Thematic Insights

US elections: the Inflation Reduction Act and the risk of repeal

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At a glance

- The Inflation Reduction Act has contributed to a sizable increase in US clean energy and tech projects, and manufacturing investments. With the Republican election campaign including plans to repeal the act, the outcome has implications for the future of these investments
- Current consensus view is that a full reversal is unlikely, but we believe the market is underappreciating the risk of a partial repeal, which could involve the weaking of tax credits and funding programmes, as well as other regulatory changes
- As part of our work around the energy transition we have developed a framework to assess this risk and the potential implications for the most exposed sectors

In November the US goes to the polls to decide who will be the next president – the Democrat incumbent Joe Biden or returning Republican nominee Donald Trump. Under Biden, in August 2022 the US introduced the Inflation Reduction Act (IRA), a federal law which aims to, among other things, invest into domestic energy production while promoting clean energy. It represents the largest ever Congressional investment in the energy transition.[1]

With reports that Trump would seek to "gut" the IRA if elected[2], at Columbia Threadneedle Investments we have developed a framework to assess the risks of a repeal of the act across those sectors that are direct beneficiaries and identify the implications for the most affected companies.

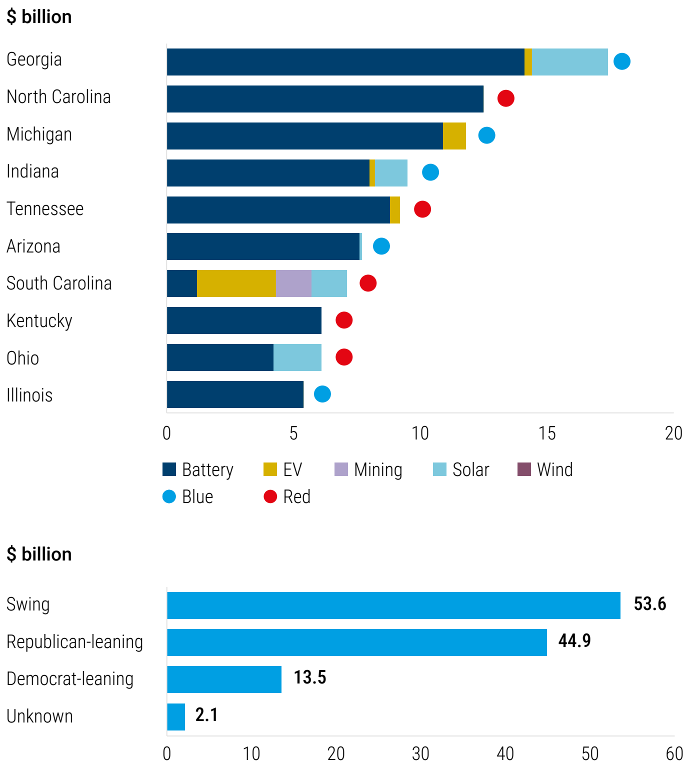
IRA significance and threat

The IRA deploys sizeable tax credits for every major economic sector key to achieving wholesale decarbonisation: energy, transport, buildings and agriculture. It also contains multiple funding and regulatory provisions. When it was unveiled in August 2022 that figure stood at $369 billion over 10 years, but recent estimates project a further $400 billion of investments, which could grow higher still since most provisions are uncapped.[3]

The IRA also has implications for industrial policy, as it provides large incentives for the domestic manufacturing of clean technologies. It seeks to establish local manufacturing capabilities to reduce the overreliance on the supply chain from China to make solar, wind and battery components[4].

Since its introduction, investment announcements have increased by 60% to more than $114 billion.[5] Most of these are for battery manufacture and are concentrated in Republican and/or swing states (Figure 1). The benefit of these investments in terms of job creation and economic growth makes many in the market believe a full repeal is unlikely in the event of a Republican victory.

