CATO POLICY ANALYSIS

June 6, 2023 Number 948

The High Price of Buying American

The Harms of Domestic Content Mandates

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EXECUTIVE SUMMARY

The high price to the American people from government Buy American initiatives is ignored in the vast array of subsidies included in the recent Inflation Reduction Act. So, too, are the repercussions of such discrimination in the trade relationships of the United States, including with a number of trading partners who are also U.S. allies. The reaction of these allies to the discriminatory features in the structure of tax credits for electric vehicles is just one example; there are others.

Buy American measures harm U.S. businesses, workers, consumers, and taxpayers. They also raise serious questions about whether these measures comply with the obligations of the United States under several international trade agreements that fall within the jurisdiction of the World Trade Organization (WTO). In implementing and applying these discriminatory measures, the United States may be in violation of WTO rules on trade in goods, on governmental subsidies, and on trade-related investment measures. The United States is unlikely to be able to prove that it is entitled to an exception to these violations under WTO rules. Having suffered significant economic losses through the years from Buy American requirements in public procurement, the United States would be wise to reconsider and not impose these conditions on obtaining public support for private purchases in the wider marketplace.

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INTRODUCTION

The Inflation Reduction Act (IRA), narrowly approved by a Democratic Congress in 2022 and strongly supported by the Biden administration, is the most ambitious climate action taken to date by the United States. It is also replete with governmental subsidies that mark a shift by the United States away from market-based solutions and toward a more state-directed industrial strategy that is aimed at speeding the shift of American industry and the economy away from reliance on carbon-emitting fossil fuel energy and toward the use of wind, solar, and other forms of renewable energy. Many of these new subsidies discriminate against the use of products from a number of the leading trading partners of the United States by conditioning the availability of the subsidies on the use of domestic content in the subsidized production.

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These Buy American provisions raise serious legal issues under the international law of the World Trade Organization (WTO) and expose the United States to potential challenges in WTO dispute settlement. Initially, the concern of the European Union (EU), the United Kingdom (UK), Japan, South Korea, and other major U.S. trading partners (and allies) has centered on the discriminatory Buy American aspects of the IRA tax credits for purchases of electric vehicles (EVs). As implementation of the sweeping legislation proceeds, other subsidies it provides will provoke still more criticism from abroad. If this is not resolved, the United States will pay a high price economically for its misguided passion for buying American, including the costs of a tit-for-tat subsidies war in trade that neither the United States nor its aggrieved trading partners can afford.

The high price to the American people from buying American is ignored in the vast array of subsidies included in the recent IRA. So, too, are the repercussions of such discrimination in the trade relationships of the United States, including with a number of trading partners who are also U.S. allies. The reaction of these allies to the discriminatory features in the structure of tax credits for electric vehicles is just one example. There are others. In addition to the economic damages caused to U.S. businesses, workers, consumers, and taxpayers by these Buy American measures, they also raise serious questions about whether these measures comply with the obligations of the United States under several international trade agreements that fall within the jurisdiction of the WTO. In implementing and applying these discriminatory measures, the United States may be in violation of WTO rules on trade in goods, on governmental subsidies, and on trade-related investment measures. The United States is unlikely to be able to prove that it is entitled to an exception to these violations under WTO rules. Having suffered significant economic losses through the years from Buy American requirements in government procurement, the United States would be wise to reconsider and not impose these conditions on obtaining public support for private purchases in the wider marketplace.

DISCRIMINATION IN TAX CREDITS FOR ELECTRIC VEHICLES

At a White House state dinner for visiting French president Emmanuel Macron, the main topic of conversation was not the quality of the wine or even the fact that the wine being served was American and not French; it was the new U.S. consumer tax credits for purchases of electric vehicles. The discriminatory aspects of these tax credits threaten to launch a new trade conflict between the United States and some of its most important geopolitical allies at a time when the alliance of democratic countries must be solidified and strengthened, not weakened by needless trade disputes.

President Biden and his administration seek to increase manufacturing production in the United States while also achieving ambitious decarbonization goals for addressing climate change. In accomplishing these aims, they also seek to weaken Russia and counter and constrain the geopolitical ambitions of China. Biden and his advisers—as well

as many members of Congress in both parties and in both chambers—see limiting China's access to new and strategic technologies and constructing alternative supply chains as key means to their success in the pursuit of these aims. Cooperation and close collaboration with America's democratic allies are indispensable in the pursuit of those ends.

The centerpiece so far in the Biden administration's pursuit of these goals is the IRA, which has much more to do with forging a transition to renewable energy in the face of climate change than it does with fighting inflation. The IRA is central to the hopes of Biden and his Democratic Party of reducing U.S. carbon emissions 40 percent by 2030—the promise they have made in climate negotiations with the wider world. The IRA is also replete with new governmental subsidies that are intended to accelerate climate action by encouraging an economic shift from dependence on carbon-emitting fossil fuels to use of solar, wind, and other renewable energies that emit less or no carbon during operation. The Buy American features of these subsidies, which in many places limit access to the subsidies to production based on domestic content, give rise to serious legal questions under international trade law and—quite predictably—are beginning to generate widespread negative reactions from U.S. trading partners, including allies whose products have been denied access to these subsidies in the IRA.

