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THE GREEN SUBSIDY ARMS RACE:

THE EU AND US GO HEAD TO HEAD WHILE THE UK STAYS OUT OF THE FRAY

At first glance, it would be hard to know from its rather generic title that the Inflation Reduction Act (IRA) contains (amongst other measures) the largest package of government support for the energy transition offered by any country in the world. President Biden's landmark legislation, which was passed last year, has set hares running across the globe, particularly in the EU. Vice President and EU competition commissioner Margrethe Vestager has said that part of the IRA is "a threat to the competitiveness of specific key sectors for the green transition of the European industry". In turn, the European Commission (EC) has announced its Green Deal Industrial Plan and proposed easing restrictions on State aid for investments in renewable energy or decarbonising industry.

America First: the EU responds to a pro-America package

The IRA is a tough offering to match. It contains a $369 billion green support package intended to support green infrastructure and attract clean energy businesses to the US, $216bn of which is earmarked for corporations. The law gives tax incentives to businesses across a range of green investment projects, including wind and solar farms, battery storage facilities and investments in renewable hydrogen. The IRA also contains incentives to 'buy American', which could lead to a long-term restructuring of supply chains. For example, for an electric vehicle to qualify for its $7,500 tax credit, all its battery components will soon need to be made in North America. The EU does not have a free trade agreement with the US meaning tariffs already apply to EU goods entering the US; 'buy American' measures like this therefore put EU-made products at a disadvantage on the US market by making EU products comparatively more expensive. At one stage, it was reported that the EC had written to Washington querying whether some of the IRA's conditions on tax credits violate World Trade Organisation (WTO) rules. However, the EC appears to be trying to relax its criticism of the IRA - in a more recent interview, Vestager said that the damage to EU businesses from US subsidies is likely to be fairly limited.

At the start of February, the EC unveiled its Green Deal Industrial Plan. The EU package does not quite match the US financially, offering €250bn in financing that Member States can use to offer subsidies and tax breaks. The Plan builds on previous initiatives and complements ongoing efforts, for example, under the European Green Deal. It is based on four pillars: (i) a predictable and simplified regulatory environment, (ii) speeding up access to finance, (iii) enhancing skills (e.g., with Net-Zero Industry Academies), and (iv) open trade for resilient supply chains (the EC will continue to develop the EU's network of Free Trade Agreements and other forms of cooperation with partners to support the green transition).

Under the second pillar, the EC announced plans to update State aid rules to allow EU Member States to subsidise clean technology manufacturing, which could have major consequences for the future of European green investment.

The Green Deal Industrial Plan's fourth pillar also seeks to ensuring that foreign subsidies do not distort competition within the single market, a principle since reiterated by Vestager. The new Foreign Subsidy Regulation seeks to give the EC further tools to combat these distortions.

The EC relaxes the State aid rulebook

The competition rules in the Treaty on the Functioning of the EU place restrictions on the grant of State aid to control the risk that financial or other assistance from the State (or other public funds) operates to disrupt normal competitive forces and threaten the EU's internal market objectives. The EC considers the control of State aid as one of the most important aspects of EU competition policy.

However, crises like the 2007-2008 financial crisis, the Covid-19 pandemic and the Russian war against Ukraine have seen the EC apply the State aid rules in a way that allows EU Member States to respond flexibly to these challenges. The EC is now using this approach to deal with the climate crisis.

As part of its Green Deal Industrial Plan and in response to the double challenges of the IRA and the energy crisis, the EC amended the State Aid Temporary Crisis Framework (TCF) on 9 March 2023 to accelerate Europe's green transition (the EC's related press release is available here and related Vestager Remarks: here). The EC adopted the TCF in March 2022 in response to the war in Ukraine, and it has since amended the framework to address the ongoing energy crisis. In addition to setting out the basis on which support for electricity demand reduction and compensation for companies for high energy prices will be permitted, the TCF also sets out the basis on which Member States can introduce measures that promote the energy transition by accelerating the roll-out of renewable energy and facilitating the decarbonisation of industrial processes. The updated guidance further addresses:

- the possibility for Member States to (i) support the deployment of all renewable energy sources; (ii) grant aid for less mature technologies, e.g., renewable hydrogen without competitive bidding, provided safeguards are in place; and (iii) incentivise investment leading to a reduction in emission by including higher aid ceilings and simplified aid calculations; and

- to address investment gaps in sectors strategic for the green transition by allowing support for the production of batteries, solar panels, wind turbines, heat-pumps, electrolysers and carbon capture usage and storage.

