

US-EU CLIMATE CHANGE INDUSTRIAL POLICY
PULLING IN DIFFERENT DIRECTIONS FOR COOPERATION, COMPETITION,
AND COMPROMISE

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- The United States and the European Union agree on prioritizing policies to address climate change, which includes securing supply chains for components essential to low-carbon technology. Despite this agreement, their policies to address climate change and low-carbon technology could foster competition.
- The US Inflation Reduction Act (IRA) reflects the competitive advantage of the US to draw in the best talents, capabilities, and resources from outside sources. This leads to a disconnect between the industrial policy benefits of the IRA within the US and the potential competitive impact the IRA has on US relationships with allies.
- The EU’s policies are shaped by the bloc’s desire to respond to external actors—including China and Russia—while protecting the common market and building up its internal capability to ensure security of supply. This is complicated by individual member-state objectives.
- The 2024 US presidential election could bring change: A Republican administration might not share the EU’s outlook on climate change, the need for government intervention, or even the close transatlantic relationship seen during the Biden administration.



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INTRODUCTION

Climate change policy and the low-carbon energy transition have opened up new avenues for the United States and the European Union to cooperate—or compete—with each other. There is a need to divest from traditional hydrocarbons, to facilitate low-carbon alternatives, like wind power, and to incentivize businesses and citizens to join these initiatives. The push for low-carbon alternatives has highlighted the corresponding demand for critical raw materials and rare earth elements. These raw materials, like cobalt, lithium, and phosphorus, among others, have become essential in the race to secure low-carbon alternatives through their use in solar panels, batteries for electric vehicles (EVs), and wind turbines. Aside from low-carbon technologies, Western countries have also recognized the need for critical raw materials in other key industries, such as defense and space, and e-mobility.

The United States and the European Union have determined that industrial policy will be a key feature to accelerate low-carbon technology development. Three policy measures—the Inflation Reduction Act (IRA) in the US, and the Critical Raw Materials Act and Net-Zero Industry Act in the EU—aim to build up critical sectors for the low-carbon energy transition. While the US and EU are aligned in a normative desire to fight climate change and agree on the need for state intervention, their respective policies at times compete. This Briefing Paper analyzes the US and EU relationship in the context of their respective new industrial policies to address climate change. The paper considers the broader contextual factors conditioning their relationship and evaluates the potential trajectories of the transatlantic relationship in relation to climate policy.

CONFRONTING THE PARADOX OF INDUSTRIAL POLICY

Industrial policy to address climate change creates a paradox. For the US government to make industrial policy palatable to voters and a bipartisan legislator base, the policies must elevate domestic firms and production. At the same time, the US government wants to attract foreign firms with critical know-how and resources. This pushes the US competitive advantage on two tracks and risks alienating allies.

Yet, for the US to be able to slash greenhouse gas emissions in accordance with its broad climate goals and transition to low-carbon alternatives without losing its competitive edge, it needs others, especially partners, to adopt complementary policies. In essence, the US will have to strike a balance between pursuing its own competitive advantage through industrial policy while not pushing so far that it loses the EU in their shared normative goal of addressing climate change. The same is true for the EU. Moreover, cooperation in the field of energy transition and climate change should be as comprehensive as possible, not just between transatlantic partners. If the transition is framed in competitive and exclusionary terms, non-partners could fall behind and continue to pollute more, to the detriment of all. Still, there is an ongoing debate on whether addressing climate change should be a shared interest of all actors, and not only of countries that share a normative base.¹

The transatlantic policies on climate change, low-carbon technology, and securing raw materials have been affected by the Covid-19 crisis, Russia's war in Ukraine, and the increasingly antagonistic relationship between the United States and China. The Covid-19 crisis highlighted the asymmetries of interdependence—especially the overreliance of Europe and the United States on Chinese supplies—and the fragility

¹ O'Sullivan, M. (2023) "Climate action in an era of great power competition". *Financial Times*, 9 July 2022. <https://on.ft.com/3NWC7aM>.



President Joe Biden meets with European Commission President Ursula von der Leyen in the Oval Office of the White House in March 2023.
Photo: Andrew Harnik, AP / Lehtikuva

of east-west supply routes.² The supply shocks provided a wake-up call for the EU and the US on supply chain vulnerabilities and China's increasing bargaining power on trade as well as political issues, and the need to increase self-reliance to improve economic resilience.