The IRA's "king's ransom" of subsidies range across numerous economic sectors, with subsidies "for clean energy, mostly via tax credits for projects ranging from solar farms to battery manufacturing to facilities that remove climate-warming carbon dioxide from the air."[1] The new law provides subsidies for critical minerals produced mainly in the United States, including advanced manufacturing tax credits ($30 billion); enhanced use of Defense Production Act contracts ($500 million); and innovative technology loan guarantees. This leaves out major non-China producers of these minerals, including Australia and Canada. The IRA also boosts tax credits for the production of zero-carbon energy (wind, solar, geothermal, hydropower) in the United States, but the biggest of these subsidies is limited to projects that meet two Buy American requirements:

- all of a project's iron and steel products must be produced in the United States, and
- all of a project's manufactured products must contain set amounts of U.S. content.

Furthermore, projects that do not satisfy these local content requirements are disqualified from certain subsidies, in whole or in part.[2] The IRA also provides additional subsidies to U.S. shipbuilders who already benefit from the protectionism afforded by the Merchant Marine Act of 1920, more commonly known as the Jones Act, which has the effect of hindering the development of offshore wind energy. Vessels that are capable of installing offshore wind turbines and that are also compliant with the restrictions of the Jones Act do not currently exist.[3]

"The Buy American features of the Inflation Reduction Act subsidies give rise to serious legal questions under international trade law and are beginning to generate widespread negative reactions from U.S. trading partners."

Significantly, also among the $369 billion in new subsidies that are intended to address climate change by speeding the transition from fossil fuels to clean technology and renewable sources of energy, the IRA offers U.S. consumers tax credits of up to $7,500 for purchases of electric vehicles assembled in North America, including in Mexico and Canada, which are parties with the United States to the United States-Mexico-Canada Agreement (USMCA, successor to the North American Free Trade Agreement). As the implementation of the IRA continues and accelerates, all of the discriminatory aspects of its various subsidies (summarized in Table 1) will draw more criticism worldwide. For now, it is the new tax credit scheme for the purchase of electric vehicles that has been the target of the most international contention.

Casting a pall on the French state dinner was the fact that, under the IRA, eligibility for half of the EV tax credit ($3,750) depends on where the electric vehicle is assembled, and eligibility for the other half depends on where the vehicle's battery materials are sourced. The IRA extends the tax credit for EV purchases only to those from countries that have a free trade

Table 1

The Inflation Reduction Act prescribes numerous domestic content requirement rules in order to access tax credits

Name/purpose of credit	Issue area/ product	Local content rule	Role of local content rule	Credit if local content rule is met
Clean Electricity Production Credit (CEPTC)	Electric power	- 100% of iron and steel that is a component of the facility must be produced in the United States; and - at least 40% of manufactured products that are components of the facility are produced in the United States, increasing to 45% on January 1, 2025; 50% on January 1, 2026; and 55% January 1, 2027. - For offshore wind, base rate for manufactured products is 20%, increasing to 27.5% on January 1, 2025; 35% on January 1, 2026; 45% on January 1, 2027; and 55% on January 1, 2028.	Condition for additional credit	10% additional to the base CEPTC dollar amount
Clean Energy Investment Tax Credit (CEITC)	Electric power	- 100% of iron and steel that is a component of the facility must be produced in the United States; and - at least 40% of manufactured products that are components of the facility are produced in the United States, increasing to 45% on January 1, 2025; 50% on January 1, 2026; and 55% January 1, 2027. - For offshore wind, base rate for manufactured products is 20%, increasing to 27.5% on January 1, 2025; 35% on January 1, 2026; 45% on January 1, 2027; and 55% on January 1, 2028.	Condition for additional credit	2–10% additional to the CEITC rate*
Advanced Manufacturing Credit	Manufacturing of green goods and infrastructure	Items must be produced in the United States.	Condition for base credit	Credits include: • 4 cents times the capacity of solar cells • 10% of the sales price of the offshore wind vessels • $35 times the capacity of battery cells • 10% of production costs for critical minerals
Clean Vehicle Credit (critical minerals)	Electric vehicles	The following percentage of the value of applicable critical minerals in the EV's battery must be extracted or processed in the United States or any country with which the United States has a free trade agreement, or recycled in North America: • 40% if placed in service before January 1, 2024 • 50% if placed in service in 2024 • 60% if placed in service in 2025 • 70% if placed in service in 2026 • 80% if placed in service in 2027 and beyond Final assembly of the vehicle must also take place in North America. For vehicles placed in service beginning in 2025, none of the applicable critical minerals contained in their battery can be extracted, processed, or recycled by a "foreign entity of concern."	Condition for base credit	$3,750 per vehicle

Table 1 (continued)

