

New Economy



Wrangling Over Green Subsidies

The US and EU seek to agree on sustainability incentives to avert a trade war

As European Commission President Ursula von der Leyen sat in the White House's Oval Office last month, she gushed before the cameras about the US's Inflation Reduction Act of 2022 (IRA). "It's great that there's such a massive investment in wind and clean technologies now," she said of America's green awakening.

It wasn't until the press shuffled out that von der Leyen shifted to a much sterner message, according to people familiar with the meeting, who asked not to be identified discussing private matters. Europe's executive chief warned President Joe Biden that the

law's bias against European companies was unacceptable and that anything short of a pragmatic fix would become a major irritant in the trans-Atlantic relationship.

The US and the European Union are negotiating a limited critical minerals deal that may put a salve on those simmering tensions, but Washington's protectionist agenda is still causing anxiety in Brussels, where the US needs help pressuring China. Meanwhile, the Biden administration remains frustrated with what it views as the EU's rigid adherence to a rules-based trading system that's no longer fit for purpose.

"Europe was genuinely surprised that the Biden administration didn't revert back to the pre-Trump days," says Kelly Ann Shaw, a partner at law firm Hogan Lovells who served on the Trump administration's trade and economic team. "They missed the memo that the politics on trade have changed."

If the US and EU can bridge their gaps on trade, they may preserve an important economic bulwark against China's rise and Russia's expansionism. But if talks founder, a new ►

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◀ trans-Atlantic trade war could undercut a mainstay of the world economic order and create lasting headwinds for global growth.

Since entering office, Biden has attempted to repair a trans-Atlantic relationship that frayed during his predecessor's costly trade wars. Biden and von der Leyen forged an important ceasefire in 2021 over a long-running dispute regarding illegal subsidies given to Airbus SE and Boeing Co., and both sides shelved duties on about \$11.5 billion of each other's exports.

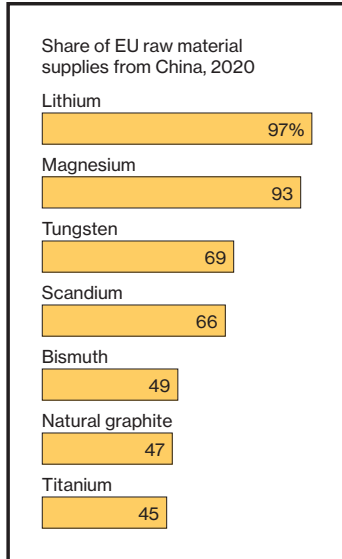
The truce established a baseline level of trust between US Trade Representative Katherine Tai and her European counterpart, EU Trade Commissioner Valdis Dombrovskis. It also provided a crucial foundation to confront back-to-back shocks that highlighted a dangerous overreliance on authoritarian nations—China's draconian Covid-19 controls that temporarily shut off much of its economy from the world, followed by Russia's invasion of Ukraine.

Early on, there was common purpose: The EU and the US cooperated to impose stiff economic penalties aimed at crippling President Vladimir Putin's war machine and developed a new energy alliance that turned Europe into the top buyer of US liquefied natural gas.

While leaders on both sides of the Atlantic welcomed this era of bonhomie after years of tariff skirmishes, their unified front against Russia masked some profound differences over each other's approaches to trade.

Beyond the more pleasant tone, the Biden administration remains fixated on China and shows far less interest in discussing ways to enhance trans-Atlantic trade cooperation, according to an EU official who declined to be identified because of the private nature of the discussions. The IRA aims to challenge China's dominance in green technologies and revolutionize America's clean energy marketplace by providing \$369 billion in tax credits and other incentives—though the final figure could end up being far greater.

The European Commission responded to the US subsidy program with its own Net Zero Industry Act, which eases access to EU state aid for clean technology investments by loosening a host of EU regulations governing investment, permitting and public procurement, among other areas.



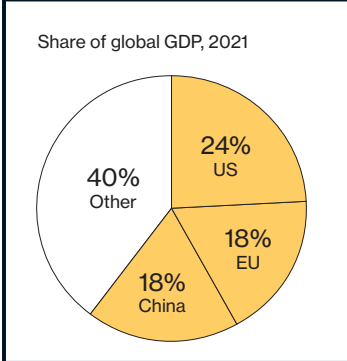
The US law irked many in Brussels, where EU officials worried the massive American subsidies would unfairly distort the market for green goods, lead to an exodus of European clean energy investment and encourage a global subsidy race. Europe was also concerned that the IRA's critical minerals rules would create an unhealthy competition between the US and EU for scarce goods located outside of China, which would paradoxically force European companies to become more reliant on Chinese inputs than ever before.

The EU briefly considered filing a World Trade Organization dispute over the US law's discriminatory provisions but ultimately decided that a public display of disunity would undermine the broader cause of cooperation against Russia.

