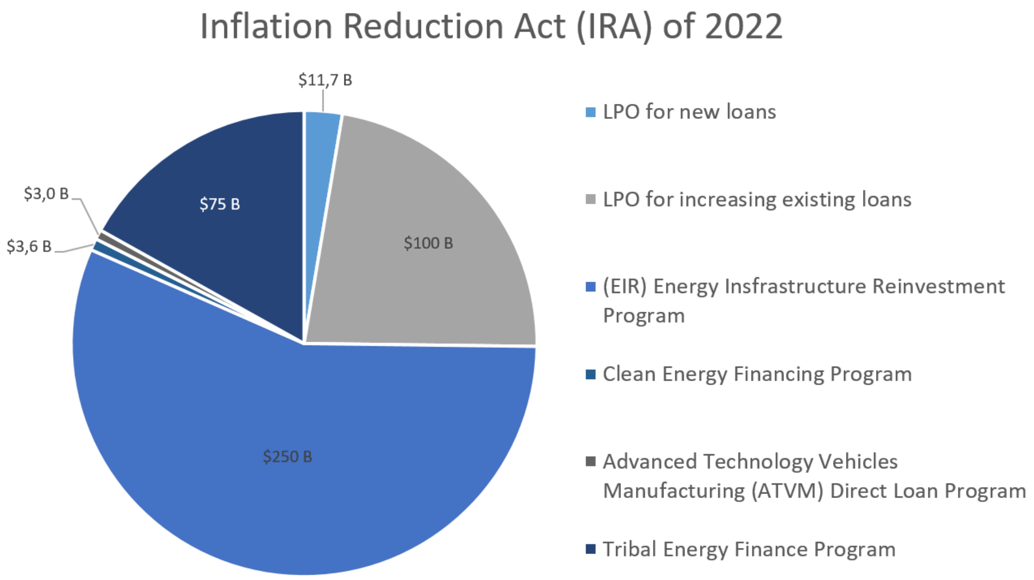
The IRA and Europe: Competition or Market Opportunity?

How will the future of the IRA and the development of the USA's green sectors affect trade relations with Europe?

Cecilia M. Thon
Researcher

The Inflation Reduction Act (IRA) is a law passed by the U.S. Congress and signed by President Biden on August 16, 2022, that combines the objectives of reducing inflation in the U.S. economy, reducing carbon emissions, and facilitating the nation's clean energy transition. It amounts to approximately $370 billion in federal spending through a series of incentives, such as grants, loans, and tax provisions, to propel the development of clean energy, alternative fuel, zero-emission vehicles, clean buildings, and clean manufacturing[1].



How does this affect Europe trade-wise?

Although it is a law directed toward US domestic policy, the IRA has some indirect effects on European markets and international trade in general. On one hand, there are some evident disadvantages for European trade. Notably, the IRA aims to strengthen domestic manufacturing and reduce reliance on imported clean energy technologies and components. This can lead to a shift in trade patterns, with a potential increase in U.S. exports of clean energy technologies and a decrease in imports of similar products.

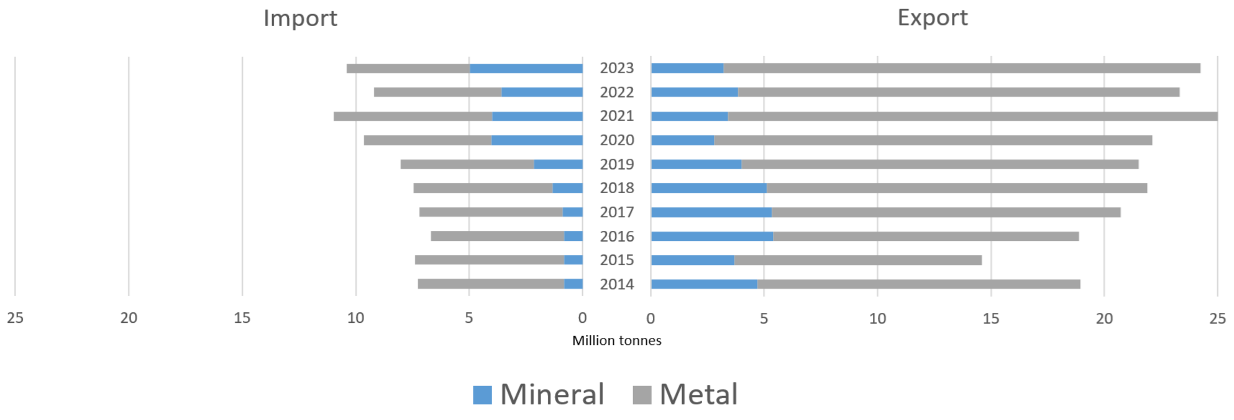
[1] Inflation Reduction Act of 2022 - US Department of Energy's LPO