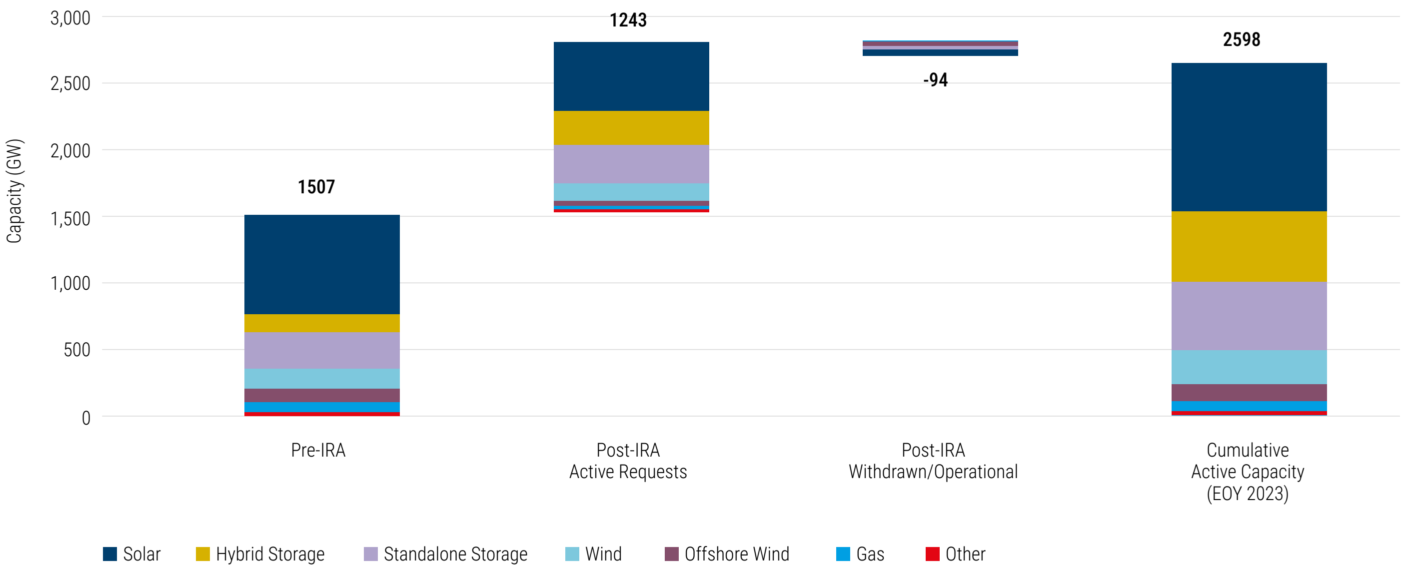
Figure 1: domestic manufacturing types and state locations (top) and billions invested (bottom)



Source: BloombergNEF. March 2024

[1] US Congressional Budget Office, 2022
[2] FT.com, Donald Trump would gut Joe Biden's landmark IRA climate law if elected, 23 November 2023
[3] US Joint Committee on Taxation, 2024
[4] Columbia Threadneedle Investments, US Inflation Reduction Act: a strong force to accelerate energy transition technologies, November 2022
[5] US Department of Energy, April 2-24

Figure 2: pre- and post-IRA energy connection requests



Source: Berkeley Lab, April 2024

With regards to the effectiveness of the IRA in driving investments in clean energy, attribution is more difficult to estimate. Investment in this space would have happened to some extent regardless of the IRA, but the near-doubling of interconnection requests from renewable projects to the grid post-IRA s a good indicator of its material effect (Figure 2).

Scenario analysis: Republican win

The market consensus is that the risk to the IRA is binary – ie either a full repeal or no repeal at all – and that a full repeal is unlikely because many of the IRA benefits are concentrated in non-Democratic states. We think this is a strong argument – but doesn't remove the risk of a partial repeal. In fact, we believe there are compelling arguments to believe a partial repeal is likely, and the market is underestimating this risk.

The main driver behind this belief comes from the legislative dynamics set to play out in 2025. If Republicans win, they could look to extend the tax cuts introduced by Trump in 2017 that are set to expire in 2025. Doing so could require them to offset spending elsewhere, and in that situation they could look to repeal parts of the IRA.

Additionally, despite some Republican officials having antipathy for some IRA provisions such as those around electric vehicles (EVs), they seem more supportive of certain IRA elements regarded as complementary to traditional energy and industrialisation, such as carbon capture and storage (CCS) and domestic manufacturing. As such, we believe a full repeal of the IRA is unlikely, with a partial repeal the more likely scenario.