Russia's war in Ukraine accelerated the West's desire to divest from Russian hydrocarbons and prevent Russia's hydrocarbon supply chokehold on Europe.³ The EU acted quickly and cohesively on sanctions against Russia to avoid a divergence of interests among individual member states. The US has partnered with the EU on these initiatives. In 2022, the US and the EU set up the Task Force on Energy Security to build on transatlantic cooperation and reduce EU dependency on Russian energy supplies.⁴

In the US, a focused effort to de-risk from China has led Congress to act in a bipartisan way, even as the Biden administration wavers between talking tough and making diplomatic overtures toward China. The EU also wants to de-risk from China and has followed the US in trying to establish economic security and internal production of critical raw materials in a way that is read as a response to China. However, individual member states depend on China to varying degrees, which is why it remains unclear how far the EU will push this de-risking agenda in practice.⁵ The European Commission has not put strong political pressure on coherence, yet. This middle way—or possible policy fragmentation—opens different avenues for the US to get either the European Union as a whole or individual member states on board with US policy on issues like critical raw materials, net-zero industries, and other climate change policy.

2 Brenton, P., M. J. Ferrantino, and M. Maliszewska (2022) "Reponses of Firms and Governments to Supply Chain Shocks Surrounding COVID-19". World Bank. April 2022. https://elibrary.worldbank.org/doi/abs/10.1596/978-1-4648-1821-9_ch4; Li, C. and Z. Lin (2021) "COVID-19 and trade: Simulated asymmetric loss". *Journal of Asian Economies*, Vol. 75 (August 2021). <https://www.science-direct.com/science/article/pii/S1049007821000567?via%3Dihub>.

3 E.g., European Parliament (2022) "Economic repercussions of Russia's war on Ukraine - Weekly Digest". Economic Governance Support Unit (EGOV), Directorate-General for Internal Policies. PE 699.540. 2 June 2022. [https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/699540/IPOL_IDA\(2022\)699540_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/699540/IPOL_IDA(2022)699540_EN.pdf).

4 U.S. Mission to the European Union (2022) "Joint Statement between the United States and the European Commission on European Energy Security". Press statement, 25 March 2022. <https://useu.usmission.gov/joint-statement-between-the-united-states-and-the-european-commission-on-european-energy-security/>.

5 European Commission (2023) "Speech by President von der Leyen on EU-China Relations to the Mercator Institute for China Studies and the European Policy Centre". https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063.

US DOMESTIC POLICY: PARTISAN ON CLIMATE SPENDING, BIPARTISAN ON DOMESTIC INDUSTRIAL POLICY

The US domestic situation greatly influences the Biden administration's climate change policy and relationship with allies. Most essentially, the Biden administration wants to retain control of the executive branch and regain full control of the US legislature in the 2024 election. President Biden's re-election strategy will rely in part on showcasing his Covid-19 economic recovery plan, which included infrastructure, and on highlighting that his administration passed multiple pieces of meaningful legislation, including the IRA, and took concrete steps to address climate change.

Biden's administration lobbied for and signed three major pieces of bipartisan legislation: the US\$1.9 trillion American Rescue Plan Act; the US\$1 trillion Bipartisan Infrastructure Law; and the CHIPS and Science Act, which allocated US\$53 billion to fund semiconductor production in the US, rather than in China.

Biden also advocated the Inflation Reduction Act, the largest US expenditure on climate change mitigation. But the IRA was not bipartisan: Republicans opposed the bill's misnomer, its increased federal spending, the tax and healthcare provisions in the bill, and the focus on climate change mitigation.⁶ Not all Democrats were on board either. The IRA was passed only by making considerable concessions to Democratic lawmakers like Senator Joe Manchin of West Virginia—concessions that included the bill's most problematic domestic incentives. Even with these measures, it still took Vice President Kamala Harris's tiebreak vote to break the 50–50 standoff in the Senate.

