. These are cross-border projects where governments can subsidize companies in strategic value chains, with special approval by the Commission. For example, Germany's recent €11 billion chip subsidy to Intel (Announced 2022) was approved as an IPCEI. Such projects reflect an explicit industrial policy: coordination among member states to avoid subsidy racing and to pool resources. The Commission has justified them on national security grounds (chips as critical tech) and innovation leadership. By insisting that IPCEIs follow a transparent application process and competition "best practices," the EU attempts to maintain legal legitimacy within its state aid regime.
- Competition and Regulatory Adjustments: While granting more subsidy space, the EU also tightens rules elsewhere to preserve competition integrity. The Digital Markets Act (DMA) and Digital Services Act (DSA) (2022) aggressively target Big Tech platforms, even as EU supports cloud infrastructure. The idea is to prevent private gatekeepers from undermining dynamic

competition. Simultaneously, as mentioned, merger control is being explored for flexibility – the Competitive Compass strategy (2025) contemplates allowing sustainability or innovation justifications in evaluating mergers. In sum, Europe is creating a hybrid regime: strong antitrust to promote entry and innovation on one front, with proactive industrial policy (alliances, subsidies) on another. This reflects Coyle's point that "there is no clear assignment of policy tools" but a need for coordination.

- Legitimacy in the EU context hinges on several factors. First, framing: EU policymakers emphasize shared goals (e.g. "Green Deal", "Digital sovereignty") and embed industrial policy within multilateral commitments (Paris Agreement, A Europe Fit for the Digital Age). The use of words like "alliance" rather than "subsidy" underscores a collegial approach. Second, rules and accountability: by maintaining that industrial alliances comply with competition law and are subject to Commission oversight, the EU signals that intervention is not arbitrary. Third, societal support: the Green Deal in particular enjoys broad public backing in EU surveys, making climate-oriented subsidies politically legible. However, some tensions remain: critics argue the EU should focus on innovation rather than subsidizing incumbents, and small member states worry about favoritism (e.g. if subsidies flow to Germany/France). The Commission thus tries to balance by funding pan-European projects (e.g. battery mega-factories in multiple countries via IPCEI).
- Wambach's analysis of Germany (a key EU player) illustrates how quickly attitudes changed. He notes that by 2024, German federal aid and tax incentives reached €67.1 billion (up from €37.9B in 2021). Projects range from Northvolt's battery plant to Intel's Dresden fab. Germany's openness about these subsidies (and its willingness to lobby for EU exceptions) helps legitimize such policy internally, even as it has drawn criticism abroad (e.g. the EU's State Aid Control adjustments that make it easier to subsidize decarbonization).

5.2 United States: Strategic Competition and Industrial Revival

In the United States, industrial policy has re-emerged under the banners of competitiveness, national security, and economic sovereignty. The driver has been bipartisan concern over lagging in critical technologies, especially relative to China's state-driven model.

- Semiconductors and Strategic Tech: Early in 2021, Congress passed the Chips and Science Act (approved Aug 2022, $280+ billion total, including ~ $53B for chips) to subsidize domestic semiconductor production and R&D. This is a clear industrial policy measure, with explicit goals of "reshoring supply chains" and countering China. It was broadly supported by both parties (though some recall the U.S. government had little of its own fab capacity by 2021). Similarly, advanced R&D is funded by the act ($170B for various research priorities). The legitimacy argument here is national security – both as dependence on East Asia for chips is seen as a risk, and because advanced chips have military uses (radar, encryption). Historically, the US government always supported tech with defense

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applications (DARPA's founding was in the early Cold War), so this is a familiar justification.

- Green Energy and Climate: The Inflation Reduction Act (IRA, 2022) is America's largest industrial policy in history (~$369B in energy and climate spending). It offers tax credits for renewable energy production, electric vehicles, hydrogen, etc. The rationale is primarily climate change (a global externality) and job creation in new industries. Unlike the EU Green Deal, the IRA is explicitly a federal domestic subsidy program, which has stirred controversy. European partners have complained that it attracts investment away from Europe. Within the US, it was argued by Democrats as necessary to meet climate pledges and by some Republicans as an employment boost. The Supreme Court's approval (West Virginia v. EPA, 2022) of the administration's ability to regulate carbon was followed by Congress using its tax and spending powers to fight climate change, indicating a legal legitimacy. The IRA's legitimacy also stems from popular concern about climate and "Buy American" sentiment. Yet critics (even within industry) worry about subsidy costs and trade tensions.
- COVID and Technology Accelerators: Although pandemic relief bills (2020-2021) were mostly fiscal stimulus, the U.S. government also took on industrial roles. Operation Warp Speed (2020) partnered with private firms to develop COVID vaccines, demonstrating public procurement as industrial strategy. Many view Warp Speed as a case where government expertise helped solve a critical challenge through competition and collaboration; it underpins the PIIE finding that American-style competition coupled with public support can succeedpiie.com. Other tech initiatives include ARPA-H (health R&D) and quantum computing programs.
- Trade and Industrial Defense: The U.S. has also used trade policy creatively. The use of Section 301 tariffs (as in 2018 on China) and the focus on "forced technology transfers" are part of a broader strategy to protect and promote American industry. While tariffs themselves violate free-trade orthodoxy, they are politically legitimated under the "national security" clause of trade law. Agriculture, for example, saw some protection in the 2010s to placate voters, but generally US trade policy favors reciprocal market access (e.g. USMCA with Canada/Mexico was pitched as an improvement over NAFTA).
- Legitimacy in the U.S. case comes from framing and performance. The bipartisan nature of measures like CHIPS and IRA suggests wide political consensus, unlike the ideologically charged 1980s. These policies are often justified with detailed legislative reports and metrics (jobs created, capacity added) to show accountability. The focus on R&D and scale-up (rather than picking tiny winners) echoes the PIIE's recommendation that R&D subsidies had best track recordspiie.com. Nevertheless, debates continue: many economists caution that any subsidy must be carefully time-limited and outcome-evaluated to avoid rent-seeking. The question of transparency (how projects are chosen) is salient; Congress requires reporting and GAO oversight on IRA spending, for