It also promotes the development of critical mineral supply chains within the U.S., thus reducing dependency on foreign sources.

The IRA seeks to propel domestic production through local content requirements (LCRs). For example, its clean vehicles credit has a “Made in America” requirement. The credit only applies if the final assembly occurs within USMCA (US, Mexico, and Canada trade Agreement) countries and a significant proportion of its components originate from North America.

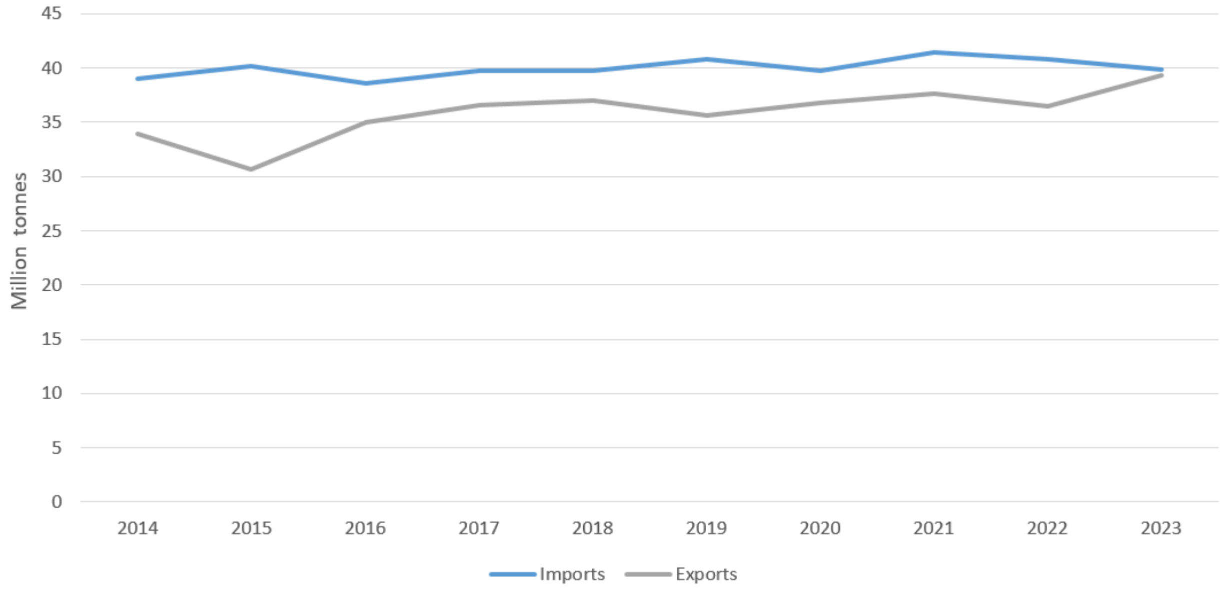
Regarding EV batteries, the minerals in the battery must be assembled in the United States or in a country with which the US holds a free trade agreement. Since the TTIP (Transatlantic Trade and Investment Partnership, a proposed trade agreement between the European Union and the United States) was fruitless, the EU does not qualify for such exemptions. This could result in discrimination against products manufactured outside the USMCA, adversely affecting third countries via trade and supply chain channels. Some argue it is protectionism is disguised and against the free trade principles set by the WTO.

Total EU Mineral & Metal Trade (Global)



Source: Eurostat

Total EU Trade in recyclable raw materials (Global)



Source: Eurostat

Similarly, the IRA's incentive schemes give Europe some competition for investment and funding in the green sectors. Not only could it reduce international trade, but it could also reduce foreign direct investment. Naturally, the incentives in the IRA attract global investors to US-based projects and, therefore, divert investment away from European clean energy projects. Regarding funding allocation, European companies in the green sector may face complications when securing funding for projects, including funding for research and development. Moreover, such funding could accelerate innovation in the US and outrun European advancements, another competitive edge.