Despite the bill's fraught passage, it became law, and the IRA has become a conversation point for transatlantic relations on climate change and industrial policy. The Biden administration is committed to implementing the IRA at home and advocating the bill's provisions outside US borders. Abroad, the IRA embodies the US competitive advantage to attract the best innovation, resources, and companies from abroad by subsidizing domestic production. This approach does not always sit well with allies, who can lose their best firms to aggressively competitive US incentives. This is especially true of the electric vehicle industry in countries like Germany and the Netherlands, by subsidizing at a higher rate and requiring domestic production

capacity.⁷ In theory, to reach a shared goal, allies ought to adopt complementary policies; in practice, more aggressive US industrial policies encourage allies to shore up their own competitive advantage, driving a wedge between them.

The complicated context surrounding transatlantic relations means that the United States is likely to approach the EU-wide policy differently from its approach to individual member states. This two-pronged approach includes high-level visits to highlight the public diplomacy initiatives and priorities of the United States alongside working-level visits, where the US can discuss individual member state needs.⁸ The war in Ukraine has changed the tenor of such meetings and increased the role that alliance politics can play. It is still unclear how the EU will respond to this, and its response depends on the nature of the bilateral US–member state cooperation. It is also unclear how much this cooperation might threaten EU political or economic cohesion, and how much that political and economic unity matters to the EU.

EUROPEAN UNION POLICY: REACTIVE POLICY FOR A NECESSARY CLIMATE TRANSITION

The European Union has pursued its own policies to address the supply of critical raw materials, energy security, and net-zero industry incentives. These policies aim to avoid fragmentation among member states, which might approach the issues with different capabilities.⁹

There are two pieces of proposed legislation that aim to strengthen EU internal resilience and facilitate the bloc's low-carbon transition: the EU Net-Zero Industry Act (NZIA) and the Critical Raw Materials Act (CRMA). These build on previous EU policies, like the European Green Deal and REPowerEU, which predate the IRA. Both EU policies introduce incentives and requirements for sourcing, production, processing, and development of critical raw materials and businesses that are linked to climate change and energy production. These

6 Meyer, Robinson (2022) "Not Even a Single Republican Voted for the Climate Bill". *The Atlantic*, 12 August 2022. <https://www.theatlantic.com/science/archive/2022/08/ira-climate-bill-house-vote-republicans/671133/>.

7 Brown, C. (2023) "Industrial policy for electric vehicle supply chains and the US-EU fight over the Inflation Reduction Act", in Aghion et al. *Sparking Europe's New Industrial Revolution: A Policy for Net Zero, Growth and Resilience*. <https://www.bruegel.org/book/sparking-europes-new-industrial-revolution-policy-net-zero-growth-and-resilience>.

8 The White House (2023) "Joint statement by President Biden and President von der Leyen". Briefing Room, Statements, 10 March 2023. <https://www.whitehouse.gov/briefing-room/statements-releases/2023/03/10/joint-statement-by-president-biden-and-president-von-der-leyen-2/>.

9 E.g., Sjørusen, H. and G. Rosen (2021) "Arguing Sanctions: On the EU's Response to the Crisis in Ukraine", in M. D. Cross and I. P. Karolewski (eds.) *European-Russian Power Relations in Turbulent Times*. University of Michigan Press: pp. 59–83. <https://www.jstor.org/stable/10.3998/mpub.10202357.5>.

policies provide a roadmap for the EU, through individual member states, to increase mining, processing, and recycling of critical raw materials.

The policies could be seen as part of the EU's efforts to divest from China and as a rebuttal to the IRA. Like their US counterparts, the policies aim to reduce reliance on single suppliers or processors, such as China, while building internal capabilities. Similarly, the preceding REPowerEU plan came with a stated desire to reduce dependence on Russian fossil fuels.

The policies have an individual member state component in that they support countries' build-up of low-carbon businesses and manufacturing. This will have a localized effect, as mining or manufacturing regions and towns re-invigorate their business or build anew. A key part of the member state component is that when it comes to implementation, subsidies for the net-zero industry come primarily from the member states. As members have different financial capabilities, this has led to arguments within the EU that allowing state aid will benefit some EU countries much more than others; measures framed as policies to avoid or combat fragmentation could in fact lead to state aid exemptions that facilitate that very fragmentation. At the same time, the CRMA, through state aid, is also able to attract US businesses to work abroad in European countries.

