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To the point!

Cross-Asset- and Strategy-Research

Europe needs an industrial policy

Protectionist tendencies on the rise worldwide

Since the fall of the Iron Curtain a good 30 years ago, the world has gone through a phase of liberalization of cross-border trade. Europe's companies have benefited considerably from the deepening of globalization. Nowhere was this positive effect stronger than in export-dependent Germany.

But this phase of opening is over. Instead, increasing trade barriers can be observed worldwide (see figure). And since Donald Trump's chaotic presidency, this worrisome trend is also evident in the U.S., once the standard-bearer for free trade and by far Europe's most important [export destination](#).

The Protectionism of the Inflation Reduction Act

But anyone who hoped that "America First" would disappear back into the protectionist mothballs with Trump's departure is now bitterly disappointed. Last August, the Inflation Reduction Act (IRA) went into effect. Despite its misleading name, the IRA is not primarily about fighting inflation. Rather, it is the largest U.S. legislative package ever to address climate change.

At first glance, this sounds positive, since Europe in particular has long complained about the U.S.'s unambitious climate policy. But there is a crucial catch: the IRA also serves as a protectionist instrument to subsidize domestic industry. It provides for up to \$400 billion in projects to accelerate the energy transition. However, only those companies whose goods and services are "Made in America" can participate in the public projects. Then there are tax incentives for automakers that process locally produced batteries, purchase incentives for American-made e-vehicles, and the like.

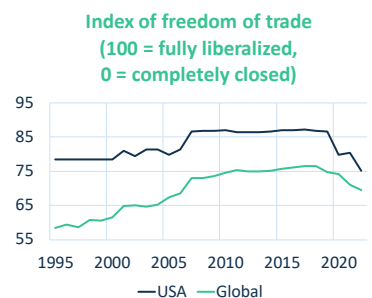


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The phase of trade liberalization is over



Source: LBBW Research; Heritage Foundation (Index of Trade Freedom).

EU attempts to renegotiate doomed to fail

Politicians and business leaders in Europe recognized the industrial policy significance of the IRA measures too late. European companies are already groaning under the pressure of rising energy prices and a lack of skilled workers. The IRA siren songs are unlikely to be resisted by some companies.

The EU is moving to get the U.S. to treat European companies equally. Presumably, however, Brussels knows about the hopelessness of these efforts. Republicans opposed the IRA from the beginning. As of this week, they now have a majority in the House of Representatives. An amendment of the IRA in favor of European competitors is therefore politically out of the question.

Europe must become active itself

Industrial policy subsidies from California to Shanghai are putting Europe on the spot. If we do not want to lose our key industries of the future, a similar response is needed. There is little prospect of continuing to play by liberal rules when key partners openly subsidize their own industries. It's not pretty. The welfare of the world will suffer. But Europe must first and foremost make trade policy for Europe and not for the world.

Relaxing the strict EU state aid law would be a first step in the right direction. Conflicts between the EU partners are pre-programmed. This is particularly true if the impression is created that it is primarily highly industrialized Germany that benefits from a reorientation of industrial policy.

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Changing the IRA in favor of Europe is politically out of the question

Europe under pressure to protect strategic "green" industries
