



## **FOCUS ON HYDROGEN: THE IMPACT OF THE US INFLATION REDUCTION ACT'S HYDROGEN INCENTIVES ON TRADE**

A key hydrogen trend to focus on for 2023 is "trade". The industry has gone from concentrating on the "colour" (i.e., grey, blue and green) of hydrogen in the energy transition to where it is made and whether it is improperly subsidised.

The Inflation Reduction Act of 2022 (IRA) provided a variety of incentives for clean energy projects in the United States. One such incentive was the introduction of a clean hydrogen tax credit that could provide credits of up to USD\$3 per kilogramme of clean hydrogen produced by a qualified green hydrogen facility. These tax incentives follow the Bipartisan Infrastructure Act's USD\$9.5 billion in funding for clean hydrogen initiatives.

Through the Bipartisan Infrastructure Act, the US Department of Energy (DOE) is pursuing lower production costs for clean hydrogen. The DOE will be funding new hydrogen hubs and is giving research grants in an attempt to reduce the cost of clean hydrogen to US\$1 per kilogramme in a decade.

The IRA has drawn the ire of the European Union (EU), which sees the tax incentives as protectionist and market distorting. These incentives are designed to attract hydrogen producers to the United States, and the EU views this as a potential significant disadvantage in the race to produce green hydrogen at scale. The cumulative effect of these US government programmes will be to reduce the delivered cost of hydrogen and its derivatives products, such as green ammonia. Thus, the FOB price for hydrogen and its derivatives in certain locations (e.g., the US Gulf Coast, and especially Texas, given certain regulatory and physical advantages) is expected to pose a real challenge for other hydrogen producers across the globe.

The EU submitted comments to the Internal Revenue Service (IRS) stating that the clean hydrogen tax credit "contains a problematic domestic production requirement that puts EU-based producers at a disadvantage as they must compete on a distorted market with subsidised US-based producers." It also expressed concern that there is no spending or production cap for this subsidy. EU sensitivity on this subject is not surprising given that Russia's invasion of Ukraine forced many countries to rethink their green energy transitions due to concerns over energy security. The EU relied on Russia for much of its oil and gas imports and responded to the invasion by accelerating permitting for renewable energy, with clean hydrogen as a major factor in its future energy plans.

The EU has threatened to challenge the US hydrogen subsidies at the World Trade Organization (WTO). Bernd Lange, the Chair of the EU Parliament Committee on International Trade, has raised this possibility if the US does not

address the EU's concerns. However, the US has paralysed the WTO's Appellate Body, rendering any decision made through the Dispute Settlement Body essentially unenforceable.

If unhappy with any WTO Dispute Settlement Panel ruling on hydrogen subsidies, the US could simply appeal that ruling to the non-existent Appellate Body and would choose not to comply with the Panel ruling, as it has done with other rulings with which it disagrees. The US and other members seek reforms to the WTO's Dispute Settlement Body, and without a functioning Appellate Body, a challenge brought under this mechanism would not yield a meaningful result for the EU.

Instead, the EU may need to resort to creating subsidies of its own in order to compete with cheap hydrogen being produced in the US, though these subsidies will be subject to the EU State aid rules, which themselves may then need adjustment. Currently, within the EU, there are two distinct schools of thought as expressed by Germany and France, respectively. On the one hand, Germany is pushing for a temporary State aid framework as adopted in the case of the 2008 financial crisis and in the more recent COVID-19 crisis, from which it benefited the most by providing significant amounts of aid to its companies.

On the other hand, the vast majority of Member States cannot benefit from a more flexible State aid framework because they lack the required liquidity / state resources to make those available to their enterprises. Instead, they would opt for an EU fund similar to the Recovery and Resilience Facility (a key part of the EU's COVID-19 economic recovery package called Next Generation EU). In this context, France and Spain signed a friendship and cooperation treaty on 19 January 2023 aimed at loosening rules on State subsidies and creating an EU sovereign fund to boost green industries across the EU. In 2023, the European Commission will launch a contracts for difference (CfDs) scheme aimed at closing the price gap between green hydrogen and grey hydrogen through the European Hydrogen Bank (EHB) investing EUR 3 billion to de-risk the market in Europe and support the REPowerEU Plan goal of producing 10 million tonnes of green hydrogen and importing a further 10 million tonnes by 2030. CfDs are explicitly mentioned in the revised EU energy State aid guidelines as a new and allowable aid instrument (so long as such aid is awarded through a competitive bidding process).