Name/purpose of credit	Issue area/ product	Local content rule	Role of local content rule	Credit if local content rule is met
Clean Vehicle Credit (battery components)	Electric vehicles	The following percentage of the value of the components of the EV's battery must be manufactured or assembled in North America: • 50% if placed in service before January 1, 2024 • 60% if placed in service in 2024 or 2025 • 70% if placed in service in 2026 • 80% if placed in service in 2027 • 90% if placed in service in 2028 • 100% if placed in service in 2029 and beyond Final assembly of the vehicle must also take place in North America. For vehicles placed in service beginning in 2025, none of their battery components can be manufactured or assembled in a "foreign entity of concern."	Condition for base credit	$3,750 per vehicle
Clean fuel production credits	Transportation fuel	Production must take place in the United States.	Condition for base credit	• 20¢–$1.00 per gallon* • 30¢–$1.75 per gallon for "sustainable aviation fuel"*

Source: Inflation Reduction Act of 2022, Pub. L. No. 117-169, 136 Stat. 4392.

Note: *Upper bound is conditional on the taxpaying firm also meeting prevailing wage and apprenticeship requirements.

agreement with the United States, such as the United States-Mexico-Canada Agreement. Thus, it does not include such American allies as Japan, South Korea, the UK, or EU members, including France. These countries—like the United States—are WTO members; however, unlike Canada and Mexico, they do not have separate bilateral free trade agreements with the United States. Carmakers from these countries typically assemble their electric vehicles overseas with the hope of selling them worldwide, including in the United States.

Significantly, the IRA also includes strict rules for sourcing and manufacturing batteries for EVs. Starting in 2023, at least 40 percent of the critical materials for batteries for electric vehicles must be sourced in the United States or in countries that have a free trade agreement with the United States. This 40 percent requirement will rise to 80 percent by 2026. Electric vehicles must also have batteries with at least 50 percent North American content by 2024 and 100 percent by 2028.[4] These stringent requirements have been introduced at a time when the United States is highly dependent on foreign production for these critical materials. Certain minerals—mainly lithium, cobalt, manganese, nickel, and graphite—"are essential to constructing the lithium-ion batteries used in electric vehicles."[5]

As it stands, China controls an estimated 60–80 percent of the chemical processing and refining of these critical battery materials, and it manufactures more than 75 percent of all EV batteries.[6] "Most of the mining for materials like lithium and cobalt isn't in China, but the country dominates the subsequent steps in the value chain."[7] The United States imports more than half of these critical materials, including all its manganese and graphite and 76 percent of its cobalt. China's significant lead in this sector can be attributed to hefty Chinese EV subsidies through the years, which have facilitated the development of a strong global battery supply chain leading upstream to China.

The IRA provides that, beginning in 2024, no battery parts can be imported from a "foreign entity of concern," such as China or Russia. The same requirements will be extended to minerals in 2025. The question for the United States—and for its allies—is how best to build their own supply chains for these critical inputs into EV batteries *soon*, so as not to be largely dependent on China as a middleman.

Further complicating matters for the United States is the perfectly foreseeable reaction of the excluded allies to the economic slight against them in the new U.S. law. While in Washington, President Macron pronounced the trade

discrimination in the EV tax credits a "job killer" for Europe.[8] France and the other excluded U.S. allies and trading partners contend that these new requirements relating to electric vehicles may violate WTO rules.[9] The EU has warned that, if applied in their current form, these new EV measures could "trigger a harmful global subsidy race" for critical green technologies and their components and create "tensions that could lead to reciprocal or retaliatory measures."[10] Thus far, this trade discrimination by the United States has not led to any action in the WTO by the affected countries. Nor has it inspired reciprocal or retaliatory subsidies. Yet, these new EV requirements could well lead to both.

THE AMERICAN RESPONSE SO FAR TO U.S. ALLIES' CONCERNS

President Biden and his administration have struggled to articulate a credible response to the concern over the new discriminatory features of the EV tax credit, which is widely shared among America's friends and trading partners outside of North America. The president must placate slighted U.S. allies while also preserving his support within his own party in Congress. Having won the bare minimum of a majority in support of the IRA in Congress with pledges of an industrial strategy that tilts the market-based American economy toward more governmental direction (ironically, in tacit emulation of authoritarian China), he is committed to following through on the trade and other economic distortions that will now result.

The United States is striving to maintain a united economic front against the Russian government of President Vladimir Putin, whose invasion of neighboring Ukraine has, thus far, inspired a cooperative effort by many Western and Asian democracies to arm and otherwise support the Ukrainians in their defense of their country. The Biden administration also seeks to unite these same democracies in a common response to what it perceives as significant and ongoing trade transgressions by China, as well as the increasingly ominous Chinese geopolitical actions. The last thing the United States needs now is a messy trade split with the EU over EV tax credits. Yet, the discriminatory IRA measures threaten to drive a divide between the United States and the EU, as well as with the UK, Japan, and South Korea, at the worst possible time for the conduct of American foreign policy.

