Global Counsel

The US Inflation Reduction Act and the EU Green Deal Industrial Plan

An overview

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Much more than a subsidy war

The US Inflation Reduction Act (IRA) has fired the starting gun on what is likely to be a new era of industrial policy around the green transition. Tensions between the US and China add a geopolitical dimension to Washington's push for technological and manufacturing leadership and sufficiency. The IRA needs to be set alongside other US policies such as the CHIPS Act and Infrastructure Act as part of a wider shift in US policy.

The IRA has triggered an anxious response from the EU, which has responded with the Green Deal Industrial Plan (GDIP). Although they are often compared at a headline level, and while they have the same aim of supporting industrial investment, the two strategies have important structural differences. The EU and the US federal government have very different powers and operate with different political mandates. This has and will continue to produce two different toolkits that will differ in their design, accessibility and impact.

What is sometimes reduced to a 'subsidy war' is better seen as the first step in what will ultimately become a large-scale reconfiguring of the North Atlantic industrial ecosystem. This is driven by the twin engines of decarbonisation and geopolitics and the twin imperatives of technological leadership and technological autonomy. That dynamic between the EU and the US may not necessarily be zero-sum. Either way, it has important implications for the EU and the US, and for the states in their industrial and strategic supply and distribution chains.

The deployment of the IRA and the GDIP are important for investors and companies in understanding the way in which a competitive dynamic between the EU and the US is likely to shape policy on both sides and the investment and operating landscape for the decade ahead. They are also a unique opportunity for firms to shape a new generation of industrial policy tools.

The key elements of the IRA

The Inflation Reduction Act's industrial subsidy component has two core rationales. The first is to underpin US manufacturing capacity in key green technologies. The second is to decouple the US from any dependence on China in these areas. In this respect, it must be seen as part of a wider retooling of US industrial policy in areas such as semiconductors. The fiscal cost of the IRA is seen in Washington as the necessary cost of re-establishing both technology leadership and technology independence in key areas.

The industrial policy component of the IRA has three pillars. The first is an extended framework of tax credits for renewable and clean electricity, carbon capture, nuclear power and clean hydrogen. The second is a set of consumer subsidies for electric vehicles (EVs). The third is an extended set of tax credits for industrial investment in a range of technologies including EVs, fuel cells and energy storage systems.

One of the notable features of the IRA is the ten-year framework for industrial support established by the law. This provides a notable degree of certainty for investors and subsidy users.

ENERGY SUBSIDIES

- Extensions, modifications, and renewals of renewable/clean electricity Investment Tax Credits (ITCs) and Production Tax Credits (PTCs) that will benefit technologies like wind, solar, geothermal, and hydropower
- Extensions, modifications and enhancements of carbon capture tax credits, new PTCs for nuclear power for existing plants and for clean hydrogen facilities that begin construction before 2033

CONSUMER SUBSIDIES

- Consumer tax credits for the purchase of new EVs, plug-in hybrids, and hydrogen fuel cell vehicles
- Tax credits will be linked to significant investments in US critical mineral processing and battery manufacturing capabilities

PRODUCER SUBSIDIES

- Renewal and extension of the Advanced Energy Project Credit for the production of fuel cells, microturbines, energy storage systems, electric grid modernization equipment, EVs, and more

The key elements of the GDIP

The IRA has prompted the EU to develop its own package of incentives and regulatory reforms to counter the perceived challenge from the US.

The EU is proposing to redirect the residue of the large Recovery and Resilience fund raised to provide loans to EU states during and after the covid-19 pandemic. This provides a loan pool of around €270bn that member states will be able to borrow and use for state aid projects.

In parallel, the EU will extend and revise the flexibilities created for EU state aid rules during the covid-19 pandemic to cover support schemes created before 2026. This will enable states to provide targeted support for renewable energy generation and storage and decarbonisation projects. The EU will also relax competitive bidding requirements in some cases and is increasing the scope for support for hydrogen-related projects.

The EU will also create a new set of rights to provide investment subsidies for a range of low-carbon technologies. This includes possible ‘matching aid’ where support is being offered in the US or elsewhere that threatens to divert investment out of the EU. This is tied to obligations that such aid provides benefits in economically-lagging areas of the EU, or in multiple member states and does not result in redirected investment within the EU.

Flanking this are a range of measures related to skills and trade policy. These largely repackage existing initiatives or workstreams. The EU will also review a range of regulatory files for opportunities to streamline investment.

