

PRESS RELEASE

The Inflation Reduction Act: How is the EU affected and how should it react?

Paris/Wiesbaden, 21.09.2023 – In a joint analysis the French Conseil d'analyse économique (CAE), the German Council of Economic Experts (GCEE) and the Franco-German Council of Economic Experts (FGCEE) assess the impact of the Inflation Reduction Act (IRA), an ambitious US subsidy programme, on the EU and discuss how the EU should react to the IRA. The main conclusion is that the IRA in itself is small, and so will be its aggregate macroeconomic effects both in Europe and the US – in particular compared to existing energy price differences. Thus instead of a blanket approach, the reaction of the EU should focus on rethinking its industrial policy doctrine and reducing the costs for energy significantly.

The IRA, aimed at promoting the production and adoption of clean energy, came into effect at the beginning of 2023. The buy-American conditions enshrined in some of the IRA's subsidies have drawn substantial criticism from the EU. The IRA itself has stirred a strong debate about the future of European industrial policy. The joint statement contributes to this debate. It quantifies the macroeconomic effects of the IRA and discusses how Europe can manage its green transition while strengthening its economic and strategic resilience, preserving jobs and productivity growth, and maintaining European solidarity and international coordination.

The precise assessment of the IRA's macroeconomic implications is a challenge, in particular as estimates of its fiscal stimulus differ widely. Thorough estimates range from \$390 to \$900 billions for the period from 2023 and 2031. The overall funding level of the various programs the EU has already initiated to meet climate targets and facilitate the green transition are comparable to the IRA. "As the IRA's subsidies have to be financed by current or future taxes we expect a minimal overall macroeconomic impact of the IRA on both the US and the EU. While specific industries will have to be supported, a sheeplike subsidy race should be avoided with the US as well as within the EU. Our industrial policy response should not be dictated by the IRA, whose economic effects do not represent significant risks for the EU. Our response should be based on Europe's own economic, social and strategic needs and on our global commitment to decarbonization." explains Camille Landais, Président délégué of the CAE.

The IRA revolves primarily around providing production and investment subsidies, many of which are uncapped. This strategy will be inefficient to address the challenges of decarbonization. The European policy mix, which involves both carbon pricing and targeted industrial intervention, is a more cost-effective approach. At the same time, Europe should learn from the simplicity and expeditiousness of the IRA approach. It should be a priority to simplify and expedite European procedures. Aid should be concentrated on sectors for which EU countries either currently possess or can be anticipated to develop comparative advantages, resulting in substantial environmental and technological externalities.

Rather than the IRA itself, it is the existing and sizable energy price differentials between the EU and the US that is likely to have substantial macroeconomic effects by negatively affecting Europe's attractiveness for companies and the competitiveness of its industries. "Concerted endeavors to

reduce energy prices within Europe are paramount. It is key to accelerate the deployment of renewable energy generation in order to strengthen energy supply. In particular as the transition strategies for the energy sector in Germany and France are quite different, we advocate for mutual support, particularly by designating both nuclear power plants and hydrogen-capable gas power facilities as transitional technologies on the path to climate neutrality within the EU taxonomy. Both countries stand to gain from intensified collaboration in expanding Europe's energy infrastructure, both for electricity and for hydrogen." says Monika Schnitzer, chair of the GCEE.

This statement is jointly published by the French Conseil d'analyse économique (CAE), the German Council of Economic Experts (GCEE) and the Franco-German Council of Economic Experts (FGCEE). Authors of the joint statement are Sébastien Jean, Camille Landais, Thomas Philippon and Aurélien Saussay, members of the CAE, as well as Monika Schnitzer, Veronika Grimm, Ulrike Malmendier, Achim Truger and Martin Werding, members of the GCEE. Monika Schnitzer and Camille Landais are also co-chairs of the FGCEE.

The Franco-German Council of Economic Experts is a permanent, bilateral body that was established on the basis of the Treaty of Aachen. It is independent and tasked with making policy recommendations on economic issues in which both countries have shared interests. The Council of Experts reports to the Franco-German Financial and Economic Council, which consists of both countries' Ministers of Finance and Economic Affairs and the Heads of the two central banks.

The co-chair of the advisory body on the German side is the chair of the German Council of Economic Experts, Monika Schnitzer. On the French side, the co-chair is the chair of the Conseil d'analyse économique, Camille Landais.

The co-chairs can each appoint up to four additional scientists to the FGCEE for the German and French sides, respectively. The activity for the advisory board is a personal honorary office.

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