During the French state visit, Biden told Macron that there could be "tweaks" to the law to smooth the way for French and other European EVs to be eligible for the tax credits.[11] The bilateral U.S.-EU Trade and Technology Council is supposed to figure out how to make these tweaks.[12] The hope is that these technocrats from both sides of the Atlantic Ocean can somehow make this controversy disappear. The IRA was passed in Congress by only one vote after nearly two years of trying—and that was with a Democratic Congress that was ostensibly supportive of Biden. Now there is a Republican House of Representatives. No one knows how either the Democrats or the Republicans in the new Congress would react to a proposal to change the law, and no one in the Biden administration wants to find out by asking.

This leaves Biden with only the possibility of an administrative solution that does not alter the intent of the statute. The problem is that the language in the IRA extends the EV tax credit only to U.S. products and to products from countries with which the United States has a free trade agreement. Only Congress can change a statute; the executive branch cannot do so. This is part of the separation of powers in the U.S. Constitution. Biden has suggested, however, that administrative rulemaking could somehow make this statutory requirement more flexible. He has said that the IRA provision limiting the tax credits to nations with free trade agreements with the United States "was added by a member of the U.S. Congress who acknowledges that he just meant allies. He didn't mean literally free trade agreements. So, there's a lot we can work out."[13]

> "The last thing the United States needs now is a messy trade split with the EU over electric vehicle tax credits."

This jaw-dropping explanation says all too much about the current capabilities of the Congress in writing legislation. Not only can major legislation rarely be enacted, but even when it is enacted, it is often rife with drafting error. This is such a case. Nearly two years of work went into drafting the IRA. But a member of Congress who was in a sufficiently senior place to add this requirement evidently did not comprehend the implications of the wording they chose to use. Additionally,

the congressional staff advising that member apparently did not notice the extent of the discrimination entailed in this wording, did not foresee its economic and geopolitical consequences, and did not warn the member that broader language should be used that would not discriminate against important U.S. allies and trusted trading partners.

To try to assuage the concerns of the victims of this trade discrimination, the Treasury Department, shortly before the new requirements took effect on January 1, 2023, issued a guidance that will allow some EV vehicles assembled outside North America to qualify for the tax credit through a separate commercial electric vehicle program if the vehicles are purchased for lease by businesses and are not for resale.[14] Furthermore, the Treasury Department has noted that the phrase "free trade agreement" is not defined in the legislation and therefore could be interpreted to include other agreements that reduce or eliminate trade barriers in addition to comprehensive free trade agreements.[15] This signals that the Biden administration may administratively adopt an expansive definition of the undefined statutory phrase.[16]

As Kathleen Claussen has noted,

> When it comes to the more than 1,200 trade-related agreements that the United States maintains covering over 100 countries, they very often "reduce or eliminate trade barriers," just not all of them. . . . [T]hese mini-deals or trade executive agreements could still be considered free trade agreements or at least "free-ing" agreements: they almost always make the exchange of goods and services easier. The United States has 107 such agreements with Japan and about 60 with the European Union, despite not having a comprehensive trade agreement with either partner. These agreements cover everything from avocados to zoning.[17]

It is unclear how much domestic pushback will be generated by these and potentially other concessions made by the Biden administration with the intent of placating U.S. allies that are victimized by this trade discrimination. Sen. Joe Manchin (D-WV), an author of the legislation and a pivotal force in the Senate, criticized the commercial lease concession, maintaining that the interpretation by the Treasury Department "bends to the desire of the companies looking for loopholes and is clearly inconsistent with the intent of the law." This, he said, "only serves to weaken our ability to become a more energy secure nation."[18] In the wake of the announcement of the treaty guidance, Manchin introduced legislation in Congress that would delay the implementation of the tax credits for electric vehicles.[19] He said that he seeks legislation that "further clarifies the original intent of the law and prevents this dangerous interpretation from Treasury from moving forward."[20] Manchin also acknowledged, however, that when he was crafting the new requirements for the EV tax credits, he did not realize that the United States and the EU do not have a free trade agreement and that he is open to "tweaks" on that requirement.[21]

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Criticisms of these administrative actions may be forthcoming domestically from both Democrats and Republicans alike. Reconciling the principles of free and open trade with the desire to lure much of the current foreign assembly and production of electric vehicles into North America and to source domestically as many inputs into EVs as possible is economically challenging, to say the least. The American supporters of these discriminatory measures have their eyes on the ongoing and intensifying competition with China in this key high-tech sector; however, the U.S. ability to compete with China in the growing global electric vehicle market will be hindered if long-existing trade ties in the automotive sector between the United States and such allies as the EU, UK, Japan, and South Korea are damaged in the process.

THE ECONOMIC DAMAGE OF DOMESTIC CONTENT REQUIREMENTS

Why would the United States risk such controversy by engaging in such trade discrimination in the first place?

