The EU's answer to the Inflation Reduction Act: «You cannot have dessert until you first eat your vegetables»

Meeting climate targets depends heavily on public and private investment and their effects on the development of new technologies. Therefore, much of the economic momentum since COVID has focused on encouraging this ecological transition. In the case of the US, the Inflation Reduction Act (IRA) was approved in August 2022. This is a set of public support measures with which the Biden Administration aims to stimulate environmentally sustainable consumption, production and investment. However, this desire brings with it protectionist clauses which have triggered protests by the EU.

What is the IRA?

The IRA is a plan with a budget of some 400 billion dollars due to be disbursed over the next decade, although it is expected to have a positive impact on the US Treasury's finances.[1] Looking at the breakdown, over 60% of the aid will go to the energy sector, 12% to industry and another 12% to improving the environment. The fact that the world's biggest economy wants to encourage the ecological transition is good news for the planet, but the protectionist bias of the plan's main subsidies is not. Specifically, for some aids available under the IRA, the subsidy or tax credit increases if the good or service in question meets certain domestic production criteria,[2] or if it is produced in a country with which the US has a free trade agreement. These types of clauses are contrary to the provisions of the World Trade Organization (WTO) and the EU considers them unfair competition from the US, which threatens to unleash a subsidy war among the world's major economies. It is estimated that the subsidies which could potentially breach WTO rules could exceed 75 billion dollars, although estimating their value is difficult since several of the support measures are not capped at any particular limit, neither in volume nor in value.[3]

How is the EU encouraging the ecological transition of European industry?

Although the EU has been trying for years to promote the ecological transition, particularly through the Recovery and Resilience Facility (RRF), the EU's answer to the IRA has been articulated through the European Commission's so-called Green Deal Industrial Plan. Unlike the IRA, this plan does not deploy new EU funds, since the EU already had various programmes in place to this end. Specifically, this plan includes three major measures: two regulatory proposals (one to promote the reduction of emissions

Funds of the Green Deal Industrial Plan

Instrument	Origin and budgetary nature	Quantity (billions)	To deduct (billions)	Reason
RePowerEU	EU funds (from the EU Emissions Trading System)	20	2.6	Requested by Spain (addendum to the RTRP)
Brexit Adjustment Reserve	EU budget (MFF 21-27)	5.4	3.0	Funds already disbursed as of April 2023
Loans under the Recovery and Resilience Facility	Loans from the Commission to Member States (MFF 21-27)	225	84.0	Requested by Spain (addendum to the RTRP)
Cohesion Funds transferable to other purposes	EU budget (MFF 21-27)	17.9		
InvestEU	Guarantees of the EU budget (MFF 21-27)	26.2	1.5	Guarantees already committed
Innovation Fund	EU funds (from the EU Emissions Trading System)	40	17.8	Funds for RePowerEU (€12 million) and others already allocated
TOTAL		334.5		
TOTAL (excl. funds already disbursed)		312.2		
TOTAL (excl. funds already disbursed and those requested by Spain)		**225.6**		

Note: *For the RRF (but not for other instruments), the sum of funds under the Industrial Plan reflects only those still available as of the beginning of 2023. This excludes both grants (which have been fully requested by Member States) and loans already requested (only by seven countries). Although Spain has also requested the total sum of loans available to it in its addendum to the RTRP, in view of the timeline involved, the Industrial Plan does not yet deduct this amount. As there have not yet been any other announcements like Spain's in other possible addenda to the RTRPs, we only deduct the funds requested by Spain, as a lower limit.*
Source: *CaixaBank Research, based on data from the European Commission.*

1. The plan contemplates some 700 billion dollars in higher tax revenues and lower spending over the next 10 years, more than offsetting the expenditure for the energy transition.
2. For instance, the credit incentives available for buying electric vehicles are 3,750 dollars per vehicle, but if a certain percentage of the minerals that make up the vehicle have been extracted or processed in the US or in a country with which there is a free trade agreement, and if the vehicle is assembled in North America, then this credit increases to 7,500 dollars. For renewable electricity production, there are bonuses applicable to the available subsidies in a similar manner, depending on the origin of the iron, steel and manufactured products used.
3. See D. Kleimann *et al.* (2023). «How Europe should answer the US Inflation Reduction Act». Policy Contribution 04/2023, Bruegel.

from industry and another on essential raw materials needed for production) and the reform (temporary, for now) of the State aid framework, allowing Member States to match subsidies offered outside the EU in order to avoid the relocation of European industry.