instance, as a check.

5.3 US Speed vs EU Consensus: Industrial Policy in Transition

Comparing EU and US approaches, some patterns emerge. Both are responding to similar challenges (climate, digital tech, China) but through different institutional channels. The EU must reconcile multi-national consensus and treaty obligations, so its policies often emphasize collective frameworks and rule-bound processes. The US, with its unitary federal system, can move faster unilaterally, but faces political swings. On competition policy: interestingly, both are loosening past orthodoxies. The EU's willingness to adjust state aid rules, and the US's prosecution of Big Tech plus subsidy programs, indicate a convergence on the need for coordinated action across market and state domains. Both also use industrial policy as diplomacy: EU fosters technology alliances with partners (e.g. Japan's pact on chips), while the US uses export controls and partnerships (AUKUS for semis between US/UK/Australia) to shape the global tech order.

6. Toward a Normative Framework of Industrial Policy Legitimacy

6.1 A Pluralistic Theory of Justified Intervention

Our analysis shows that the legitimacy of industrial policy is not a fixed binary, but evolves with context. In times of crisis or strategic shift, societies are more willing to accept state action. After World War II, rebuilding war-torn economies provided moral license for massive government planning and subsidies. During the Cold War, the existential rivalry justified anything that could strengthen defense industries. In the neoliberal period, skepticism ruled: any deviation from free markets was labeled distortion. Now, a new set of crises—climate, pandemics, and global power shifts—has pushed the Overton window back toward intervention (Rodrik, 2004).

Economic legitimacy rests on clear market failures or strategic imperatives. Climate change is almost universally accepted as a market failure (an unpriced externality), making green subsidies politically legitimate. The U.S. and EU also frame semiconductor and AI policies as national security necessities—a powerful justification in any system. By contrast, policies that seem purely commercial (e.g., support for a particular carmaker or airline) struggle for legitimacy unless packaged as critical for jobs or regional stability. The failure of earlier experiments (e.g., Europe's 1970s "champion firms") has left a legacy of caution. Policymakers now stress that interventions must be time-bound, contestable (e.g., open to others eventually), and targeted at efficiency. As Wambach (2023) observes, untargeted subsidies often failed; grants to efficient firms might succeed.

Competition theory has had a profound impact on how legitimacy is framed. The shift from viewing markets as static equilibria to evolutionary processes (dynamic competition) supports the idea that state

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policy can be part of a healthy competitive ecology. If competition is understood as Schumpeterian rivalry, then government-funded R&D or infrastructure is merely feeding that rivalry. In practice, this means regulators often justify industrial policy on innovation grounds—for example, the EU allowing state aid to Intel because it increases chipmaking innovation, not simply to prop up a legacy player (Petit et al., 2024). However, static competition concerns remain: as the Business at OECD (BIAC, 2023) note warns, intervention that "seeks a particular market outcome" must be scrutinized. Thus, legitimacy is enhanced when policy is designed to enhance market structures, not entrench them. For example, the CHIPS Act requires recipients to agree to reasonable pricing and open licensing, trying to ensure domestic subsidies do not translate into monopoly profits (The White House, 2022).

6.2 Democratic Accountability and Institutional Design

Institutional legitimacy is a critical pillar of justified industrial policy. In the European Union, the requirement for European Commission approval—especially in matters of state aid—offers an impression of impartial oversight, even though some critics argue that the Commission tends to favor industrial champions. Mechanisms like Important Projects of Common European Interest (IPCEIs), which involve multiple member states, further help to mitigate perceptions of national favoritism. Meanwhile, in the United States, the revival of Congressional authority—evidenced by the legislative grounding of the CHIPS Act and the Inflation Reduction Act—enhances democratic legitimacy through formalized oversight mechanisms such as GAO reviews and statutory reporting obligations.