It is because the Biden administration and congressional Democrats, along with a growing number of congressional Republicans, see Buy American provisions as advantageous because they think those provisions either advance a decarbonizing transition in energy and manufacturing production or else enhance U.S. economic competitiveness in domestic and foreign markets. In their eyes, domestic content requirements are essential to what they perceive as an eroded manufacturing base that has been victimized in recent decades by unfair foreign competition from China and elsewhere. They view these requirements as incentives for buying American-made products and as encouragements for both keeping production onshore and stimulating foreign direct investment in U.S.-based production. Buying American is seen as a way of lifting America anew to the dominant role in the world economy that it played in the first few decades following World War II.

The administration makes no apologies for its embrace of domestic content requirements and other forms of economic nationalism as part of a government-led industrial policy. As Deputy Secretary of Commerce Don Graves expressed it,

> For the first time in decades, we have a generational opportunity to lay claim to the competitive industries of the future, along with the good-paying jobs and economic security that will come with them. But it's going to require government, business, workers, and communities to work together in new and innovative ways, and it will require the private sector to consider national competitiveness and economic security as part of their corporate social responsibility.[22]

Framed as an "industrial strategy," Graves said that the aims of the administration are to "rebuild and invest in our industrial base, bolster our resilience to threats from adversaries and climate change, and chart a path to long-term growth."[23] Domestic content requirements are perceived as being necessary to accomplishing this.

Yet the economic reality is that domestic content requirements will not achieve these aims. Instead, they will undermine them. A requirement to Buy American leads to less competition and thus to higher prices. This, in turn, leads ultimately to a global economy in which higher-priced American goods are priced out of markets: fewer American-made goods will be bought than would otherwise be bought through freer trade. Such a requirement also leads to less innovation. With competition limited, there is less of an incentive for domestic producers to keep up with their competition by innovating. Thus, with producers burdened by domestic content requirements, the protectionist legislation, such as the subsidy provisions in the IRA, will have the opposite effect of what Congress and the administration intended: the provisions will create a domestic disincentive to engage in the extent of innovation that is necessary to make the transition to a cleaner and greener economy.

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But political representation is complicated by complexity, and trying to explain the downsides of economic nationalism to skeptical congressional constituents is difficult because they equate buying American with an expression of patriotism. Nevertheless, it is true that there is an abundance of evidence dating back decades demonstrating that these negative consequences of economic nationalism exist.[24] Enhancing the competitiveness of American production both in the U.S. economy and in the global economy is the right goal, but it is not a goal that can be reached through the shortsighted and self-defeating devices of economic nationalism.

Graves said that the ambition of the administration is "to enable the private sector to do what it does best—innovate, scale, and compete."[25] But domestic content requirements are obstacles to doing this. Such requirements are always tempting as means of securing domestic support for legislation, and a call to Buy American is always a guaranteed applause line in a political campaign for either party. However, domestic content requirements to Buy American distort trade while denying domestic producers and consumers alike

the benefits of the competition, the lower prices, and the broader choices of energy and environmental alternatives that are being offered by being open to foreign trade and to foreign direct investment.[26] This in turn impedes innovation. Domestic content requirements thus create a national economy that is smaller than it otherwise would be in the absence of such requirements.

The key to increased economic competitiveness is increased productivity: the making of more goods while using fewer resources to do so. This requires an efficient allocation of resources. Buy American provisions cause an inefficient allocation of domestic resources by artificially inflating production in a targeted industry independent of its competitiveness and at the expense of other industries and sectors. Because of this inefficient resource allocation, less technology transfer can occur and thus increases in productivity are inhibited. Downstream from final production, there are increased production costs because of increased prices for intermediate inputs of goods and services, and there are potential supply bottlenecks that result in reduced competitiveness.

Likewise, internationally there are increased production costs of inputs of goods and services, as well as inefficiencies in coordination in supply chain networks, and thus fewer gains from trade and less overall new wealth. In today's economy, and despite the recent reorientation and retrenchment of some international supply chains, inputs into final production frequently cross borders many times before becoming part of end products. Government-imposed distortions to this process can diminish competitiveness both domestically and worldwide. For consumers, there are increased prices of often lower-quality goods. Moreover, where there are domestic content requirements, the latest technologies are not always available.

Initially, domestic content requirements may enable domestic producers to capture economies of scale and enter global markets, but over the long term, they insulate firms from competition and thereby diminish the incentive for innovation. Because domestic content requirements seldom contain sunset provisions (those with an expiration date), they tend to remain in force for a long time, leaving in place the disincentive for innovation and thereby impeding productivity growth. Few beneficiaries of subsidies ever ask that their subsidies be withdrawn. What is more, at a time when innovation in addressing climate change and its multiplying effects is urgently needed, such disincentives for innovation are doubly deleterious. As the eminent Swiss trade scholar Thomas Cottier observed: "From the point of view of decarbonisation, a local content requirement does not make sense as it increases costs for hardware and installations. Imported and competitive products are likely to contribute to more rapid deployment of the technology."[27] Leading American trade scholar Robert Howse added that "domestic content requirements and other discriminatory measures actually undermine environmental objectives, by shifting production to higher-cost jurisdictions, and therefore making clean energy, or clean energy technologies, more expensive than they need to be."[28]

> "The transition to cleaner technologies and renewable energy will occur sooner and be more successful if the United States works closely with its allies and not against them."

