Insight

Energy Tax Credits in the Build Back Better Act Run Afoul of the World Trade Organization

TOM LEE | DECEMBER 20, 2021

Executive Summary

- In the Build Back Better framework (BBB), the Biden Administration has made reducing carbon emissions, while focusing on "Buy American" provisions, a major goal.
- To achieve this, the Build Back Better Act (BBBA) contains numerous climate-related tax credits that increase in value if the products they cover are produced in the United States.
- These types of provisions are de facto protectionist domestic content subsidies which are prohibited by existing World Trade Organization rules.
- The BBBA's climate-related tax credits would damage relations between the United States and its strategic trade partners and would hurt American producers of clean energy.

Introduction

One of President Biden's main goals in his Build Back Better (BBB) Framework is to reduce carbon emissions while adhering to "Buy American" provisions. The administration's desire is to increase domestic demand for clean energy goods and products and to give U.S. manufacturers and firms priority in filling that demand. The White House states that the BBB framework "ensures clean energy technology . . . will be built in the United States with American made steel and other materials, creating hundreds of thousands of good jobs here at home."[1]

To achieve these goals, the House passed a budget reconciliation bill, the Build Back Better Act (BBBA), which is the legislative vehicle for the BBB framework. It includes numerous tax credits for clean energy consumption and production. The tax credits increase in value for goods that are produced in the United States, and for those produced in unionized facilities. These types of tax credits, based on "Buy American" incentives, are de facto domestic content subsidies that are prohibited under existing World Trade Organization (WTO) rules. The BBBA would damage trade relations between the United States and its strategic partners and, in turn, would hurt U.S. producers and manufacturers of clean energy.

The Climate-Related Tax Credits and Domestic Content

The BBBA includes tax credits to incentivize the purchase of electric vehicles (EV). Buyers or new or used EVs would qualify for a $7,500 tax credit. EVs with battery cells manufactured in the United States would be eligible for another $500 in tax credits. EVs assembled at American factories with union-represented workers would be eligible for another $4,500 in tax credits. If all conditions are met, consumers could receive a tax credit of up to $12,500, provided the credit does not exceed 50 percent of the vehicle's value. For more, see Ewelina Czapla's and Isabel Soto's analyses here and here.

The BBBA would also add and modify numerous investment and production tax credits on energy projects. Electricity producers that operate renewable energy facilities, including solar and wind, would be eligible for these credits. The value of these credits increases if the facilities use iron and steel products produced in the United States. There is also a provision to provide production tax credits for numerous solar and wind products. As with other credits, the value of these credits increases if the final assembly of the components is completed in a facility in the United States.

Protectionism and Running Afoul of World Trade Organization Rules

Because the tax credits increase in value based on "Buy American" incentives, they favor the use of domestic goods. This is in violation of Article 3.1(b) of the WTO's Agreement on Subsidies and Countervailing Measures which states "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods" are prohibited.[2] Similarly, the tax credits violate Article III of the General Agreement on Tariffs and Trade (GATT), a central component of the WTO, which states "internal taxes and other internal charges … affecting the internal sale, offering for sale, purchase … distribution or use of products, and internal quantitative regulations requiring … processing or use of products in specified amounts or proportions, should not be applied to … domestic products so as to afford protection to domestic production."[3]

It is especially damning that the BBB framework states it will "boost the competitiveness of existing industries, like steel, cement, and aluminum, through grants, loans, tax credits, and procurement to drive capital investment in the decarbonization and revitalization of American manufacturing." The Biden Administration is engaging in trade protectionism, much like the Trump Administration–and the only difference is an emphasis on reducing carbon emissions.

Damaging Strategic Trade and U.S. Manufacturing

The numerous climate-related tax credits based on "Buy American" incentives would damage trade relations between the United States and its strategic allies. Canada has already raised the alarm on the EV tax credits, pointing out they are not just a violation of WTO rules, but of United States Mexico Canada Free Trade Agreement (USMCA) rules, as well.[4] The European Union, Germany, Japan, France, South Korea, Italy, and other important strategic allies have written a joint letter to the United States highlighting their concerns that "limiting eligibility for the credit to vehicles based on their U.S. domestic assembly and local content is inconsistent with U.S. commitments made under WTO multilateral agreements."[5] It is likely these countries would retaliate as the WTO allows countries to impose countervailing tariffs on goods that are deemed to receive illegal subsidies. Foreign countervailing tariffs would reduce demand for American clean energy and hurt U.S. producers and manufacturers of those climate-friendly products. Canada has also announced it will look to impose retaliatory tariffs on other goods not related to this dispute.[6] The economic damage would not be confined to the trade of energy products.

Conclusion

With the BBBA, the Biden Administration has put a large emphasis on energy-related tax credits operating under "Buy American" incentives. Ideally, these kinds of tax credits could kill two birds with one stone: Reduce carbon emissions while raising the competitiveness of U.S. manufacturing industries. In BBBA's current form, the energy-related tax credits will likely fail to increase demand for U.S. clean energy products, however. The tax credits would create a form of protectionism that violates WTO rules and would damage trade relations between the United States and its strategic allies and, in turn, hurt U.S. manufacturers and producers of clean energy-related products. Policymakers should instead allow American clean energy producers and providers to focus on their own strengths while avoiding costs that stem from economic protectionism.

[1] https://www.whitehouse.gov/build-back-better/

[2] https://www.wto.org/english/docs_e/legal_e/24-scm.pdf

[3] https://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm

[4] One of the main provisions in USMCA is to follow Article III of GATT

[5] https://www.reuters.com/business/autos-transportation/international-opposition-mounts-proposed-us-ev-tax-credit-2021-10-30/

[6] https://www.cbc.ca/news/business/electric-car-retaliation-column-don-pittis-1.6255204