The UK in a World of Green Industrial Strategies

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Workshop Summary: UK Trade and Public Policy Network (TaPP)[1]

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The confluence of the climate crisis and a global economic crisis has driven demand for government action to support business and support the development of 'climate-friendly' economies. Recent developments in the US and the EU both entail significant consequences for the UK.

On 19th January 2023 we held a TaPP workshop to discuss recent developments in the US, EU, and UK, and consider the position of the UK within a world of green industrial strategies. This note summarises the discussion.

US: Discriminatory-By-Design Green Industrial Policy

The turn towards green industrial policy in the US is driven by three motivations: the Biden administration are 'true believers' in industrial policy, which is a distinct shift away from the neoliberalism that characterised previous administrations. In particular, they are seeking to use trade policy to generate new employment within the US (the 'worker-first' trade policy); respond to genuine concern about the environment; and also undermine China's development of new technologies. The Inflation Reduction Act (IRA) reflects all three motives.

Understanding these motives is important for the trade regime, not least as the rules of the WTO are accustomed to evaluating and assessing which industrial measures are reasonable and consistent with governments' legal obligations. However, there is less clarity around measures taken for sustainability (traditionally defended under Article XX GATT) and national security (more recently used actively under Article XXI GATT). The mix of motives make it hard to assess compatibility of US green industrial policy with US commitments under the WTO (and comparable commitments under FTAs).

A key element of the IRA is US$400bn in subsidies for clean energy, including a wide range of products from solar panels to electric vehicles. There are concerns over the WTO legality of tax credits for electric vehicles, which are due to start in 2023. The policy is openly discriminatory as to qualify or tax credit, 'final assembly' must take place in North America; a specific percentage of the critical minerals used to make the battery must come from countries with whom the US has an FTA (which excludes China and the EU), starting with 40% by 2024 and rising to 80% by 2026; and specific entities – "foreign entities of concern" - are excluded from eligibility (a measure targeting China).

Currently no electric vehicle currently produced in North America meets these criteria, partly because China remains the major source of critical minerals globally. Given this, workshop participants raised the question of whether the policy will work on its own terms. Will the tax credits be sufficient to restructure supply chains and jobs and drive a shift to production and consumption of electric vehicles in North America, or are the criteria too stringent to be effective? Also, there is an exclusion for commercial vehicles, raising doubts as to how to classify a vehicle as 'commercial'.

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[1] The Trade & Public Policy (TaPP) Network connects academic researchers with civil servants, parliamentary researchers, journalists, and others looking for expert input on UK trade policy. We aim to increase the breadth and depth of evidence available to decision-makers in UK policy and help inform the public debate. It is the largest network of academic experts on UK trade policy. More information is available at https://tappnetwork.org/about.

[2] We thank Geraldo Vidigal, Ilaria Espa, and Emily Lydgate for presentations during the workshop and input on this summary, and the workshop participants for their insights. Any errors or omissions are our own.

The US example highlights the challenges of designing green industrial policies that will deliver on environmental objectives, garner sufficient domestic political support to be enacted, and minimise negative spill overs for trade partners. How should one assess whether US policy is optimally designed and whether discrimination is justifiable? From a purely environmental perspective, non-discriminatory subsidies are likely to be more effective (and would be less trade distorting) but are unlikely to garner sufficient domestic political support to be enacted. Eliminating the discriminatory elements (thereby reducing trade distortions) might make the policies politically impossible to implement, making the best the enemy of the good.

EU: Plethora of Overlapping Green Industrial Initiatives

Green industrial policy in the EU is evolving rapidly and there is a myriad of overlapping initiatives. Initiatives with substantial green industrial policy elements include the European Green Deal; the Fit For 55 Package; the revision of the EU emission trading scheme (ETS), including a strengthened Innovation Fund, and the adoption of a carbon border adjustment mechanism (CBAM); the EU's recovery plan including its Recovery and Resilience Facility; the REPowerEU plan aimed at accelerating moves to diversify away from Russian energy supplies after the outbreak of the Ukraine war; NextGenerationEU Green Bonds; and, the newly announced 'Green Deal Industrial Plan'.

Within the 'Green Deal Industrial Plan' and its pillar, a number of initiatives will be pursued, including: plans for a Net-Zero Industry Act which will set out clean technology objectives for 2030 and is designed to be the EU's response to the US Inflation Reduction Act; a temporary adaptation of EU state aid rules potentially contemplating, inter alia, exemptions from state aid notification requirements under the General Block Exemption Regulation for hydrogen and electric-vehicle sectors and "anti-relocation" investment aid, including tax breaks, for green investments in strategic sectors to counteract the adverse distortions arising from US subsidies, particularly the risk that EU companies producing electric vehicles will be tempted to relocate to the US to benefit from US subsidies; and, a faster, easier to fund and simpler to access process for Projects of Common European Interest (PCEI) on clean tech. The plan will also complement and reinforce the efforts that the EU, like the US, is pursuing to shore up its supply chains in areas like critical minerals (under its Critical Raw Materials Act) and batteries for electric vehicles (under the European Chips Act), to reduce dependence on China.

In addition to EU-wide initiatives, member states are pursuing their own green initiatives, with Germany, France and the Netherlands spending an estimated US$100bn, US$55 and US$45, respectively. Coupled with spending by other member states, like Spain and Italy, the total spend by individual member states is an estimated US$250bn. Given the plethora of initiatives across the EU it is hard to assess exactly how much financing is being targeted to green subsidies, but the sums are vast. The EU is worried that wide differences in member states' capacity for spending may lead to fragmentation of the EU market. To avoid that and support the transition across the whole Union, the launch of a new European Sovereignty Fund for green and digital initiatives was announced. Based on information currently available, the Fund should become operational as part of a wider mid-term EU budgetary review due in the Summer 2023.

