



Orienting a Complex Terrain

How the "Inflation Reduction Act" (IRA)
effects global businesses



In today's dynamic global landscape, companies are facing an unprecedented array of risks. The Inflation Reduction Act (IRA) of 16 August 2022, while a significant step towards decarbonisation and inflation control, introduces a new set of challenges and uncertainties for businesses. The geopolitical tug-of-war over critical raw materials, the shifting sands of international investment priorities, and the potential for increased energy price volatility all underscore the need for businesses to be agile and well-informed.

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The IRA's Dual Role: Green Transition and Inflation Control

The IRA is a US federal law that aims to curb inflation by boosting the production of domestic clean energy, lowering prescription drug costs. However, one year after the passage of the IRA, the legislation is most often associated with decarbonisation rather than its impact on inflation.

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Whilst there are now many positive signs for the US economy, there are still concerns, such as the still high volatility of food and energy prices. In addition, the Fed has been relying on interest rate hikes to combat rising prices since the beginning of the year. These increases have made it difficult for companies to finance their operations through borrowing, which in turn has made goods and services more expensive for consumers.

With core inflation still more than double the Fed's target, the Fed is likely to raise rates at least once more, prolonging the challenges for businesses and consumers. The potential relocation of industries, the changing dynamics of supply chains, and the evolving regulatory environment can all pose significant threats to a company's bottom line. Furthermore, the interplay between macroeconomic conditions, monetary policy, and the energy market can have profound implications for businesses, affecting everything from operational costs to strategic planning.



Shifting Global Dynamics: The Geopolitical Ripple Effect

The IRA's provisions impact on the US clean energy value chain is likely to be significant, particularly for solar power and hydrogen, and electric fuel production - and will be even greater if IRA subsidies are extended. The total cost of wind, solar and green hydrogen production could in some cases be close to zero or even negative. If negative, the most efficient US producers could charge for the production of clean energy before selling it to customers, further increasing their profitability and competitiveness and likely attracting more investment. As a result, European business leaders are likely to reassess their investment plans and prioritise investment in production facilities in the US in order to take advantage of the IRA's subsidies as soon as possible.

The IRA's Role in Technology Advancement and EU's Response

Therefore, IRA's provisions have further strengthened US leadership in global decarbonisation efforts and made the US an even more powerful actor in the geopolitics of oil and gas. For these reasons, the US's Western allies, such as the EU, Japan and Australia, have expressed concern that the money made available by IRA funds will shift innovative and fast-growing clean energy industries to the US, making their industries less competitive. As higher energy prices in Europe are likely to persist until at least 2024, competitive pressures will also influence the decisions of European industrial companies whether to remain inactive, relocate to countries with lower energy costs such as the US, become insolvent or produce goods at an uneconomic price.

European business leaders should therefore consider a decline in competitiveness in the European market in their business continuity plans and focus their strategies on differentiation if they are to be competitive.





Critical Minerals and Supply Chain Security

The IRA can lead to technology up-scaling, increased technology diffusion and research and innovation to the benefit of the global climate and economy. However, exporters of goods from the EU will face local content requirements that are likely to limit their benefits.

In response to the provisions of the IRA, the EU has relaxed its own state aid rules through the Green Deal Industrial Plan, a series of proposals that aim to secure the EU's industrial lead in the fast-growing net-zero technology sector, and the Temporary Crisis and Transition Framework, which allows EU member states to use state aid to match foreign state aid if they can credibly demonstrate that companies would otherwise relocate elsewhere.

For these reasons, it is crucial for European business leaders to conduct global risk monitoring to help them identify potential divestments from EU green initiatives to US green initiatives, and to better understand the market in the face of possible changes in consumer behaviour and new regulations.

Macroeconomic Factors and Risk Management in the Energy Landscape

However, policymakers see the supply chain of critical raw materials as a geo-strategic imperative rather than the manufacturing component. Neither the US nor the EU is currently a major producer of the critical minerals needed for the environmental transition.

There is already a competition for raw materials with China, a major player in the sourcing and supply of critical raw materials for green energy production, and the IRA will lead to an increase in US demand for these minerals. This increases the geopolitical risk around security of supply. In this context, the US has signed agreements with Japan, Australia and the UK to eliminate export tariffs on critical minerals and promote coordination in the supply of these minerals, and a US-EU agreement currently under negotiation is expected to follow.

This US initiative to relax its protectionist mineral sourcing policies in the IRA is a further step to promote coordination among Western partners and reduce China's power to improve supply chain security.



Strategic Advisory and Board Services: Guiding Businesses Through Uncertainty

Given that, for example, clean energy investments are more sensitive to interest rate rises due to the relatively higher cost of capital, and that scarcity of raw materials or a tight labour market are likely to affect the success of IRA climate change investments, we can conclude that macroeconomic conditions are more likely to affect the IRA success than IRA's investments could affect macroeconomic conditions. However, the energy landscape is becoming increasingly complex and the introduction of renewable energy sources has further increased demand and price volatility.

- The expected increase in energy price volatility requires companies to structure a robust risk management approach that understands key energy market trends by monitoring and collecting appropriate data, conducting analysis and then using the results to inform decision making
- In addition, risk management consultants can help understand the complex interaction between monetary policy and energy markets, and provide tailored solutions to stabilise costs and protect margins.

In this complex risk environment, it is imperative for companies to have a clear strategy in place to navigate these challenges.

This is where Strategic Advisory and Board Services come into play. By leveraging expertise in risk management, market analysis, and strategic planning, businesses can position themselves to not only weather the storm but to thrive in it.

Whether it's understanding the nuances of the IRA, anticipating shifts in the global energy market, or devising strategies to mitigate supply chain disruptions, a strategic advisor can provide the insights and guidance needed to make informed decisions.

Contact us to learn more about our Strategic Advisory and Board Services.

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