

How Europeans are responding to the *Inflation Reduction Act*

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The *Inflation Reduction Act* marks a major turning point in the decarbonization of the US economy. Although it is good news for climate action, its modalities constitute a threat for many actors, notably the Europeans. European authorities are now under pressure to provide a vigorous and rapid response. It is now clear that climate transition constitutes a new axis in trade tensions between major powers.

The *Inflation Reduction Act*, a major piece of legislation for decarbonizing the US economy... which is problematic to Europeans

The *Inflation Reduction Act* (IRA) was passed by the US Congress in the summer of 2022 and was touted by the White House as the law "comprising the largest climate investments in US history", even whether it also includes tax measures unrelated to the climate (tax hikes for some large companies) and measures relating to health. This is undoubtedly good news for the climate because according to some estimates, the IRA would allow the United States to reduce its greenhouse gas emissions by 31 to 44% in 2030 compared to 2005 levels (compared to a reduction 24 to 35% otherwise).

The IRA includes \$369bn in new spending focused on energy and climate over the next 10 years. The IRA's biggest spending item is about \$260 billion in clean energy tax credits for private companies. In reality, it is above all a question of the renewal of tax credits on production and on investment in renewable energies (production of electricity via wind, solar, biomass but also the production of hydroelectricity) which had expired at the end of 2021 and which are now extended until the end of 2024. The tax credit for carbon sequestration has been extended until 2033: to qualify, power plants will need to capture at least 75% of their CO₂ emissions and factories will need to capture at least 50% of their CO₂ emissions. A tax credit on the production of green hydrogen, that is to say hydrogen produced with a process that does not emit more than 4 kilos of CO₂ per kilo of hydrogen, has been created for ten years (the extent of the tax credit per kilo of hydrogen will thus depend on the degree of cleanliness

of the production process). Finally, a tax credit for the production of nuclear electricity has also been created.

In addition to the decarbonization of electricity generation, the IRA has the great objective of developing a real clean energy industry (for example, the United States currently imports 80% of the solar panels installed there), because the States are very behind in this area and very dependent on China. Several business tax credits have been created for this: for the domestic production of solar panels, wind turbines, batteries and the extraction of essential minerals for clean energy. The goal is to strengthen the sovereignty of the United States in terms of clean energy. This desire to promote the emergence of an industry linked to clean energies is reflected in the subsidies paid to individuals: the IRA provides subsidies of \$7,500 for the purchase of new electric or hydrogen vehicles and \$4,000 for used vehicles. It also provides subsidies for the installation of solar panels (up to 30% of expenses) and heat pumps (up to \$2,000). The condition for receiving the subsidies is that the equipment purchased is manufactured in the United States and that a certain quantity of the components and raw materials used come from the United States themselves or from countries with which the United States has an agreement. commercial. A number of electric vehicle models are therefore not eligible for IRA subsidies and this is what has prompted a number of European companies to announce the opening of factories in the United States (and in some case of the closure of factories in Europe, etc.).

See Appendices – Graph 1

What response from the Europeans?

The announcement of the American IRA was like a new blow for European industry, whose competitiveness was already being undermined by a much more expensive energy than in the rest of the world. Until recently, European industrial policy took second place to EU competition and trade policies. It was based on market rules, including in its climate transition, for example by using carbon taxation (emissions quota market, ETS), by strengthening environmental standards and by creating an ecosystem favorable to investment through public-private partnerships initiated by public investment. Prohibition of state aid and direct subsidies to industrial companies and subsidies to consumers with no requirement of local content to benefit from them were the norm. Thus, the implementation of subsidies for the installation of solar panels in Germany in 2010 did not prevent numerous bankruptcies in the photovoltaic cell production sector, including the leader Solarworld in 2017, due to Asian competition.

The suspension of the limits on State aid during the Covid crisis constituted a major relaxation of European doctrine in industrial matters. The European Commission estimates that it authorized more than €3 trillion in aid to companies by European countries in 2020 via 389 decisions. These amounts included loan programs guaranteed by the States and part of the authorizations were not used but it shows that the support authorized was of considerable magnitude. Europe had already begun an analysis of its strategic dependencies, that were then brought to light by the covid crisis and the resulting supply disruptions. Europe therefore wanted to build and strengthen European value chains in industrial sectors deemed key, whether digital or energy transition: batteries, hydrogen, etc. The creation of alliances, the Next Generation EU recovery plan and the Green Deal agenda have accelerated the movement.