Regarding European policy, some consider the EU Green Deal Industrial Plan to be the EU's response to the IRA in an attempt to keep clean energy companies from leaving the EU for the US. Economists and trade experts believe that car batteries and microchip production will have the most significant impact due to the lower production costs the US offers. In other sectors, production costs for solar panels, wind turbines, and hydrogen power could lead to lower prices in the United States. For example, some figures predict that the IRA coil makes solar and wind could become the cheapest in the global market between 2025 and 2030[2], which can shift demand away from European products towards USA products.

On the other hand, the IRA could be more of an opportunity than a cost for European producers and traders. Some studies downplay the IRA's effect on European exports. For one, even if the US seeks to be a competition in the international clean-tech market, it will be some years before production numbers reach that of EU countries, and as the article will discuss further on, in the not-so-far future, the IRA's incentive power and investment attraction could subside depending on the upcoming presidential election.
With this in mind, some trade experts consider that the subsidies could have a more limited impact on trade balances since many European manufacturers have or are building production facilities in the US and can benefit from IRA's incentive schemes. Instead, it is more likely that European companies will benefit through the overall increase in demand for clean-tech components and products. Some could make use of IRA incentives through joint ventures, partnerships, and collaborative R&D collaboration with US companies. For example, many European EV manufacturers have existing or are currently building production facilities in the US and can benefit from IRA's incentive schemes.

Secondly, EU clean tech exports to the US only account for only a fraction of total US clean tech exports, even before the IRA was implemented[3]. The reason: both the EU and the US import most of their clean-tech products and components from China. One of the IRA's goals is to reduce its dependency on Chinese clean-tech imports; through cooperation, the United States and the EU could potentially overthrow China's dominance over this sector and secure a more significant fraction of international markets. In other words, more than a rival for cleantech, the US could help the EU go against their mutual "bigger fish to fry." Unlike the delicate trade relations between the United States and China, recently affected by new trade tariffs on Chinese clean-tech imports (such as EVs, lithium-ion batteries, solar cells, critical minerals, among others), a trade war between the United States and Europe is highly unlikely. The most