The EU and the other affected U.S. allies could try to match the IRA subsidies with subsidies of their own. Some within the EU have urged doing precisely that, even at the risk of setting off a tit-for-tat subsidies race. But that would only add to the economic damage of the discriminatory dimensions of the IRA subsidies on both sides of the Atlantic Ocean, while perhaps also spreading that trade-distorting race worldwide.[29] This is not merely a matter of the EV tax credits. France calculates that about $200 billion of the $369 billion in new IRA subsidies are inconsistent with U.S. WTO obligations.[30] Retaliation by the EU and others against these massive U.S. subsidies by endeavoring to match them would be enormously expensive. It is not clear that these American allies and trading partners can afford such a subsidy war. (Whether the United States can afford this level of largesse at the expense of American taxpayers is another question.) And what would Russia and China be doing while the United States and its allies squabbled over tit-for-tat subsidies and other forms of trade discrimination? The transition to cleaner technologies and renewable energy

will occur sooner and be more successful if the United States works closely with its allies and not against them.

WTO RULES RELATING TO DOMESTIC CONTENT REQUIREMENTS

For these economic reasons, international trade rules have long imposed disciplines on the trade distortions caused by domestic content requirements. Among these legal disciplines, three WTO rules are especially relevant. The first are the rules against discriminatory internal taxation and regulation in Article III of the General Agreement on Tariffs and Trade (the GATT). The second is the rule prohibiting subsidies that are contingent upon the use of domestic content in Article 3.1(b) of the Agreement on Subsidies and Countervailing Measures (the SCM Agreement). The third is the requirement in Article 2.1 of the Agreement on Trade-Related Investment Measures (the TRIMS Agreement) that no trade-related investment measure shall be applied inconsistently with Article III of the GATT. Table 2 below summarizes WTO dispute settlement cases where panels and/or the Appellate Body ruled against local content requirements.

The same measure can violate all three of these rules, which have been strictly applied by WTO panels and the WTO Appellate Body in dispute settlement, consistently with the instructions given to jurists by WTO members in the Dispute Settlement Understanding, which is part of the WTO treaty.[31] The United States assembly and sourcing measures relating to EV tax credits are highly vulnerable to challenge in WTO dispute settlement under all three of these rules. So, too, are the discriminatory elements in other IRA subsidies provisions. Furthermore, no credible defense appears to be available to the United States under WTO rules to justify these violations.

First, there is GATT Article III. The Appellate Body has stated, quoting Article III:1, that, "The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production.'"[32] Article III:2, second sentence, provides that no WTO member "shall apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in" Article III:1.[33] For a violation of Article III:2, second sentence, to be established, there must be a situation in which "directly competitive or substitutable" imported and domestic products are "not similarly taxed" through an "internal tax or other charge" that is applied in a way that protects domestic production.[34] A pivotal question relating to a potential challenge in WTO dispute settlement to the electric vehicle tax credit in the IRA would be whether it is applied in a manner that affords "protection to domestic production." It seems obvious that protecting domestic production is indeed the purpose of the discriminatory structure of this tax credit.

> "The United States assembly and sourcing measures relating to electric vehicle tax credits are highly vulnerable to challenge in WTO dispute settlement."

Article III:4 of the GATT provides, in pertinent part, that "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."[35] This national-treatment rule forbids discrimination in favor of local producers over foreign producers of like imported products. As the WTO Appellate Body has explained, "For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the imported products are accorded 'less favourable' treatment than that accorded to like domestic products."[36]

A key question relating to potential challenges to IRA subsidies in WTO dispute settlement under Article III:4 would be whether these U.S. measures result in less favorable treatment. The test of whether treatment is less favorable to imported products than to domestic like products focuses on the conditions of competition and whether there is an

Table 2

WTO jurists have previously found domestic content requirements to be in violation of the WTO agreements