ENERGY AND PRODUCTION SUBSIDIES

- €270bn in loans available to member states through the residual Recovery and Resilience Fund to create industrial subsidy programs.
- Adapted and extended flexibilities for EU state aid rules to allow states to increase the quantum of support for defined low-carbon investments and to match support provided elsewhere that threatens to divert an investment out of the EU.

SKILLS POLICY

- EU funding for Net-Zero Industrial Academies and large-scale skills partnerships for onshore renewables.

TRADE POLICY

- Focus on streamlining EU supply and distribution networks and strategic cooperation with the US through the TTC.

REGULATION

- The GDIP and flanking workplans will assess EU regulation for opportunities to streamline industrial investment processes.

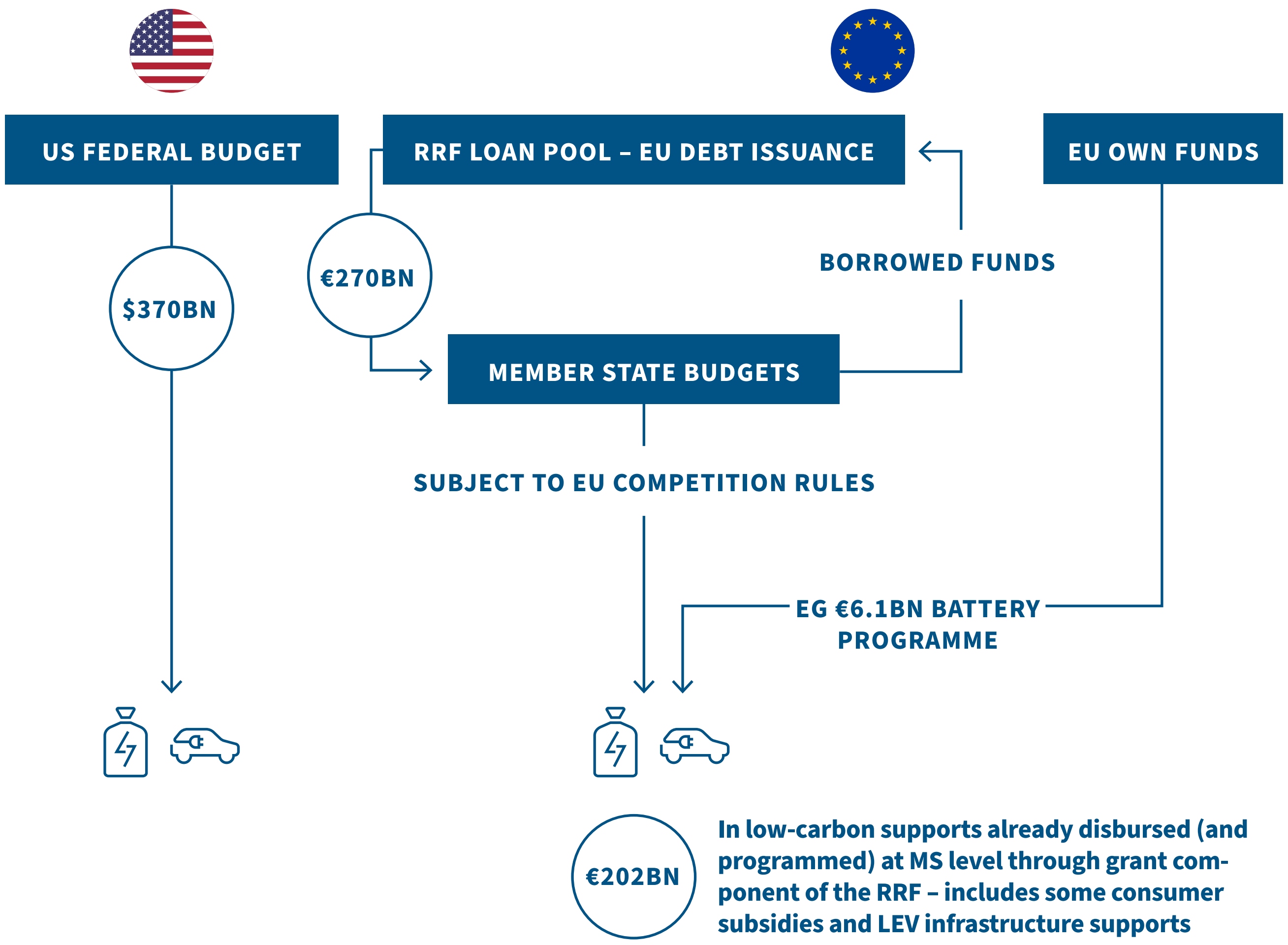
How they will spend it

Both the EU and US plans are designed around state aid, chiefly in the form of tax credits in the US and a range of potential options for EU states. However, the EU is constrained in deploying financial support in a number of ways that the US federal government is not. This will matter for deployment rates.