It is also worth noting that the EU continues to pursue its wider green industrial agenda via its trade policy. This includes its preferential trade agreements which contain dedicated chapters on energy and raw materials, and looser cooperation initiatives, notably the EU-US 'green steel and aluminium' deal.

UK: Missing-In-Action Green Industrial Policy

As the US and EU spend significant amounts on green industrial policies, where does this leave the UK? The UK needs to decide on its own green industrial strategy as well as how to respond to the impacts of policies pursued by its major trading partners, especially if the US and EU enter into a green subsidy race.

There are clear signs the UK government is interested in these issues. For instance, its Net-Zero Strategy includes public subsidy and investment initiatives, and it has pledged to phase out diesel and petrol vehicles by 2030. However, the UK lacks consistency and ambition. This is illustrated in the car industry, which having already lost investment post-Brexit, is now faced with the recent collapse of the start-up Britishvolt (which had planned to build a major plant manufacturing batteries for electric vehicles) and BMW's decision to relocate the manufacture of the electric Mini from the UK to China.

Overall, an ambitious UK green industrial policy faces serious headwinds. The UK is not a big enough economy to compete in a subsidy race; the government is distracted by other policies issues (not least ongoing industrial action across the public sector). Green industrial policy does not appear a priority with both the Conservative and Labour parties advocating different levels of fiscal conservatism that are unlikely to lead to a large scale green industrial policy.

Where now for the UK, what are its options?

In the absence of an ambitious domestic policy agenda, UK industry is likely to be negatively impacted by US and EU subsidies, particularly if (as seems likely) subsidies are designed in a discriminatory manner. The UK's relevant weight in the global economy will make it far harder to insist its interests are considered in new US or EU schemes. In this case, will the UK choose to confront the US and EU? Will it challenge the discriminatory aspects of the IRA? And how will the UK respond if the EU loosens state aid rules, particularly at a time when the EU is also tightening its approach to foreign subsidies?

In considering its options, the UK needs to meet four core objectives: first, to protect UK business from the adverse impacts of subsidised goods; second, to avoid becoming side-lined as new 'green' supply chains are developed; third, meet its net-zero commitments; and fourth, as a middle power dependent on functioning institutions, to uphold (or at least not undermine) the rules-based multilateral trading system. All the while, the UK is rightly wary of being seen to align with China, further limiting its options.

It was proposed that the UK has four options (to be pursued in tandem):

(1) **Immediately shield UK business:** To counter the adverse effects of US and EU subsidies the UK should make active use of countervailing duties as soon as possible. Here two separate options were proposed. First, the active use of countervailing duties to respond to harmful 'green' subsidies, potentially supported by providing additional resource for the Trade Remedies Authority (including a dedicated unit to conduct investigations on 'green' subsidised goods). Potential negative handling could be mitigated by committing to redirecting collected countervailing duties toward net-zero projects in a non-discriminatory manner (including consumption subsidies). Second, to expand the use of undertakings which are currently used (most often) at a firm level. Instead, drawing on limited international examples, the UK could use countervailing duties as leverage to agree government-level undertakings. They might take the form of an export restraint but could equally go further, including possible commitments to fund UK net-zero projects, investment funds, or businesses.

(2) **Prepare to confront discriminatory green subsidies:** The UK needs to overcome its current nervousness around 'conflict' with partners and be open to litigation. Though disputes can become contentious, not all trade disputes are necessarily so. Initiating litigation, including joining formal disputes raised by other countries, increases pressure. This is unlikely to include the withdrawal of the discriminatory subsidy (not least given long-standing problems with the WTO dispute settlement system). But it does increase the likelihood of a negotiated settlement (for which the UK should have a ready 'shopping list'). In relation to the US, the WTO would be the forum of choice. In the case of the EU, such a claim could be pursued via either the TCA or the WTO, though the WTO is considered preferable as the TCA is still considered politically sensitive, and its bilateral nature reduces the ability to create effective alliances through WTO dispute settlement.[3]

[3] Indeed, the EU's challenge of alleged local content requirements in UK subsidies via the WTO instead of TCA was widely considered a constructive move that reduced the entrenchment of positions to sensitivities over Brexit.

(3) **Develop new strategies for subsidies reform:** The UK should take advantage of the new challenges to the global subsidies regime to work with other WTO members, demonstrating thought leadership, to consider options for future subsidies reform. The trade policy world faces new contradictions and inconsistencies: while the US, EU and others have long challenged China's use of industrial subsidies, they are now actively deploying their own green industrial subsidies that are (at least) discriminatory in nature. Given the urgency of tackling the climate emergency, and the need to spur a rapid green transition in the high-emitting economies including the US and EU, what is the optimal way forward? How should adverse impacts on third countries (middle-sized and small economies) be addressed without undermining a green transition? And should there be special flexibilities or compensation for developing countries with low historical emissions? The core challenge in bringing China into discussions on subsidy reform has long been that they have little to gain from new commitments. Here, greater clarity on both elements of state capitalism and green industrial policy, could offer sufficient incentives for all sides. Though success should not be considered likely given the challenges of multilateral reform, it would show the UK's commitment to the rules-based multilateral trading system.

(4) **Invest in green regulatory diplomacy**: it should be expected that green industrial policies will become more, not less, common. And the UK's position should not be hostile to such schemes: only where they are designed to unfairly disadvantage UK interests (broadly understood). As such, there is considerable work that can be done in relation to the underlying architecture of any green economy where the UK (and its recognised standard setting body, the BSI) can make meaningful contributions. From developing, supporting, and funding access to internationally agreed standards on carbon accounting, reporting, chain of custody management, and so on, the UK can contribute significant technical expertise and resource.