For a non-EU audience, the complexity of the EU policy process is important: Both the Critical Raw Materials Act and the Net-Zero Industry Act proposals are based on Art. 114 of the Treaty on the Functioning of the EU (internal market harmonization), meaning that the EU's ordinary legislative procedure applies. Both proposals have been drafted by the Commission and are currently in the process of being considered by the European Parliament and by the European Council, which must agree on a common position.

At this point in the legislative process, both member states and parliamentary groups can propose amendments and revisions to reach a compromise. In practice, informal dialogues are common in this phase as a place for discussion to reach a provisional agreement. If a provisional agreement can be reached, then the policies are usually adopted by the Parliament and the Council at the first reading. Thus, a feature of the EU legislative process is that while member states must act within the legislation they produce, those same member states have a significant say in how this policy is created: they are co-decision-makers, which means that if they fail to reach a qualified majority in the Council, there is no EU legislation.

There is one fundamental difference between the IRA and either the CRMA or NZIA: money. After the EU's Covid spending spree and following the rise of right-wing governments in many member states, there is little appetite for EU industrial subsidies on a scale that could compete with the US. There are also other differences between the US and EU policies, such as the type of subsidies. The IRA is awash with tax breaks and direct production subsidies. These are not common tools in the EU, which is more comfortable subsidizing research and development.

Despite these differences, talk on how to marry up the transatlantic policies has intensified. The EU has made a normative decision to reduce climate emissions and to transition to a low-carbon market. It should be seen as a good thing that the US is taking similar actions to the EU and has the financial resources to do so: It is crucial that major countries, like the US, are actively working toward the low-carbon transition. How the EU responds to the more competitive aspects of the IRA depends on the different avenues the US pursues for cooperation; the responses from the EU and individual member states to those overtures; the broader intentions of the European Commission in drafting, advocating, and pushing for Europe's policies; and the evolving geopolitical and geoeconomic contexts.

POLICY IN PRACTICE: A FINNISH LOCALIZED EFFECT

Finland has a plethora of critical raw materials and rare earth elements, including those used for electric vehicle batteries.¹⁰ Even before its NATO accession, Finland, along with the EU Commission, was a part of the US Minerals Security Partnership, launched in 2022 to assist in critical mineral supply chains.¹¹ For an EU member state like Finland, NATO accession has changed the country's domestic understanding, its regional standing, its relationship to other European countries and the EU, and its bilateral relationship with the United States. This deepened relationship could affect the pressure that the United States can put on Finland on matters like access to critical minerals, raw materials, and key technologies.

10 Geological Survey of Finland (2023) Mineral Deposits and Exploration. <https://gtkdata.gtk.fi/mdae/index.html>; Finnish Minerals Group (2023) "EU Puts More Emphasis on Critical Raw Materials – Finland Must Secure Its Own Position". 16 March 2023. <https://www.mineralsgroup.fi/topical/news/eu-puts-more-emphasis-on-critical-raw-materials-finland-must-secure-its-own-position.html>.

11 U.S. Department of State (2022) "Minerals Security Partnership". Media Note, 14 June 2022. <https://www.state.gov/minerals-security-partnership/>.

By its own assessment, Finland's influence in the EU on environment-related issues has been weak, but is gaining traction.¹² Finland has an interest in maintaining political norms of cooperation within the Union. At the same time, Finland has a strong desire to shape EU policy on matters that it considers important, such as environmental protection. Beyond this, Finland wants a strong EU foreign policy, which, to a large degree, relies on cohesion. Still, Finland also wants to ensure that EU policy reflects Finnish internal standards or processes. Flare-up points between Finland and the EU could include treatment of Indigenous communities and environmentally protected land in Finland's High North, where many critical raw materials are located.

In its domestic situation, Finland has a new government and priorities that are determined by that new government. Critical raw materials form a strong industrial base, an important component of the Finnish economy. Although Finland's mining system is badly outdated, this does not change Finland's appeal in the eyes of major players, including the US and the EU. Both see Finland as important when it comes to meeting climate, critical raw material, and sustainability goals. The US is likely to continue to work bilaterally with Finland to facilitate cooperation on its own raw material and net-zero industry ventures, which the US sees as supporting Finland's industry as well.¹³ In building this relationship, the US must ensure that it treats Finland as an equal partner and not merely as an extractive location.