The EU itself has only limited fiscal resources: it raises only very small amounts of tax directly and has only recently been granted very constrained debt-issuance powers. The GDIP response deliberately draws on the existing envelope of debt issuance powers created in response to the covid-19 pandemic and EU member states have so far resisted creating new pools of common funding. This reflects the inevitable tension within the EU over the distribution of such resources and a European Commission without the political authority to make such distributional decisions.

There is also a relatively small pool of available EU budget resources disbursed directly by the European Commission for strategically important capabilities. Most important in this context is the €6.1bn provided to support EV battery development in two tranches since 2019. Beyond this, member states will need to use their own resources, subject to a temporarily relaxed set of state aid rules. Importantly, because EU measures will be deployed by member states, strategic decision-making will be decentralised, and actions duplicative.

All EU and member state disbursements must meet EU state aid rules. Even with the relaxation of rules included in the GDIP frameworks, this still caps subsidies nominally and as a percentage of proposed investments and proscribes subsidies that risk diverting investment within the EU. No US subsidy has to meet an equivalent test.



How are EU countries implementing GDIP measures?

In line with GDIP objectives, EU countries are deploying a mix of national and EU resources underpinned by a temporary flexibility in state aid rules for specific clean tech sectors. Fragmentation of these measures across the EU and upcoming national elections in some member states make the durability of these measures uncertain.

In most cases, governments are introducing sector-specific and targeted measures. This includes programmes in Spain and Italy to support the domestic production of renewable hydrogen and batteries. The most notable exceptions is France’s Green Industry Bill, designed to mirror the GDIP structure and the US’ IRA tax incentives. It introduces incentives across sectors to spur greenfield and brownfield investment, while supporting the demand for clean tech goods with tax benefits for consumers.

Resources from the Recovery and Resilience Fund remain the core source of funding for most member states to support ‘green transition’ projects. These are often combined with EU Regional Development Funds for smaller and peripheral member states. Given EU countries’ disparities on public spending capacity, the lapsing of the RRF in 2026 will inevitably prompt a debate on financial incentives for clean tech industries and level playing field in the EU internal market.

COUNTRY	TYPE OF MEASURES	ADOPTED UNDER TCTF?
	→ Tax incentives → Direct grants	NO
	→ Tax incentives → Direct grants → Subsidised loans	YES
	→ Direct grants	YES
	→ Direct grants	NO
	→ Tax incentives → Direct grants	YES
	→ Direct grants → Subsidised loans	YES

Accessing industrial subsidies

In principle, both the EU and the US are bound by international trade rules to ensure that the incentives they create do not discriminate between domestic and foreign firms. In practice, both sides will design rules and develop practices designed to ensure that the bulk of benefits are captured by domestic players or preferred strategic partners. Understanding these will be important for firms seeking to engage with incentives.

Direct access to IRA subsidies is conditioned on a range of domestic content use requirements, minimum labour conditions and a range of minimum technical performance requirements. EU member states have yet to design their own variants, but they can be expected to use minimum standards requirements in a similar way. In both the US and the EU expanded investment screening regimes are likely to act as a de facto check on access to supports for non-preferred partners.

Indirect access to subsidies via the supply or value chain will be impacted by these and other measures. Domestic content requirements - even where technically impermissible under WTO rules - may limit scope for cross-border supply. Product Specific Rules such as the EU's rules on battery content in the EU-UK Trade and Cooperation Agreement will be designed to limit sourcing choices. The US in particular can be expected to consider a range of other restrictions on Chinese content, or supply by firms that also operate in China.

	US	EU
DIRECT ACCESS		
	CONDITIONS INCLUDE: → De facto nationality restrictions through investment screening → Domestic content requirements → Minimum wage and apprenticeship obligations → Some technical performance requirements	**CONDITIONS INCLUDE:** → De facto nationality restrictions through investment screening **MAY BE IMPACTED BY:** → Standards requirements designed to exclude non-EU investors
INDIRECT ACCESS: SUPPLY CHAIN		
	MAY BE IMPACTED BY: → Domestic content requirements → Use restrictions on Chinese or other imports; FTA product specific rules → Future national security measures	**MAY BE IMPACTED BY:** → Standards requirements designed to exclude non-EU suppliers → FTA product specific rules
INDIRECT ACCESS: INTANGIBLES		
	MAY BE IMPACTED BY: → Future value-add or national security requirements	**MAY BE IMPACTED BY:** → Future value-add or national security requirements

Will US measures survive elections in 2024?