Case ID	Parties	Products involved	Measures contested	WTO agreement provisions at issue*	Years active
DS54, 55, 59, 64	Complainants: European Communities, Japan, United States Respondent: Indonesia	Automobiles and auto parts	- "1993 Programme" providing tariff reductions or exemptions on imports of auto parts based on local content percentage - "1996 Programme" providing benefits such as luxury tax exemption and tariff exemption to "qualifying" (based on local content) or Indonesian cars	• TRIMS art. 2.1	1997–1998
DS139, 142	Complainants: Japan, European Communities Respondent: Canada	Motor vehicles and parts	- Import duty exemptions for certain manufacturers, in conjunction with Canadian Value-Added (CVA) and production-to-sales ratio requirements	• GATT III:4 • GATTS art. XVII	1999–2000
DS108 (Article 21.5)	Complainant: European Communities Respondent: United States	All foreign goods affected by the U.S. measure	- FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the "ETI" Act)	• GATT art. III:4	2000–2002
DS146, 175	Complainants: United States, European Communities Respondent: India	Automobiles and auto parts	- "Indigenization" (i.e., local content requirement) imposed on the automotive sector	• GATT art. III:4	2000–2002
DS267	Complainant: Brazil Respondent: United States	Upland cotton	- U.S. agricultural "domestic support" measures, export credit guarantees, and other measures alleged to be export and domestic content subsidies	• ASCM art. 3.1(b) and 3.2	2003–2005
DS339, 340, 342	Complainants: United States, European Communities, Canada Respondent: China	Auto parts	- A 25 percent "charge" on certain imported auto parts	• GATT III:4	2006–2009
DS412, 416	Complainants: Japan, European Union Respondent: Canada	Certain electricity generation equipment (for renewable energy) and the electricity generated	- Feed-in Tariff (FIT) program of the province of Ontario and the contracts implementing it	• TRIMS art. 2.1 • GATT art. III:4	2011–2013
DS438, 444, 445	Complainants: European Union, United States, Japan Respondent: Argentina	Goods imported into Argentina	- Measures conditioning the importation of goods into Argentina (or the contention of other benefits), including requirements to reach a certain level of local content in domestic production	• GATT art III:4	2013–2015
DS456	Complainant: United States Respondent: India	Solar cells and/or modules	- Domestic content requirements imposed by India on solar power developers selling electricity to the government	• GATT art. III:4 • TRIMS art. 2.1 • GATT art. III:8 (government procurement derogation)	2014–2016

Sources: *WTO Dispute Settlement: One-Page Case Summaries, 1995–2020* (Geneva: World Trade Organization, 2021); and "WTO Case Law Index," WorldTradeLaw.net.

Notes: European Communities was the official name of the European Union at the WTO until November 30, 2009.

*Only provisions raised in the context of local content restrictions.

"effective equality of opportunities" in the marketplace.[37] Treatment is less favorable when there is a denial of equal competitive opportunities in the marketplace.[38] With respect to the EV taxing scheme, because of the price differentials that are created, the denial of tax credits for purchases of EVs to products from countries that do not have a free trade agreement with the United States and that do not meet the IRA's battery sourcing requirements constitutes a denial of an equal competitive opportunity to those products in the U.S. marketplace. A similar denial of equal competitive opportunities in the marketplace is likely to result from the discriminatory grant of other subsidies under the IRA.

> "Small wonder that U.S. trading partners are puzzled by the recent about-face in U.S. trade policy on domestic content requirements. For decades, market-oriented Americans have been telling them to refrain from granting trade-distortive governmental subsidies."

Second, there is the SCM Agreement, which disciplines certain kinds of governmental subsidies. Some are inconsistent with the agreement if they have certain injurious trade effects.[39] Others are prohibited by the it simply because of how they are structured.[40] Article 3.1(b) of the SCM Agreement prohibits "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."[41] Such subsidies are illegal per se under this WTO rule, irrespective of any proof of injurious trade effects.[42] With such subsidies, trade injury is, as a matter of law, presumed. Subsidies are contingent "upon the use of domestic over imported goods" if the use of domestic goods is "a condition, in the sense of a requirement, for receiving a subsidy."[43] Clearly, this is the case with respect to the assembly and battery sourcing requirements for eligibility for tax credits when purchasing an electric vehicle under the IRA. If a country from which a vehicle or a battery input or component is sourced does not have a free trade agreement with the United States, then that purchase is not eligible for the tax credit.

Until recently, the United States was in the forefront among WTO members in opposing domestic content requirements such as those found in the IRA. Such requirements, of course, can result in discrimination against U.S. exports, just as they can result in discrimination against imports into the United States. Economically, domestic content requirements are a double-edged sword. Most recently, and perhaps most famously, in 2018, during the prolonged Boeing-Airbus civilian aircraft dispute, the United States failed to prove its claim that the European subsidies at issue were, in fact, prohibited import substitution subsidies under Article 3.1(b).[44] Small wonder that U.S. trading partners are puzzled by the recent about-face in U.S. trade policy on domestic content requirements. For decades, market-oriented Americans have been telling them to refrain from granting trade-distortive governmental subsidies.

Third and lastly, there is Article 2.1 of the TRIMS Agreement, which provides that "no Member shall apply any TRIM that is inconsistent with the provisions of Article III" of the GATT of 1994.[45] The TRIMS Agreement essentially interprets and clarifies the provisions of GATT Article III where trade-related investment measures are concerned.[46] TRIMS measures have been heavily scrutinized in WTO committees. As with import substitution subsidies under the SCM Agreement, the United States has, until recently, supported this strict scrutiny. For example, the United States has argued that what it sees as local content requirements related to China's cybersecurity measures restrict the ability of Chinese companies to procure the technologies of their choice and the requirements also reduce market access for foreign investors.[47] In addition, the United States has argued that localization measures in India's measures relating to pharmaceutical and medical devices; mining, oil, gas, and solar aspects of the energy industry; and the telecommunication, agriculture, and retail industries are in violation of the TRIMS Agreement.[48] Such measures imposed by other countries discriminate against U.S. goods and U.S. foreign direct investments.