Faced with the IRA, Europe first reacted by activating the path of negotiation, with the Directorate General for Trade being mandated to negotiate concessions on the local content aspect within an American-European task force. A breakthrough was obtained in December 2022 to make purchase subsidies available for European commercial vehicles like American vehicles. The central issue of private vehicles is still under negotiation. Even if the subsidy and tax credit rules explicitly violate WTO rules, the EU does not wish to engage in litigation with the United States brought to the WTO.

Then, in December 2022, the European Council asked the Commission to formulate an industrial policy proposal in response to the IRA in the 1st quarter of 2023. In Davos, Ursula Von der Leyen the President of the European Commission declared that "for to maintain the attractiveness of European industry, it is necessary to be competitive with the offers and incentives that are currently offered outside the European Union". Six countries (Denmark, Finland, Ireland, the Netherlands, Poland and Sweden) asked the Commission to exercise caution in changing the state aid framework. They highlight the risk of internal market fragmentation, subsidy races and weaker regional development.

The Commission presented its project on 1 February, entitled the Green Deal Industrial Plan, based on 4 pillars: a predictable and simplified regulatory environment, a temporary crisis and transition framework to foster the EU's energy transition which provides for a relaxation rules on state aid until the end of 2025, the strengthening of skills and an open and diversified trade to ensure supplies. The project on state aids provides in particular for "alignment grants" which will allow European countries to align themselves with the grants offered by other countries and thus encourage European companies to invest in Europe in the sectors keys to the energy transition. This project raises many questions since it marks a break with the "technological neutrality" that has prevailed in Europe until now. In addition, the definition of the scope of industries that may or may not receive subsidies will be the subject of fierce discussions... It should be noted that heavy industry is thus absent from the projects mentioned, while its decarbonization is a major subject for the European Union. Then, the subsidies can only be granted after having demonstrated the real risks of diversion of the production investment outside the EU. On the funding side, not all countries have the same budgetary leeway to grant subsidies. The Commission proposes to use European funds, in particular the remaining funding from the RePower EU programs (€250 billion), Invest EU and the innovation fund. In the medium term, it will propose the creation of a European Sovereignty Fund financed by the EU's multi-annual budget (the details of which will be specified before the summer of 2023). The Member States will discuss these proposals at the European Council on February 9 and 10 and probably at that of March and will be able to propose adjustments.

Europe demonstrates a strong desire to promote its industry and defend its competitiveness in the face of renewed protectionism from China and

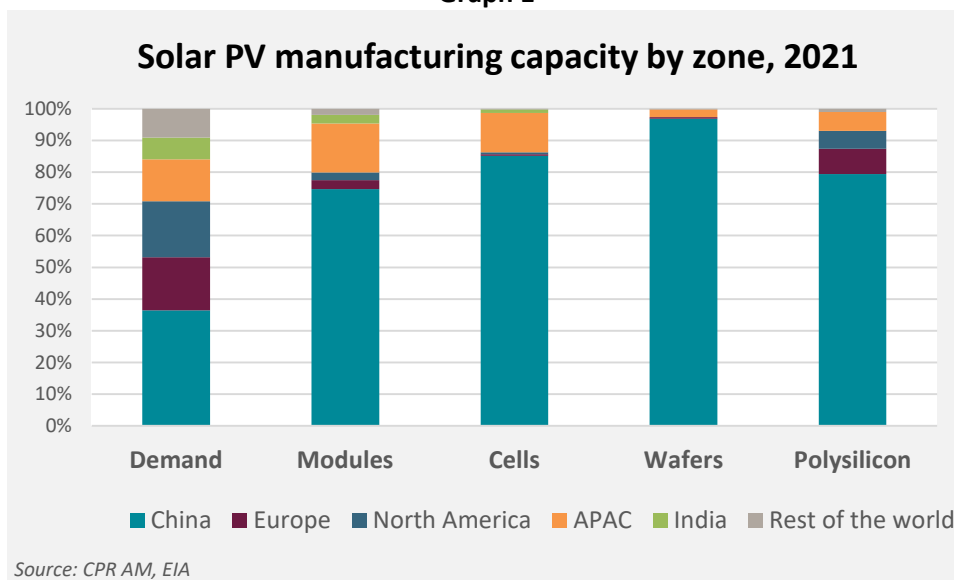
the United States in particular. But the risks lie in the complexity of the European measures envisaged while the IRA has the merit of simplicity, the difficult definition of the scope of industries eligible for aid and the timeframe for implementing effective measures. The European response must not be delayed because the

energy crisis of 2022 has already constituted a strong incentive for companies to develop production infrastructures outside the borders of the EU.

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Appendices

Graph 1



Information:

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