The 2024 elections represent Republicans' first real opportunity to repeal the IRA's clean energy tax credits, and as the elections draw closer, Democrats are growing increasingly concerned.

However, there are real constraints to any attempt to repeal the IRA. The IRA's tax credits are explicitly laid out in the legislation that was passed in Congress. This means that Congress - not federal agencies - is the only body which can repeal or make material modifications to the bill's tax credits, which must be done via the legislative process.

To be sure, a Republican administration can make marginal changes by updating tax credit guidelines. But the core of the IRA tax credits will remain intact unless Congress acts.

Passing legislation repealing the IRA will only happen if Republicans sweep in 2024, an unlikely outcome despite President Biden's unpopularity. Divided government makes any attempt to rescind the IRA dead on arrival.

Even if Republicans sweep, slim margins in Congress will force Republicans to resort to budget reconciliation for any chance at repeal. The caucus is not completely aligned on an IRA repeal, and Republican lawmakers themselves have acknowledged the difficulties in repealing the IRA. In a GOP sweep scenario, select tax credits, not the entire package, are more likely be repealed (see right).

IN THE EVENT OF A GOP SWEEP IN 2024, TAX CREDITS THAT ARE MOST LIKELY TO BE REPEALED OR MODIFIED...

- **30D CLEAN VEHICLE TAX CREDIT**
- **CLEAN ELECTRICITY PTC (45Y) & ITC (48E)**
- **45Z CLEAN FUEL PTC & 40B SAF CREDIT**

...LESS LIKELY TO BE REPEALED OR MODIFIED...

- **48C ADVANCED MANUFACTURING CREDIT**
- **45X ADVANCED MANUFACTURING PTC**
- **25D RESIDENTIAL CLEAN ENERGY CREDIT**

...AND LEAST LIKELY TO BE REPEALED OR MODIFIED

- **DIRECT PAY PROVISIONS**
- **45U NUCLEAR POWER PTC**
- **45V CLEAN HYDROGEN PTC**

What will the GDIP look like post-2024?

Contrary to the US, a leadership change in Brussels is unlikely to backtrack on the GDIP or measures within it. Competitiveness will be the overarching theme of the next European Commission and the GDIP - a wide-ranging policy programme rather than a single legislation - will remain the broad policy framework within which Brussels will pursue its industrial policy ambitions.

More significant proposals around common EU resources or on a permanent revision of state aid rules might re-emerge under a more interventionist Commission. Discussions will prove extremely divisive among member states, and unlikely before the renegotiation of the EU's multiannual budget beyond 2027. Extending the revised Temporary Crisis and Transition Framework (TCTF) post December 2025 is likely to remain the preferred option.

The implementation of streamlined permitting procedures under the Net Zero Industry Act (NZIA) and the Critical Raw Materials Act (CRMA) is unlikely to generate a strong enough incentive to support the GDIP's industrial policy objectives. With the TCTF potentially lapsing in December 2025 and the NZIA unlikely to be in place before mid-2024, if at all, business will have a limited window to take advantage of the combined benefit of the two.

Ultimately, because of the limits to the Commission's mandate and powers, most of the instruments, funding - and, more importantly, conditionalities attach to them - will be decided and deployed at national level. Corporates and investors should increasingly focus on EU capitals as they seek to tap into the revamped industrial policy agenda.

ENERGY AND PRODUCTION SUBSIDIES

→ A potential (further) extension of state aid flexibilities could spur additional targeted investments into low carbon technologies.

SKILLS POLICY

→ Significant measures from Brussels are unlikely as skills policy is largely driven by national approaches. Strained budgets and competing priorities will likely mean that the agenda remains in the back burner.

TRADE POLICY

→ A more extensive use of the bloc's trade defence toolkit to protect domestic producers is likely, combined with continued emphasis on 'strategic partnerships' with selected third countries.

REGULATION

→ Focus will shift onto finalising key GDIP legislative proposals. Implementation of regulation's core elements (i.e., streamlined permitting procedures) will lie entirely on national and regional authorities.

