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United States: a green industrial policy in the making

The US Congress's August approval of the Inflation Reduction Act (IRA) came as a surprise to most observers. With the mid-term elections just months away and no majority in Congress, no one expected new legislation to be passed. Yet, the Democrats and Republicans managed to reach a compromise. We discuss below the measures announced to promote the environmental transition, which is the centrepiece of the act. Europe has much to gain from looking more closely at the modalities of the new US green industrial policy.

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The IRA includes in particular $369bn in spending over a ten-year period in favour of decarbonisation, renewable energies and energy security. This is more than four times the amount that the 2009 American Recovery and Reinvestment Act devoted to investments in renewable energies and green technologies, making it **the largest federal legislative package in US history in this area.**

The IRA aims to accelerate the transition towards renewable energies. In extending several tax credits for decarbonated electricity generation and the purchase of new electric vehicles until 2031, the legislation aims to stimulate investments. **The IRA thus marks a shift in US industrial policy and in Democratic Party doctrine.**

Paradoxically and despite the law's name (the Inflation Reduction Act), **it is unlikely to slow down inflation on the horizon of our forecasts.** Whatever impact there is on prices, it will be minimal and will take several years to play out, with a lower fiscal deficit, an increase in raw materials supplies via investment in production and other critical infrastructures, and a reduction in drug prices (our focus here is the measures in favour of the energy transition). Additional downward pressure is expected on oil and gas prices by reducing consumption. Princeton University's REPEAT project estimates that crude oil prices will be lowered by about 5% and US natural gas prices by some 10-20% in the medium term (2030-35).

Environmental provisions are the law's centrepiece

The IRA would allow the United States to meet its goal of reducing GHG emissions by 50% from 2005 to 2030

The provisions include subsidies, tax credits, environmental justice measures, and investments in essential energy infrastructures.

The goal is to reduce the US's greenhouse gas (GHG) emissions. **This is clearly the first comprehensive plan proposed by the federal government to fight climate change.**

In addition to decarbonised electricity generation, the IRA also aims to reduce GHG emissions through energy efficiency. According to certain studies (e.g., by Energy Innovation), **the IRA will reduce GHG emissions** by 820-1200 mn metric tonnes (MMT) of CO_2 equivalent (CO_2e) – or **by about 40% compared to 2005 levels – by 2030.** This would allow the United States to meet its goal of reducing GHG emissions by 50% from 2005 to 2030. **The main GHG reductions will be achieved in the electricity sector** through massive investments in renewable energies and the electric grid.

In reducing the cost of clean energies and other climate solutions, the IRA will allow states, cities, and companies to raise more easily their climate ambitions.

According to Princeton energy and climate experts (REPEAT project)[1], the IRA will reduce the United States' annual energy spending by at least 4% in 2030, or an annual savings of almost $50bn for households, companies, and industry. This will result in hundreds of dollars of annual savings for US households.

Federal tax credits, rebates, and investments will lower the cost of electric vehicles, will enhance energy efficiency in buildings, and will fund investments by industry. The IRA could thus boost growth in wind and solar capacity.

The IRA should generate almost $3,500bn in cumulative investments in new US energy supply infrastructures over the next decade (2023-32). This includes more than $20bn in annual investments in transport, CO_2 sequestering and fossil fuel energy generation with carbon capture by 2030. The annual investment in hydrogen production is expected to triple by 2030 (to $3bn annually) amounting to more than $50bn by 2035. Investments in wind and photovoltaic solar energy are expected to double, reaching $321bn in 2030.

The IRA will lead to major additional energy system investments by households and companies, including the purchase of electric vehicles and devices, and more efficient and more electric-focused heating systems and industrial processes. It also provides for tens of billions of dollars in subsidies, tax credits and loans to expand clean energies and their use. **All this will stimulate additional investments and jobs. This will also boost innovation and maturing of important new clean technologies**, the building out of clean energy supply chains, improved public health, and environmental justice.

[1] *https://www.princeton.edu/news/2022/08/25/princeton-energy-and-climate-experts-weigh-impactinflation- reduction-act*

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The new technologies will get a boost from subsidies that are expected to have an impact similar to tax credits on production and investment tax credits that helped expand wind and solar energy industries and lower costs during the past decade (by 70% to 90% since 2009).

Lastly, the IRA will support the development of US manufacturing of components and assemblies for solar and wind energy, batteries, and electric vehicles, among other things. **The IRA provides for subsidies, loans, and tax incentives that will lead to hundreds of billions of dollars in cumulative investments by 2030.**

Overall, according to estimates, up to 1.3mn new jobs could be created by the measures, in particular in construction and services, and they could add 0.6-0.8% to GDP by 2030. Some \$51-74bn could be saved annually by preventing climate-related damage (which would raise total savings to a range of \$329-535bn when including all other measures passed in the legislation).

Carbon tax shelved: the price of compromise between Republicans and Democrats

The strategy adopted by the US authorities contrasts with the approach taken by Europeans, which has focused on the carbon tax

The compromise between Republicans and Democrats was made possible only by the shelving of the carbon tax idea, which had so far been a key proposal to accelerate the climate transition. It is true that the carbon tax is opposed by the vast majority of Americans. Only 28% of them are in favour, whereas more than half of them are in favour of subsidies or in favour of low-carbon technologies and investments in green infrastructures.

The strategy adopted by the US authorities contrasts with the approach taken by Europeans, which has focused on the carbon tax and the carbon market. In a way, the tax credit (the main financial tool of the IRA) has supplanted the carbon tax.

In placing the priority on developing the decarbonised technologies sector, the Biden administration is implementing a true green industrial policy. The measures aim to transform supply-side conditions, and that marks a shift in Democratic Party doctrine. Most experts believe that the measures taken will not be sufficient to achieve carbon neutrality by 2050. However, it will certainly allow the United States to regain some leadership in this area. And the fact that a bipartisan agreement was reached by Congress a few months before mid-term elections raises the likelihood that new measures will be passed in the coming years, regardless of the political leanings of the next administration.

This is very good news for the planet, but this pragmatic approach should also grab the attention of other countries, starting from **Europe,** where extensive investments also must be undertaken. The carbon market route could be usefully supplemented by **proactive fiscal measures at the European level.** Europeans will also have to show imagination in achieving their goals. **The current energy crisis could and should be the catalyst for joint and coordinated action in this area. It is a matter of competitiveness and strategic autonomy for Europe.**

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