LOOKING AHEAD TO THE 2024 US ELECTION

The 2024 US presidential election introduces uncertainties in transatlantic cooperation or competition. The election is a worrisome situation for the European Union, and the EU is closely tracking US political developments. The US appears to be a partner now, but will it remain so if the administration changes? The result of the 2024 election could determine whether the United States will stay oriented toward Europe and continue to emphasize climate change in its policy.

Should the Republican Party regain the White House, there are some potential developments for the EU to follow. A Republican administration would likely question the role of the state in influencing domestic economic policy, and in particular challenge government spending on climate policy. There is strong climate change skepticism among most of the Republican leadership. When asked about climate change during the first Republican primary debate, hosted by Fox News, the Republican candidates downplayed, dodged, or denied climate change: former US ambassador to the UN, Nikki Haley, was the only one to acknowledge climate change as real, though she ignored US culpability, choosing to put the blame on India and China. Climate change is not a high priority among the Republican voter base: recent polling shows Republicans care more about the economy than climate change, though the issue may be gaining traction among younger Republicans.¹⁴

A Republican administration may well roll back some of the IRA, but it is not clear whether and in what form that might happen. Republican presidential candidate Ron DeSantis's economic plan, released in August 2023, incorporates elements of industrial policy in its anti-China competition stance.¹⁵ It is unclear what a continuation or alteration of US industrial policy with a Republican flavor would mean for the transatlantic partnership. In some ways, a less aggressive US industrial policy could prove beneficial for the EU to strengthen its own competitive advantage, but in other ways, the EU and its member states would lose an ally on climate change topics. It would also lead to a more difficult discussion on how to square the circle between domestic advantage for the US and cooperation with an ally's industrial policy. Moreover, a Republican administration, with its America-first focus, is likely to try to build up US domestic capacity in carbon-intensive manufacturing sectors and traditional hydrocarbon extraction jobs—important to the core of the Republican voter base.

When Donald Trump held the presidential office, his administration preferred to work bilaterally. To accomplish this, the US under a Republican administration might try to drive a wedge between countries to isolate them and create an asymmetry of US power in favor of the US. This could strain the transatlantic alliance and

12 Ministry for Foreign Affairs of Finland (2022) "Evaluation of the Finnish Development Policy Influencing in the European Union. Thematic brief - Climate change and forestry", 24 October 2022. https://um.fi/documents/384998/0/Thematic_brief_Climate_change_and_forestry.pdf/9057ba92-4961-8a10-f8d9-020ad-f2baef?t=1666604528369.

13 U.S. Department of State (2023) "Under Secretary of State Fernandez's Travel to Sweden, Norway, Finland, France, and the UK". Media Note, 31 May 2023. <https://www.state.gov/under-secretary-fernandezs-travel-to-sweden-norway-finland-france-and-the-uk/>.

14 Montanaro Domenico (2023) Three-quarters of Republicans prioritize the economy over climate change. NPR, August 3, 2023. <https://www.npr.org/2023/08/03/1191678009/climate-change-republicans-economy-natural-disasters-biden-trump-poll>.

15 DeSantis for President (2023) "Declaration of Economic Independence: We Win. They Lose". <https://rondesantis.com/mission/Declaration-of-economic-independence/>.

erode EU cohesion, which would open the door for other major powers, like Russia and China, to exacerbate internal EU divisions to their own gain. The EU is less susceptible when it acts in unison.

As the US and EU have seen over the past 18 months, there is much to accomplish through cohesion and a common objective. Still, the EU wants to avoid being too dependent on anything in sectors where economic competition is likely to arise. This can lead to hedging through “wait and see” avoidance—or to rushing the timeline to lock things in place. Regardless of the party in power, the EU should be prepared for the US

to try to deal bilaterally with member states, and the Commission should consider whether this matters. The US should recognize the EU’s wariness, and if the Biden administration is interested in pressing forward with net-zero and critical raw material cooperation in the greater global interest, the administration should work alongside the EU. Both the US and the EU should be mindful of the potential for change in the 2024 US election and the ever-shifting global developments that contextualize their relationship and responses to climate change. /