Beyond the EU and the US

The development of the IRA and the GDIP confronts other advanced industrial economies with important questions. The incentives created by the EU and the US are designed to shift the investment case for production in both markets and will impact underlying rates of return in both cases.

Countering or replicating that incentive effect may be costly, but it will be seen as necessary by some governments. This will create leverage and bargaining power for industry in some cases. Where incentives change investment strategies, there are both risks and opportunities for the supply chains that support them.

However, the strategic challenge does not reduce simply to the question of how to compete with the incentives created by the US and the EU. Some states may conclude they have the most to gain by free-riding on the subsidised technological transition the US and the EU are aiming to deliver. Others may adopt a defensive position and seek to use trade defence tools to countervail the impact of subsidies.

More generally, the shift exemplified by the IRA and the GDIP creates an important window of opportunity for intelligent industrial policy design. There will be a premium on smart and practical ideas for the green transition and for a pragmatic approach to strategic interdependence in the design, production and deployment of some of the key technologies of the next decade.

RESPONDING TO EU AND US INDUSTRIAL STRATEGY

States will select from a range of strategies

FREE-RIDING STRATEGIES

Not all states will choose to try and compete with the US and the EU for industrial investment. Some will calculate that the greater benefit lies in importing the subsidised production generated in the US and EU.

TARGETED INCENTIVE STRATEGIES

Fiscally constrained states will be constrained to be highly pragmatic, focusing available resources on a small number of segments or individual sites vulnerable to relocation.

BROAD-BASED INDUSTRIAL STRATEGIES

More broad-based responses to the IRA and the GDIP are likely to focus on tax credits, investment guarantees, skills investment and elements of regulatory relief.

TRADE DEFENCE STRATEGIES

In principle, the IRA exposes the US and states imitating it to the use of countervailing duties designed to counter the effects of subsidies – especially if domestic producers see them as harmful.

SOURCES: EUROSTAT, EUROPEAN COMMISSION, BLOOMBERG

Navigating a new industrial ecosystem

UNDERSTAND AND TRACK

Understand the drivers of the IRA and GDIP and what policymakers are trying to achieve.

Understand the policymaking frameworks in the US, the EU and EU member states that shape the form, scale and likely impact of industrial policy choices.

Track the development of policy in the US, the EU and elsewhere as subsidies are designed and deployed and other regulatory interventions are implemented.

Understand how other states will respond to the US and EU frameworks and the ways this may impact the incentives they create.

ASSESS

Map the incentive structure impacts of the IRA and GDIP for an asset or supply chain.

Identify opportunities and risks around these evolving incentives and develop strategies to respond to them both at the level of US and EU authorities and in EU member states.

ENGAGE

Engage constructively with the industrial policy design questions raised by the dynamic created by the IRA and the GDIP - and the deeper geopolitical and technological questions behind it.

Global Counsel's IRA/GDIP services

Global Counsel has been central to providing strategic advice to corporates and investors on politics, policy and regulation issues across the globe. These case studies serve as indicative examples of the type of support GC is able to provide.

INVESTMENT STRATEGY

We can help firms considering investments in the EU or US:

- Review and prioritise physical locations on the basis of possible industrial policy incentives.
- Identify specific IRA/GDIP opportunities that may apply and how to access them.
- Stress test judgements about the durability of incentives factored into inward invest plans and identify risks around policy change.

PORTFOLIO REVIEW

We can help portfolio managers with investments in the EU or US:

- Review and audit their portfolios for both risks and opportunities linked to IRA/GDIP policy design.
- Engaging with management teams on accessing IRA/GDIP incentives.
- Design forward looking investment strategies around the trajectory of industrial policy in the EU or US.

ADVOCACY DESIGN

We can help firms active in the EU or US:

- Understand the evolution of policy incentives in their market and how to engage with the policy design process.
- Map the landscape of industrial policy supports elsewhere, or provided on their competitors, to inform advocacy and its evidence base.
- Design impactful advocacy and evidence to support targeted advocacy and campaigns.

STAKEHOLDER ANALYSIS

We can help firms operating global supply chains:

- Understand how the IRA/GDIP or linked industrial policy may impact supply chain design choices.
- Identify and mitigate areas in which subsidy programmes may expose imported goods to risk of trade defence or other anti-subsidy action that need to be a factor in risk management.

The GC IRA/GDIP team

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Giulia is an expert on EU industrial and state aid policy as well as critical raw materials, and advises GC clients on the development of the EU GDIP and its flanking policy changes.

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