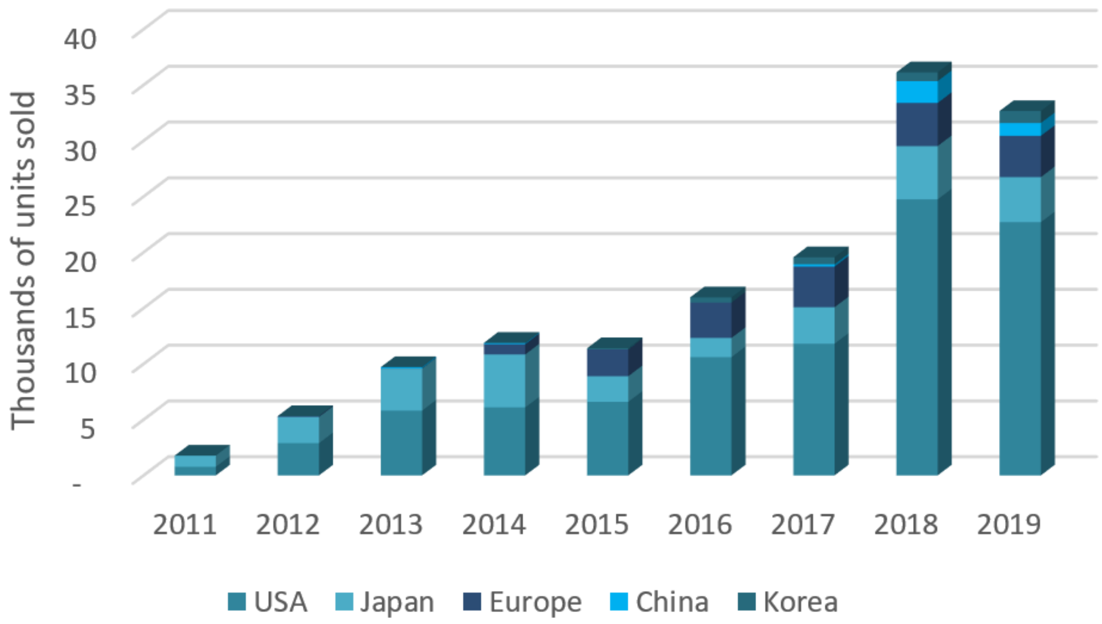
---

[2] US Inflation Reduction Act: A catalyst for climate action

[3] Trade balance of clean energy technologies in Europe in 2021

probable course of action will be an increase in negotiation channels and cooperative action to boost green industries and access mutual benefits. For example, the EU Commission adopted draft negotiating directives on 14 June 2023 for a critical minerals agreement with the US. The agreement seeks to support the development of EU-US supply chains in critical raw materials needed for the production of electric vehicle batteries[4].

Electric Vehicle Sales by Country of Origin



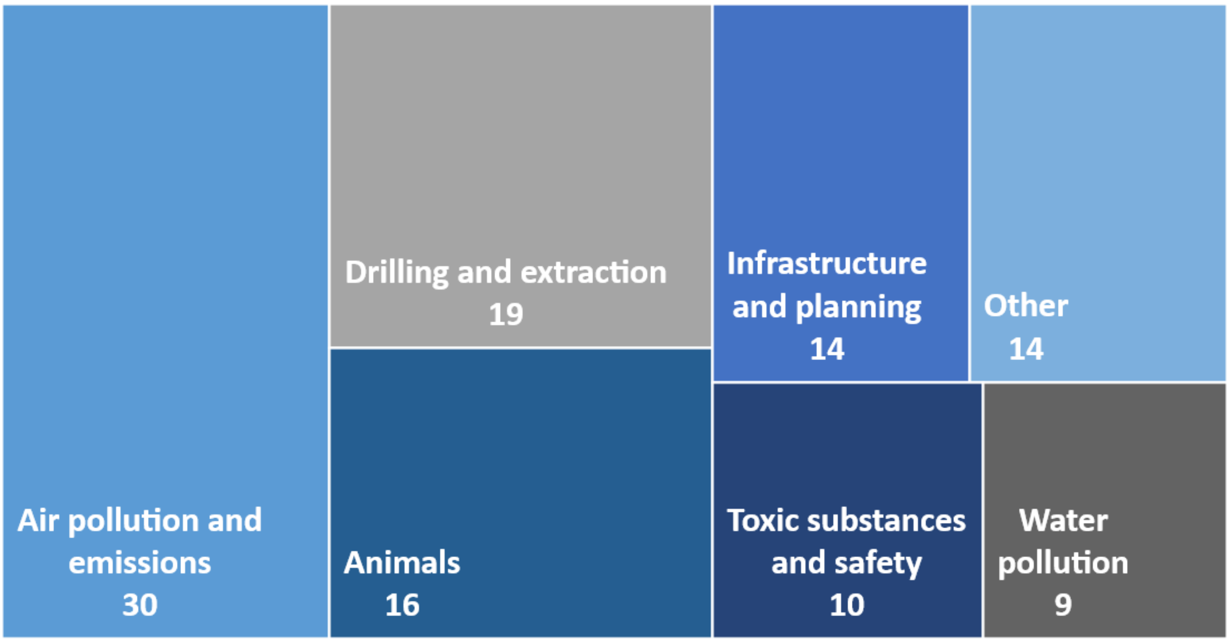
Source: Transportation Research Center at Argonne National Laboratory

[4] EU-US critical minerals agreement

The IRA's near-future: Trump's potential 2024 election

It is fair to say that the Inflation Reduction Act will be affected if Donald Trump wins the 2024 presidential election. Trump is notorious for softening or "rolling back" environmental policies, including the Clean Water Rule, Fuel Economy Standards, and the Clean Power Plan. During his last term, the rollbacks amounted to more than 100 environmental rules. He also fast-tracked specific environmentally sensitive projects, such as the Keystone XL and Dakota Access Pipelines, and the Arctic National Wildlife Refuge (ANWR) drilling permits. Not to mention his controversial withdrawal from the Paris Agreement and his carefree attitude toward climate change policy. Just like with Obama-era policies on the environment, it is very likely that he will reverse many of Joe Biden's policies and initiatives if he manages to beat the incumbent president in November.

