

PRESS RELEASE

## How should Europe respond to the Inflation Reduction Act?

- According to analyses of the GCEE, the IRA will have only a minor impact on the overall economy in Europe in and of itself. However, in individual sectors, the incentives for investment in the U.S. are likely to increase relative to Europe.
- The EU should reduce the bureaucratic burden of its subsidies and focus them more on emission reduction. In order to reduce the already existing energy price gap to the U.S., the energy supply and the energy infrastructure should be expanded.
- For the first time, the GCEE publishes a Policy Brief. This new publication format aims at a timely discussion of current topics and will appear irregularly.

**Wiesbaden, 14.07.2023** – With the Inflation Reduction Act (IRA), a comprehensive subsidy programme for low-emission technologies came into force in the U.S. at the beginning of 2023. The German Council of Economic Experts (GCEE) shares the fears expressed by various parties regarding the IRA only to a limited extent. The GCEE expects that on aggregate, the IRA subsidies themselves will have only a minor economic impact in the European Union (EU). For individual industries relevant to achieving the climate targets, however, the IRA subsidies could increase the attractiveness of the U.S. as a production location and thus strengthen the incentive to invest in the U.S. rather than in the EU. However, the existing energy price differences are likely to have a significantly greater impact on the relative attractiveness of the EU than the IRA itself. The GCEE discusses how the EU and its member states should respond to the IRA in its Policy Brief, a new publication that will appear irregularly.

### Avoid subsidy race, revise subsidy system

In order to strengthen the relative competitiveness of European companies, several parties request additional subsidies in the EU in response to the IRA. A subsidy race triggered by the IRA would entail significant welfare losses for both the U.S. and the EU and should therefore be avoided. "EU member states should coordinate their responses to the IRA and agree on a common approach at the European level," stresses Monika Schnitzer, chair of the council. "National support programmes should not lead to a bidding war within the EU."

When comparing the scope of the support programmes for green technologies in Europe and the U.S., the GCEE finds that the EU already supports low-emission technologies with the Green Deal Industrial Plan to a comparable extent as the U.S. with the corresponding programmes within the IRA. However, the tax breaks for companies are much more predictable and are not capped in case of production expansions, contrasting application procedures for subsidy programmes and the allocation of funds in the EU. "The existing European subsidy programs need to be reviewed – how can we simply access eligible companies, and how can we reduce bureaucratic hurdles?" asks council member Ulrike

Malmendier. "At the same time, subsidies should be more closely aligned with the expected emission reductions from the subsidised activities."

### Expand energy supply to reduce energy price differential

Subsidies for low-emission and sustainable electricity generation are the largest single item within the IRA and will likely have the broadest impact. For this, 43.6 per cent of the planned subsidy volume is earmarked in the form of tax credits. Several studies estimate that the IRA will reduce the price of electricity in the U.S. by about 1 ct per kilowatt hour. "We expect that the already existing energy price differences will have a much stronger impact on Europe's attractiveness as a production location than the IRA itself," says council member Achim Truger. In the past three months, electricity prices in Germany were on average 9 ct per kilowatt hour higher than in the U.S. "In order to reduce the relative energy costs, the electricity supply and the energy infrastructure should be expanded rapidly," explains council member Martin Werding. To this end, the expansion of renewable energies should be accelerated and hydrogen-capable gas-fired power plants should be added in Germany. The incentives to make electricity demand and supply more flexible should be significantly increased. This can be achieved, for example, by reforming the structure of grid charges or by strengthening regionally differentiated price signals through a regional division of the market into price zones. In addition, the EU member states should cooperate more closely in the Europe-wide expansion of energy infrastructure and in the import of energy sources.

### Secure raw material supply, strengthen trade agreements

The expansion of renewable energies, together with the IRA's battery and hydrogen production, is likely to increase demand for critical raw materials and increase competition for scarce resources. The EU should help secure and diversify the supply of critical raw materials. New agreements should be concluded with countries that possess or process critical raw materials. At the same time, incentives for the development of domestic raw material production and recycling should be strengthened.

The IRA tax credits are particularly high if a large share of the raw materials and intermediate products used stem from the U.S. or from countries with which the U.S. has free trade agreements. "The EU should speed up negotiations on a free trade agreement with the U.S. and ratify agreements that have already been negotiated, such as Mercosur," demands council member Veronika Grimm.

The GCEE is publishing its first Policy Brief today. In this new format, current issues or already existing positions are analysed and discussed from a new angle. Policy Briefs will be published irregularly.

The German Council of Economic Experts (GCEE) provides support to policymakers and the general public on questions and matters of economic policy. It was founded as an independent body in 1963 and currently consists of the council members: Professor Dr. Veronika Grimm,

Professor Dr. Dr. Ulrike Malmendier, Professor Dr. Dr. h.c. Monika Schnitzer (chair) Professor Dr. Achim Truger, Professor Dr. Martin Werding. By publishing regular reports, the GCEE aims to help the general public and decision-makers in politics, business and society to form a reasoned opinion on economic policy developments in Germany.

Further information on the German Council of Economic Experts and its publications are available at <http://www.sachverstaendigenrat-wirtschaft.de/en> or follow us on Twitter [@GCEE\\_en](https://twitter.com/GCEE_en).

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