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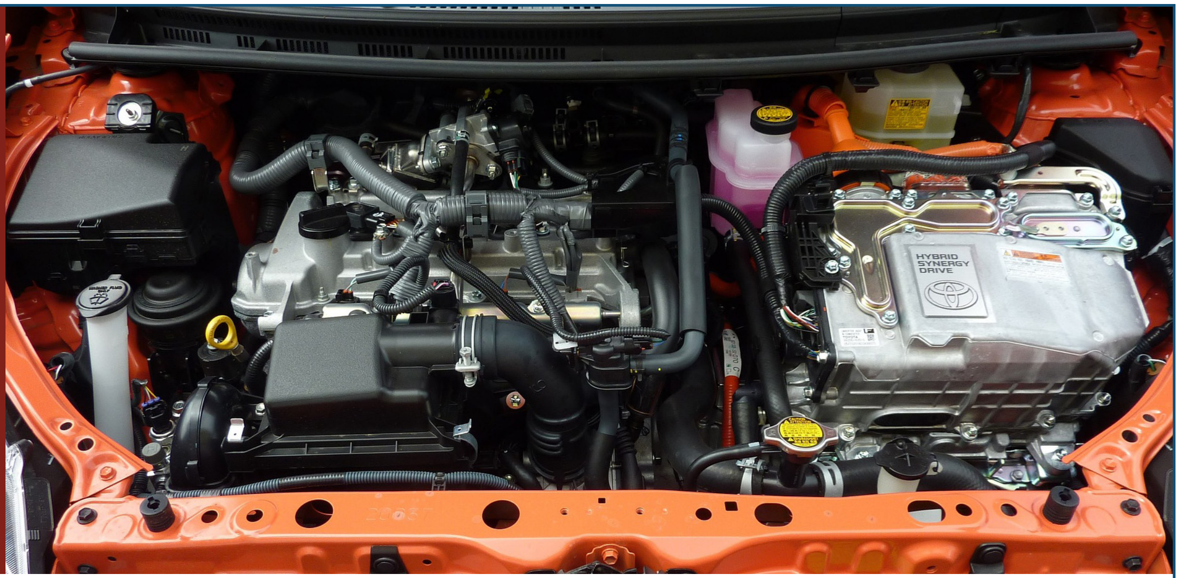

Aligning U.S. Leadership and Ally Support on Clean Energy

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The 117th Congress passed major pieces of legislation that make large investments in clean energy, including the Inflation Reduction Act (IRA) and the CHIPS and Science Act. However, many foreign observers perceived such legislation as an attempt to recover and strengthen the U.S. domestic economy and its infrastructure through protectionist means. Among these critics are U.S. Indo-Pacific allies South Korea and Japan, which have voiced concerns over the loss of tax incentives for foreign entities operating electric vehicle (EV) battery plants within the United States and increased competition among foreign companies to access the U.S. market, among other concerns. This brief examines the implications of the IRA for U.S. allies in Asia and considers options for the 118th Congress to balance the strategic interests of the United States with those of its allies.

The Implications of the IRA for U.S. Allies in Asia

The IRA and related legislation like the Bipartisan Infrastructure Law and the CHIPS and Science Act aim to boost a flagging U.S. economy while addressing energy and climate concerns. However, these laws have effectively denied some tax incentives to South Korean and Japanese businesses, among others, resulting in heightened friction with key partners who are essential for achieving broader U.S. energy and climate goals. Even though South Korea and Japan were set on expanding their climate cooperation with the United States, elements of the IRA have put them at a considerable disadvantage. Though these laws offer a green catalyst for the United States to deliver on its climate goals, they could end up jeopardizing partnerships that not only benefit the U.S. economy but also are key to the United States' role in leading a coalition to achieve a global clean energy transition. Ultimately, leaving the legislation as is without considering ally voices in terms of reinterpreting these subsidies and other commercial concerns for overseas entities could end up costing the United States more in the long run.

One of the key components of the IRA that has attracted criticism from countries like South Korea and Japan is the EV provision, which has set stricter domestic content requirements for automakers to receive full credit for EVs. In addition to the traditional requirement for vehicles to be produced in the United States, car manufacturers will need to fulfill two requirements, each for $3,750 credit eligibility: (1) 40% of an EV battery's minerals will need to be sourced from the United States or U.S. free trade agreement (FTA) partners (with the threshold rising to 80% by 2027); and (2) 50% of the battery components will need to be sourced from the United States or U.S. FTA partners (with the threshold rising to 100% by 2029).

South Korea's response to the passage of the IRA has been swift and critical, claiming that the legislation both violates trade rules and undermines economic cooperation between the two countries, specifically when it comes to supply chain resilience, semiconductors, and climate change. The IRA came as a blow to South Korean firms that have made significant investments in EV battery production in the United States. Early last year, for example, Hyundai and Kia announced plans to invest $5.5 billion into a joint EV and EV battery production facility in the state of Georgia.

Japan has voiced similar concerns over the IRA, further complicated by the lack of a comprehensive FTA with the United States. Without addressing these concerns, the United States runs the risk of alienating key partners and undermining its leadership position on clean energy.

Options for Congress

So far, the United States has responded to elements of these criticisms. The 118th Congress could bolster and unify these efforts to smooth implementation of the IRA through several means.

First, Congress could pass legislation giving a grace period for manufacturers working to meet IRA standards. Similar to the Affordable Electric Vehicles for America Act, such a bill would allow foreign automakers time to meet the IRA's requirements while still encouraging EV adoption amid strong market demand in the United States. Manufacturers from partner countries have already shown a willingness to move their processes to U.S. soil, but opening new mines, restructuring supply chains, and relocating manufacturing operations are all steps that can take months or years. Giving key partners from South Korea and Japan sufficient time to make these changes, instead of disqualifying them from tax credits in the interim, would directly address their primary

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concerns with the IRA while still maintaining the short-term supply of EVs and pursuing the long-term goal of supply chain diversification.

Second, delegations of U.S. lawmakers could travel to key partner countries in the clean energy transition that have voiced concern over recent legislation. Business delegations from South Korea have already visited Washington, and the presidents of both South Korea and the United States have discussed measures to allay concerns over the IRA. Congressional delegations planned by the State Department would provide a balanced understanding of the effects of U.S. legislation on local stakeholders.

Finally, members of Congress can directly request the IRS, which is currently finalizing guidance for adopting the new battery and manufacturing requirements, to take the perspectives of key U.S. allies and partners into account. These requirements have not yet come into effect and at the time writing are pending an issuance of guidance from the Treasury Department. During this window of opportunity, Congress will be able to offer recommendations on several key issues, including which countries qualify for the sourcing of minerals in the upcoming guidance. Though the legislation is designed to last the rest of this decade, ensuring that the first months of implementation are as smooth as possible will set up both the United States and its allies and partners around the world to realize the full benefits of the clean energy transition.

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The views expressed are those of the authors.

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