Rule Reversals by Donald Trump



Since the IRA's introduction, investment announcements have increased by 60% to more than $114 billion (US dollars). The IRA contributed to a significant increase in US clean energy and tech projects and manufacturing investments. With the GOP's adamant stance against the IRA and talks of plans to repeal the act, the future of these investments could be at risk. However, nothing is set in stone. Above all else, Trump is a businessman; if he sees an opportunity for profit, his policies will not squander it so rashly. The amount of jobs created and the economic growth stemming from these investments and projects could be enough to convince Republicans to issue a partial repeal or even a revision instead of a total repeal[5]. Republicans seem to have a more vigorous opposition to specific IRA provisions over others. For example, most are vehemently against tax credits for purchasing electric vehicles but support developing alternative energy sources as complements to oil & gas (rather than replacements), domestic manufacturing incentives, carbon capture and storage, and methane emission penalties. What's more, many of these investments are for battery manufacturing located in Republican states. According to a report elaborated by Columbia Threadneedle Investments, some sectors are at a much higher risk than others, such as: EV tax credits and funding, infrastructure energy efficiency credits and funding, clean energy funding, and emissions standards.

Meanwhile, other sectors are less at risk, such as hydrogen development, grid diversification, production tax credits for renewables, and offshore wind projects. Some might even gain more support from Republicans, like nuclear energy development and manufacturing.

Moreover, global trends in sustainability and environmental-focused investments are hard to dismiss, especially if the United States wishes to remain competitive in the international commercial scene. Trump's antagonistic stance towards US trade competitor, China, could make him think twice about repealing some of the IRA's policies, whose objective was to steer the US away from its overreliance on the Chinese supply chain. Unless a solid alternative is put to the table, completely revoking the IRA could prove to be an unwise strategy for Trump's commercial rivalry with China.

[5] US elections: the Inflation Reduction Act and the risk of repeal

Therefore, a partial repeal is the most likely scenario rather than a complete reversal. Still, the consequences of a partial repeal on current investments should not be underrated. A partial repeal could mean weaker tax credits, cut funding from programs and government agencies (such as the EPA or the Department of Energy), and several regulatory changes. Worldwide investors in green sectors and clean technology should keep an eye on the upcoming elections this November and plan their long-term strategy accordingly.

References:

"INFLATION REDUCTION ACT OF 2022." n.d. Department of Energy. Accessed July 22, 2024. https://www.energy.gov/lpo/inflation-reduction-act-2022.

Luna, Natalia. 2024. "US elections: the Inflation Reduction Act and the risk of repeal." Columbia Threadneedle Investments. https://www.columbiathreadneedle.co.uk/en/inst/insights/us-elections-the-inflation-reduction-act-and-the-risk-of-repeal/.

Suwanrumpha, Lillian, and Noah Gordon. 2024. "The New U.S. Clean Tech Tariffs Will Have Global Impacts." Carnegie Endowment for International Peace. https://carnegieendowment.org/emissary/2024/05/ev-battery-china-tariffs-biden-global-impact?lang=en.

Szczepański, Marcin. n.d. "EU-US critical minerals agreement." European Parliament. Accessed July 22, 2024. https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/754617/EPRS_BRI(2023)754617_EN.pdf.

Tiseo, Ian. 2023. "Trade balance of clean tech in Europe 2021, by product." Statistica - Environmental Technology & Greentech. https://www.statista.com/statistics/1427917/europe-clean-energy-tech-trade-balance-by-product/.

Transportation Research Center at Argonne National Laboratory. 2020. "U.S. Electric Plug-In EV Sales by Model." U.S. Plug-in Electric Vehicle Sales by Model. https://afdc.energy.gov/data/10567.

"US Inflation Reduction Act: A catalyst for climate action." 2022. Credit Suisse. https://www.credit-suisse.com/about-us-news/en/articles/news-and-expertise/us-inflation-reduction-act-a-catalyst-for-climate-action-202211.html.