A route that could yield a win-win result over the hydrogen subsidies would be through bilateral or multilateral negotiations. The US and the EU both recognise the importance of collaboration on energy security since Russia's invasion of Ukraine. Additionally, under the Biden Administration, the US and the EU have worked to improve transatlantic trade relationships as a way to combat what they see as China's unfair trade practices. A bilateral task force was established in October 2022 to work through the EU's concerns with the IRA, but EU Commission Executive Vice President and Trade Commissioner Valdis Dombrovskis has stated that he does not believe that this task force will be able to solve all the issues the EU has with the IRA. Nonetheless, US Trade Representative Katherine Tai has expressed optimism that the US and the EU can work through this challenge, as they have worked through similar challenges (e.g., the disputes over large civil aircraft subsidies, US tariffs on imports of EU steel and aluminium, etc.). The US and the EU continue to engage on this issue and others through the Trade and Technology Council.

### What's happening at the WTO?

The Trump Administration refused to allow the appointment of new members to the WTO Appellate Body, which eventually prevented the Appellate Body from being able to function in 2019. The Biden Administration has also refused to appoint new members to the Appellate Body, citing that the organisation needs reforms, a point with which many other WTO members agree. At the 12th Ministerial Conference of the WTO in 2022, the Biden Administration agreed to a deadline for a fully functioning dispute settlement body by 2024. However, the US appears to be in no hurry.

The hope is that bilateral and multilateral engagement can help avoid a "race to the bottom" in a battle of State aid for low-priced hydrogen.

## EV Batteries Subsidies

Bilateral or multilateral negotiations over the electric vehicles (EV) batteries subsidies present a different problem. The IRA exempts EV batteries rules of origin production requirements for countries with which the US has free trade agreements. This exemption would leave out important trade partners, such as the EU and Japan because no free trade agreements exist between the US and these partners. Treasury Secretary Janet Yellen addressed this issue, stating that negotiations could prompt new free trade agreements. However, the Biden Administration has not made trade negotiations a strategic political priority. Additionally, Trade Promotion Authority (TPA) expired in 2022 and has not been renewed, which will limit the US Trade Representative in its ability to negotiate free trade agreements. Trade Promotion Authority is an act by Congress to delegate its Constitutional authority to negotiate trade deals to the Executive Branch. Typically, TPA is requested by the President, but it is not required (i.e., Congress can grant the authority on its own). TPA would be necessary to help expedite any free trade agreement with the EU. The Office of the US Trade Representative can negotiate a free trade agreement and present it to Congress for a yes-or-no vote. Otherwise, it is up to Congress to negotiate the trade agreement, which is cumbersome due to the expansive nature of political viewpoints and priorities of individual members of that legislative body. US Trade Representative Katherine Tai, when asked about Secretary Yellen's comments, stated that the Biden Administration would be open to negotiating "a new type of trade deal" that would fit within the Biden Administration's approach. This "new type of trade deal" could come in the form of the US-Japan Trade Agreement or the US-Japan Digital Trade Agreement, which were struck during the Trump Administration. These agreements were not considered traditional free trade agreements (they were agreements to allow for limited tariff reductions and quota expansions to improve market access) and were implemented through TPA and Executive Order respectively, avoiding the need for Congressional approval. The IRS is expected to issue implementing rules for the IRA in March 2023. In a December concept paper, it indicated that it would propose the Treasury Secretary would be able to "identify additional free trade agreements" beyond the list of traditional US free trade agreements that could qualify under the mineral sourcing requirements for EV batteries under the IRA. The IRS would also propose to allow the Treasury Secretary to "evaluate any newly negotiated agreements" under the same requirements. With Jeff Zients to become the next Chief of Staff for President Biden, there could come an increased focus on trade; Mr. Zients helped President Obama secure TPA renewal during negotiations for the Trans-Pacific Partnership (TPP).

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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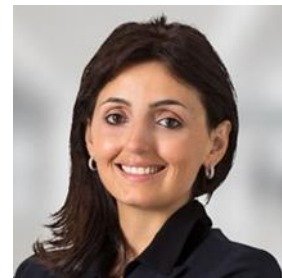
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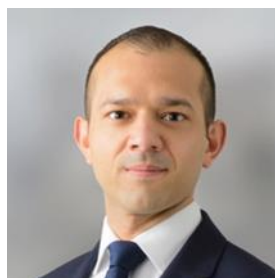
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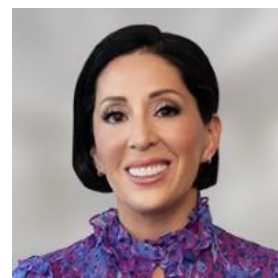
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