These new provisions are in place until 31 December 2025. The EC also amended the General Block Exemption Rules (GBER) on 9 March. The GBER identifies specific categories of State aid which are exempt from the requirement of prior notification to and approval by the EC; instead, Member States can grant the aid and then update the EC of these measures afterwards. The amendment at the start of March provides more flexibility to support sectors that are key for the transition to climate neutrality and a net-zero industry, for example by increasing the notification thresholds for environmental aid as well as research, development and innovation aid.

Could subsidy competition do more harm than good?

Some may say that this global competition of governments to support green investment can only be a good thing for our planet. The additional cost of using a product or service powered by clean energy is often a significant barrier to scaling up the energy transition. This is an issue government subsidies could address, particularly when new technologies are in their infancy.

However, there has been opposition within the EU to the EC's proposals because of the destabilising effect relaxing State aid rules could have on the bloc. Some 11 Member States, including Ireland, Poland, the Netherlands, Hungary, Czechia and Denmark, have reportedly advised the EC to exercise "great caution" when loosening State aid rules, arguing that the harms these changes risk within the Union itself could be "greater than the positive effects".

France and Germany (the EU's two biggest economies) account for almost 80% of the State aid notified under a TCF to help Member States cope with the Covid-19 pandemic. Vestager, while emphasising that any changes to State aid rules in response to the IRA "must preserve the integrity of the single market", also admitted that currently "European countries are not equal when it comes to State aid". There are risks that this inequality will worsen going forward if State aid policy is amended to facilitate increased green investment. Financial or political tension within the single market as a result of State aid changes could risk hampering unified European efforts to combat global warming.

Similarly, if the world's major powers get caught up in jostling for position as a subsidy leader, there is a risk that they could lose sight of the fact that net zero is not a zero sum game. Collaboration will also be key to combatting the climate crisis, both on a European and global level.

The EC appears to be seeking to address both these risks. It has indicated it is exploring avenues to achieve greater common financing at EU level for net-zero technologies, with the eventual aim of establishing a European Sovereignty Fund. The Green Deal Industrial Plan's fourth pillar also makes clear that the EC wants to prioritise "global cooperation and making trade work for the green transition"; however, it remains to be seen whether other countries, notably the US, will embrace this spirit of cooperation.

The British are coming? Not for now

The UK is yet to really enter this global competition on green subsidies. At the end of January, the chancellor Jeremy Hunt indicated that the UK government will announce a "highly competitive" package at some point in the future. However, he did state explicitly that he did not think subsidies are "necessarily the best way", placing a greater emphasis on creating a regulatory structure that encourages investment. A government energy minister told the House of Lords that the EC's proposals did not seem to be a "particular threat" to the UK, he acknowledged the IRA was "significantly" more worrying.

The Institute of Directors recently published a survey showing eight out of ten of its members were in favour of increased subsidy support in response to the measures of the US and the EU.

The Spring Budget did contain some financial support for the development of new, innovative green technologies; Mr Hunt promised £20 billion of support for the development of Carbon Capture Usage and Storage, and indicated there would be future public investment in nuclear power, including a competition for the development of Small Modular Reactors. However, when announcing an extension of the £600million tax relief for energy efficiency measures under the Climate Change Agreement (introduced in response to the energy crisis), the Chancellor emphasised “the long-term solution is not subsidy but security”.

The UK’s new Subsidy Control Act would govern any additional green subsidies the UK government decides to introduce in the future. The Act contains specific Energy & Environment principles which these subsidies will need to comply with. The Competition and Market Authority’s Subsidy Advice Unit (SAU) also has a role, for certain types of subsidies, in providing non-binding advice on whether the proposed subsidies are compliant with the new UK regime. After opening for business on 4 January 2023, the SAU’s first report published on 22 February was on Contracts for Difference for Renewables Scheme referred to the unit by BEIS. While it emphasised this report was purely advisory and did not directly assess whether the scheme complies with the subsidy control rules, the SAU report did contain some comments on how BEIS evaluated the compliance of the scheme with the energy and environment principles in the new law.

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