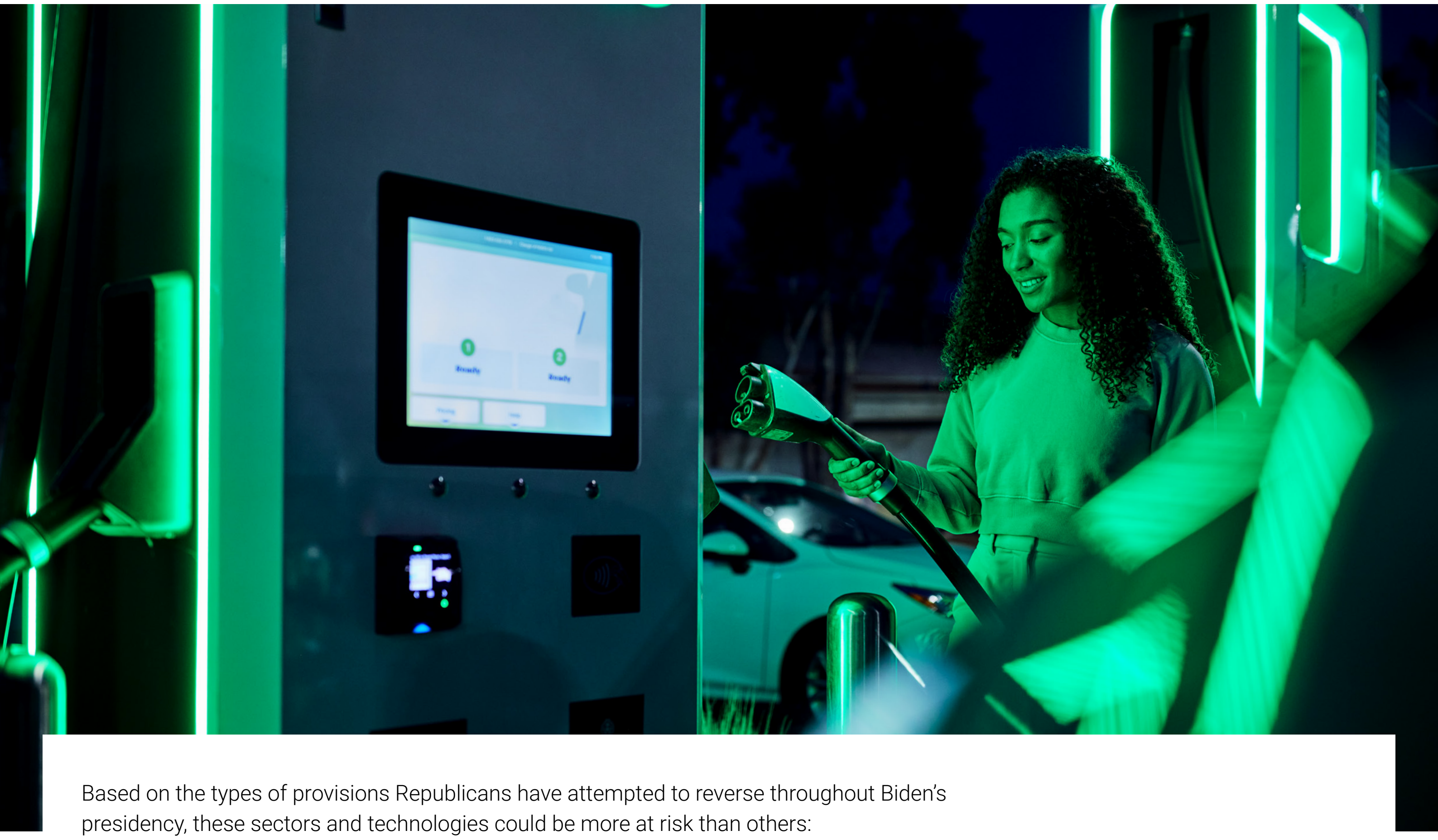
What a partial repeal could mean in practice

A partial repeal could see a weaking of any – or all – of three components of the IRA package:

1. A partial repeal of tax credits could mean capping some of the incentives, shortening their availability, or making the requirements to monetise them more difficult.

2. A partial repeal of IRA funding could mean cutting the additional funding distributed by the Department of Energy (DoE) and the Environmental Protection Agency (EPA). These programmes are of particular importance for the less mature clean technologies that need extra support in order to scale.

3. A partial repeal could see the reversal of multiple regulations, particularly those from the EPA that set emissions rules for many sectors to incentivise decarbonisation.



Based on the types of provisions Republicans have attempted to reverse throughout Biden's presidency, these sectors and technologies could be more at risk than others:

1 High risk
- EV tax credit and related funding programmes
- Energy efficiency house/buildings credits and funding
- Clean energy funding
- Tax credits features, bonus credit provisions
- Emissions standards

2 Less vulnerable
- Grid
- CCS
- Clean hydrogen
- Clean fuels, sustainable aviation fuel

3 Medium risk
- Production tax credits for renewables
- Offshore wind approvals

4 Potentially supercharged
- Nuclear
- Domestic manufacturing

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Figure 3: executive and legislative ways to water down the IRA

Topic	Supported for selected policies by Republicans	Authority	Scenario
Energy	Loosen EPA authority and regulation	Executive	Trump wins
Energy	Restrict DOE funding programmes	Executive	Trump wins
Energy	Tighten Treasury guidance for IRA credits, pending rules or existing, to make it more onerous	Executive	Trump wins
Anti-China	Increase Tariffs on Chinese products	Executive	Trump wins
Energy	Repeal IRA tax incentives	Legislative	Trump + Republican Congress
Energy	Reform energy permitting	Legislative	Trump + Republican Congress
Infrastructure	Build out infrastructure	Legislative	Trump + Republican Congress
Anti-China	Impose tariffs on Chinese products	Legislative	Trump + bipartisan support
Anti-China + energy	"Foreign Polluting Fee"** = Carbon border tax on imports of goods with higher emissions than US (aluminium and steel among others)	Legislative	Trump + bipartisan support