Transparency and procedural rigor play a fundamental role in reinforcing this legitimacy. Open calls for proposals, clearly defined public criteria for funding, and independent evaluations all contribute to a perception of fairness and meritocracy. For instance, the EU's Digital Strategy ensures that industrial alliances are vetted against competition law standards, while U.S. agencies like the Department of Energy provide public guidance for CHIPS application procedures.

Furthermore, contemporary industrial policies are often designed with a market-oriented architecture. Even when the state takes a proactive role, instruments like performance-based grants, export benchmarks, and venture capital mechanisms are used to simulate market incentives. The EU's Carbon Border Adjustment Mechanism (CBAM), for example, employs pricing structures to enforce environmental goals, whereas the U.S. CHIPS Act includes public–private venture capital partnerships to discipline state support with market logic.

Political consensus is another condition that shapes legitimacy. Policies grounded in broad cross-party and cross-national agreement—such as climate transition and technological sovereignty—tend to enjoy stronger legitimacy. By contrast, narrowly tailored bailouts for

specific distressed industries often face public skepticism, unless justified by acute crises such as systemic unemployment or regional economic collapse.

Finally, alignment with international legal frameworks reinforces credibility. Both WTO rules and their evolving "WTO+" counterparts, as well as internal EU legal constraints, set boundaries on permissible interventions. The legitimacy of subsidies is often enhanced when governments frame them in relation to these global or regional obligations—for example, by tying them to climate goals under the Paris Agreement or invoking national security clauses to justify industrial shielding (Rodrik, 2014; Coyle, 2024). Democratic accountability mechanisms such as legislative oversight, strategy reports, and parliamentary reviews ensure that elected officials remain answerable for industrial outcomes, thereby preventing legitimacy erosion over time.

6.3 Dynamic Competition as a Guiding Principle

In sum, reconciling state intervention with competition requires not rejecting competition but reframing it. A dynamic competition approach accepts that government can be a catalyst for innovation and rivalry. Policies are legitimate when they reshape markets toward better outcomes—not when they entrench incumbents.

Empirical evidence supports this framing: R&D- and technology-push efforts yield more competitive outcomes than import protectionism (Hufbauer & Jung, 2021). However, since many success stories are rationalized after the fact, robust ex-ante and ex-post evaluation is vital for maintaining legitimacy over time.

Conclusion

Industrial policy in the 21st century faces a legitimacy paradox: stakeholders want the dynamism of open markets, yet also demand that public policy secure strategic outcomes (jobs, innovation, sustainability). This paper has explored how European and American policymakers are navigating this tension. I find that theoretical frameworks emphasizing dynamic competition and innovation are helping to justify interventions that would once have been taboo. Meanwhile, stronger governance and transparency mechanisms are being built to align these interventions with competitive market principles. In practice, the legitimacy of state intervention now often rests on its contribution to long-term competitive performance and societal goals.

Historically, the pendulum has swung between interventionist regimes (post-WWII) and laissez-faire (late 20th century). I are now in a new swing towards a hybrid model. In the EU, this takes the form of "market-conforming" alliances for strategic sectors, backed by competition-compliant regulation (e.g. IPCEIs, CBAM). In the US, it means large-scale federal programs in semiconductors, clean energy, and biotech, constructed via legislation and justified as national imperatives. Both actors emphasize that these measures coexist with, and even complement, competition and trade openness – a claim supported to varying degrees by the evidence on dynamic competitiveness.

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Key drivers of legitimacy include political consensus around clear objectives (climate neutrality, supply security), and institutional reforms that tie industrial strategy to broader competition and trade frameworks. For example, adjusting merger guidelines to consider innovation impacts, or linking subsidies to R&D performance, helps meld state aims with competitive outcomes. Fulfilling legitimacy also requires delivering results: the public grows skeptical if promised industries fail or if subsidies appear wasteful. Thus, outcome evaluation and course correction are as important as the initial rationale. As Hufbauer and Jung underline, the track record of industrial policy is mixed, cautioning policymakers to focus on their success factors (basic R&D, trade opening) and learn from failures.

Looking ahead, the reconciling of industrial policy with dynamic competition will likely proceed through institutional innovation. Potential avenues include: expanded roles for independent innovation agencies, hybrid public–private funding vehicles, and international coordination (e.g. OECD competition policy adjusting to differentiated industrial strategies). The literature suggests that there is nothing inherently illegitimate about well-designed, well-governed industrial policy; indeed, its legitimacy can be enhanced by explicitly framing it as part of a competitive ecosystem. Ultimately, legitimacy will hinge on whether industrial policy delivers sustainable growth, jobs, and resilience without sacrificing market fairness. The recent trend — combining expert analysis with democratic scrutiny — seems to be the direction taken in both the EU and US.

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