There are a number of key aspects which stand out in this set of measures. Firstly, it aims to reduce bureaucracy so that public aid can be granted as easily as it is in the US. Secondly, in order to safeguard competition in the common market, greater flexibility is granted to the poorest regions of the EU to grant subsidies and thus avoid relocations. This does not, however, completely address the grievance that, in a single market such as the EU, the Member States with the greatest budgetary capacity – some of which also have poorer regions – will be more able to grant subsidies to their companies, sometimes simply because these countries have are bigger economies. Finally, it is also noteworthy that the targets for local production and recycling of raw materials set out in the proposal are not a binding mandate, but rather a benchmark target for monitoring European strategic dependencies throughout the industrial value chain. Because of the non-binding nature of the targets, these provisions are not contrary to WTO rules, unlike the aforementioned provisions of the IRA.

How much money has the EU allocated to this? How much is still available?

The Green Deal Industrial Plan merely recapitulates the funds which the EU has already mobilised to facilitate this transition, and in some cases adapts which areas and tasks those funds are allocated to, but it does not offer any new funding besides that already available. The total sum of funds that the plan recapitulates is very substantial (around 335 billion euros according to the Green Deal Industrial Plan, which represents 2.1% of EU GDP in 2022), and this comes on top of to the grants already approved under the RRF, the impact of which is mostly yet to be reflected. This 335 billion represents a comparatively greater budgetary effort on the part of the EU than that of the US with the IRA (2.1% of EU GDP versus 1.6% of US GDP).

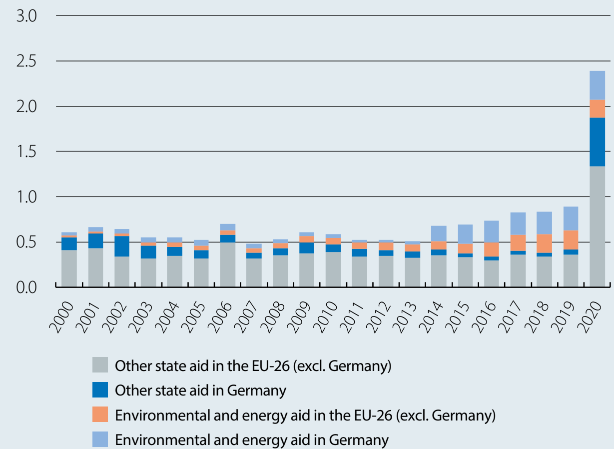
However, if we discount the funds that have already been committed, or which soon will be, just 225 billion of the aforementioned 335 billion will be made available to European industry. This is equivalent to 1.4% of the EU's GDP in 2022, and is a comparatively lower effort than that of the US with the IRA.

What are national governments doing in the EU?

In short: the EU's answer to the IRA does not involve additional funding, but rather represents a streamlining and simplification of what is already in place, and it gives Member States greater flexibility when it comes to granting aid and subsidies. It is precisely this aspect that could help to maintain a balance between the different blocs, although it still poses problems for the European economy, as the subsidies for the production of renewable energies of recent years have shown. These subsidies amounted to 511 billion euros between 2015 and 2021,[4] of which over 80 billion were allocated in 2020 alone (0.57% of EU GDP). However, the differences between countries are significant, particularly between Germany and the rest (Germany alone granted 33.5 billion euros in 2020, 0.94% of its GDP and 0.32% of the GDP of the EU).[5] This inequality is also reflected in the state aid: in the area of environmental protection, for more than five years now Germany has been providing more aid than all other EU Member States combined.

State aid in the EU, by country and sphere

(% of EU GDP)



Source: *CaixaBank Research, based on data from the State Aid Scoreboard 2021 by the European Commission's Directorate-General for Competition.*

Finally, it is also worth noting that the EU and the US are already working towards allowing goods that are produced in the EU to access the US subsidies on an equal footing with those produced in countries with which the US has a free trade agreement. This offers some optimism on how transatlantic competition to encourage green industry with public funds could evolve. Ultimately, both the IRA and the EU's Green Deal Industrial Plan will facilitate the ecological transition and the fight against global climate change, although globalisation and the relationship with China will suffer.

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4. In constant 2021 euros, see: European Commission, Directorate-General for Energy. T. Badouard *et al.* (2022). «Study on energy subsidies and other government interventions in the European Union: final report: 2022 edition». Publications Office of the European Union.
5. Spain's share (less than 0.2% of GDP) is also lower than that of France and Italy.