Source: Columbia Threadneedle Investments, April 2024. ** **Proposed bill by three Republican senators in November 2023

How a repeal scenario could materialise

A Republican president could have multiple avenues for hindering the energy transition through executive action without the need of support from Congress – in the form of policy restrictions (through changes in federal agencies) or the expansion of tariffs (under certain circumstances), for example. It is this risk that we believe is underappreciated. In a scenario in which there is also a Republican majority in Congress, legislation could be passed to repeal the IRA in part or in full, as well as passing permitting reform (Figure 3).

Implications

At Columbia Threadneedle we have developed a comprehensive and holistic methodology to assess the repeal risk for the clean technologies and sectors that are direct recipients of IRA support. We considered the risk of reversal of each IRA provision, as well as that of other relevant regulatory developments that could have an impact, such as higher import tariffs or the reversal of relevant sector regulations. We categorised the risks as high, medium or low likelihood. We then consider the interplay of all the dynamics of an IRA repeal. For example, domestic manufacturers of cleantech could be positively affected by a scenario that retains their subsidies and increases tariffs on Chinese competitors; but they could be negatively affected by the potential slowdown in areas such as renewables or electrification if applicable credits are weakened. So businesses can be both positively and negatively impacted at the same time. (Figure 4).

Figure 4: key sectors and potential outcomes from an IRA repeal

Scenario US elections risk: IRA Package Repeal Risk				Impact Assessment
Sector	**Weaker IRA tax credits**	**Lower Funding Programmes**	**Other potential relevant related regulation**	**Direction**
EV	High	High	Higher Chinese Tariffs on batteries	Negative
Solar Onshore Wind	Medium - High	High	Higher Chinese Tariffs on solar, wind, batteries components	Slight negative
Offshore Wind	Medium - High	High	Restriction on federal offshore wind approvals	Negative
Nuclear	Low	Low	-	Positive
Grid	Not applicable: no tax credits	Low	Delay in Permitting reform?	Neutral
Buildings	High	High	-	Slight negative
CCS	Low	Medium	-	Slight negative
Clean Hydrogen	High	Medium	Higher Chinese Tariffs on solar, wind components	Negative
SAF	Low	Medium	-	Slight negative
Solar OEMs	Low	Low	Higher Chinese Tariffs on solar panels	Positive in theory but unclear overall impact: Keeping subsidies and increasing tariffs on Chinese products that compete with domestic ones could lead to higher demand for domestic OEMs.However, overall impact at specific companies will depend on whether there is a slowdown on clean energy and electrification growth if some other credits are repealed
Wind OEMs	Low	Low	Higher Chinese Tariffs on wind turbines	
Batteries OEMs	Low	Low	Higher Chinese Tariffs on batteries	
Mining OEMs	Low	Low	Higher Chinese Tariffs on critical minerals	

Columbia Threadneedle Investments analysis, March 2024

The dynamics of a repeal could also have secondary and broader implications beyond decarbonisation, for example, with regards to the macro and geopolitical implications for many industries globally if we see a more inflationary scenario result from more protectionist measures.

As active investors who recognise the complexity of this scenario, we will engage with those companies most exposed to IRA repeal risks over the coming months and incorporate insights from these discussions in our investment decisions.

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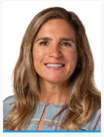
Conclusion

Current market consensus is that, in the event of a Republican victory in November's US presidential election, the risk to the US Inflation Reduction Act is binary – either a full repeal or no repeal at all. However, we believe there is a third option in play, a partial repeal. In fact we think this could be the most likely outcome and the market is underappreciating this risk and all the investment implications that go with it.

With the various sectors having potentially very different outcomes from any changes to the IRA, we have assessed the impact considering the interplay not just of the risk of lower tax credits, but also changes to funding programmes and regulatory provisions – in particular the potential imposition of higher tariffs on Chinese cleantech imports. Within each sector, we have then identified the companies most exposed to these risks and set a plan to engage with them to incorporate insights and better quantify the impact. We are using this analysis to ensure we are well positioned should this scenario play out.

Get to know the author



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Natalia joined the Thematic Research team in 2020 and focuses on analysing the investment risks and opportunities coming from climate change and the energy transition across sectors and companies. She collaborates very closely with investment teams and engages with companies exposed to these themes. Previously, she worked as a credit analyst at Goldman Sachs. She also teaches sustainable finance at business schools.

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