"The overall reason that the EU and US are trying to have a civilized disagreement is the war in Ukraine," says former EU Trade Commissioner Cecilia Malmstrom. "Any obvious cleavage or big disagreement will be used by Putin, and that is not a good idea."

The proposed critical minerals deal aims to alleviate these concerns by setting new trans-Atlantic terms aimed at reducing dependence on China for raw materials. In return, the US will provide EU companies with greater access to some of the IRA's subsidies and tax credits.

Ultimately, the US wants to create a club of like-minded countries that agree to reduce their dependence on China for raw materials such as lithium, cobalt, nickel and magnesium, which are key ingredients for electric motors and batteries. The US and Japan signed a similar agreement in March. Reducing Europe's overreliance on China for key raw materials is a clear priority for Brussels because the EU currently sources some 98% of its rare earth supplies from China.



The critical minerals deal may be a positive step, but the US Treasury Department's green subsidy guidelines won't address all of the EU's concerns. There also remains a lingering fear in Europe that if Donald Trump is reelected he'll pivot back to a more combative approach. That's a

point of tension that China is keen to exploit as it works to drive a deeper wedge between the US and Europe.

Over the past decade and particularly during the Trump administration, China made significant inroads into the European marketplace and strengthened its relationships with France, Germany and the Netherlands. Last year, Chinese President Xi Jinping hosted German

Chancellor Olaf Scholz and a powerhouse delegation of German executives from BASF, BioNTech and Deutsche Bank to underscore Beijing's close ties with Europe's largest economy.

Xi knows that China's \$6.8 trillion consumer marketplace is an essential destination for European exports of cars, pharmaceuticals and machinery. German automakers BMW, Mercedes-Benz and Volkswagen have built dozens of factories in China, and all three manufacturers now sell more vehicles in China than in any other market.

Europe has no plans to completely cut off trade relations with China, but it recognizes the need to minimize its dependence and strike a more assertive tone. The US also hopes to garner EU support for new trade tools to penalize Beijing's nonmarket economy practices—like its massive state subsidies for the steel and aluminum sector. That's why the US and the EU are negotiating a potential agreement to “drive decarbonization while also limiting anticompetitive and nonmarket practices” from countries such as China, US Trade Representative Tai told US lawmakers in March.

In December, she proposed the creation of a group of nations that would agree to raise tariffs on imports of foreign steel and aluminum produced by carbon-intensive practices—a move that's ostensibly aimed at China.

The US and EU hope to conclude the Global Arrangement on Sustainable Steel and Aluminum before the expiration of a bilateral tariff truce in October. Otherwise, it could trigger a trade war relapse and automatically restore Trump-era tariffs on more than \$10 billion of trans-Atlantic exports—such as Harley Davidson motorcycles and French wine—as soon as Jan. 1.

But EU officials say the deal, as proposed, will violate WTO rules and preserve the US's ability to impose tariffs at a later date, leaving Europe at the whim of future administrations.

The stakes are massive for getting this right. The US-EU trade relationship is arguably the world's most influential democratic alliance. Bilateral trade between the US and Europe accounts for 42% of global gross domestic product and directly employs almost 10 million workers at foreign affiliates on both sides of the Atlantic.

If the US and the EU can get on the same page, it could persuade other Group of Seven allies to embrace a new economic order that forces China to play by their rules. “A US that's allied with Europe seeing eye to eye on China is a much more serious proposition for China,” says Wendy Cutler, a vice president at the Washington-based Asia Society. —*Bryce Baschuk, Alberto Nardelli and Eric Martin*

THE BOTTOM LINE Resolving US-EU trade conflict is critical for preserving the world's most influential democratic alliance, an important bulwark against China's rise and Russia's expansionism.



Green Aviation Inches Toward Takeoff

The EU's decarbonization targets are spurring efforts to commercialize sustainable solutions

Getting an 80-ton Airbus A320 off the ground requires huge amounts of energy, with a fully fueled aircraft capable of flying 4,800 kilometers (3,000 miles) loading up on more than 20,000 liters (5,283 gallons) of kerosene, almost 10 times the average annual gasoline consumption of a car. Long-distance journeys are even more polluting: A flight from Frankfurt to New York on a Boeing 747 jumbo jet emits around the same amount of carbon dioxide as heating 440 German homes for a year (roughly 2,000 kilograms, or 4,400 pounds, per passenger).

It's no wonder then that aviation has become a prime target of climate activists and lawmakers, who are calling for people to fly less or take the train on shorter routes. Some countries are already taking action by outlawing short flights where the train offers a reasonable alternative. Last year, more radical opponents broke through perimeter fences and literally glued themselves to the tarmacs at Berlin and Munich airports. Greenpeace wants to see private jets banned in Europe, branding them as “staggeringly polluting and generally pointless.”

Airlines and aircraft manufacturers are recognizing that they must decarbonize if they want to stave off protests and legislative restrictions on growth. And ▶

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