Does the United States have a legal defense under WTO law to its own domestic content requirements in the IRA? Article XX of the GATT sets out general exceptions to GATT obligations.[49] Potentially relevant to claims of a GATT violation is Article XX(g), which provides a general exception for measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction

with restrictions on domestic production or consumption."[50] The Appellate Body has ruled that for a measure to be related to the conservation of exhaustible natural resources, there must be "a close and genuine relationship of ends and means" between that measure and the conservation objective of the WTO member maintaining the measure.[51] With respect, for example, to the IRA tax credits for EV purchases, there appears to be such a means-end relationship; the means of the tax credits serve the end of conserving air and, indirectly, other exhaustible natural resources by mitigating climate change.

But that is not the conclusion of the legal inquiry into whether this general exception is justified under GATT Article XX. Once it is established that a measure could be justified under Article XX, the WTO member defending the measure must also prove that it is "not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade."[52] Here the United States is likely to fall short. With respect, for example, to the EV tax credits, how likely is it that the United States could prove that—for reasons relating to the conservation of exhaustible natural resources—its decision to discriminate by providing the tax credit for products from Canada and Mexico but not for those from the EU, UK, Japan, South Korea, and other countries is anything but "arbitrary and unjustifiable"? (Worth noting here is that while the general exceptions in GATT Article XX apply to trade-related investment measures under the TRIMS Agreement,[53] it is unclear whether these exceptions apply to subsidies under the SCM Agreement.[54])

It may be suggested that any WTO violations in the IRA can be justified by the national security exception in Article XXI of the GATT.[55] The United States continues to insist that the mere invocation of the national security exception in GATT Article XXI is sufficient to excuse what would otherwise be a WTO violation. A series of WTO panels have, however, ruled consistently that this is not so. Acceptance by WTO jurists of the contemporary and bipartisan U.S. view that the WTO has no jurisdiction on such matters would open up a black hole of national security in which professed national security measures of all kinds could swallow up the entirety of all WTO obligations—something the United States itself warned against when the national security exception was written at the creation of the multilateral trading system in the immediate aftermath of World War II.[56] What is more, as with GATT Article XX, it is unclear under WTO law whether a GATT Article XXI defense is available for a violation of the SCM Agreement. Furthermore, it is equally unclear under WTO law whether the scope of the coverage of Article XXI includes such competitiveness measures, whatever their broader and long-term national security implications.

What are the chances that disputes over the subsidies in the IRA will end up in WTO dispute settlement? The U.S. allies whose products are the subjects of this trade discrimination appear reluctant to go to the WTO for dispute settlement. While expressing their aggrievement, Japan, South Korea, and the UK seem, for now, to prefer to hold back while letting the EU take the lead on this issue. If, however, the EU did file a WTO complaint challenging the EV tax credit scheme or any of the other discriminatory aspects of the IRA, those other U.S. trading partners could be expected to join as co-complainants in the dispute. A proliferation of WTO dispute settlement could ensue.

"The Europeans seem to prefer negotiation to litigation. With U.S. intransigence continuing to keep the WTO Appellate Body bereft of any judges, the EU is perhaps also not optimistic about securing a resolution of the dispute from the WTO dispute settlement system."

Having recently resolved some long-lingering trade disputes with the United States, the EU is understandably hesitant to launch into more. The Europeans seem to prefer negotiation to litigation. With U.S. intransigence continuing to keep the WTO Appellate Body bereft of any judges, the EU is perhaps also not optimistic about securing a resolution of the dispute from the WTO dispute settlement system. Should the EU (and other U.S. allies) bring a case and prevail before a WTO panel, the United States could prevent the adoption of the panel report by the WTO by filing an appeal to an Appellate Body which currently has no judges to hear an appeal. It could also simply announce that it will not comply with the adverse ruling, repeating what it did—to its shame—after the adverse ruling over the Section 232 tariffs

imposed on steel and aluminum imports by former president Donald Trump.[57] These potential outcomes, of course, have dimensions that extend far beyond the legality under WTO law of the EV tax credits and other IRA subsidies, including fundamental systemic issues about the fate of the WTO dispute settlement system and the WTO itself.

CONCLUSION

Article III:8(a) of the GATT provides that the provisions of Article III—including the "national treatment" obligation in Article III:4—shall not apply to laws, regulations, or requirements relating to government procurement.[58] Relying on this exception, and apart from the limitations on it to which the United States has agreed in the plurilateral WTO Government Procurement Agreement,[59] the federal government has long been in the business of buying American in its public purchases.[60] The costs to American taxpayers and the American economy have been enormous. By one estimate, the United States would gain 300,000 jobs if it got rid of its domestic content rules in public purchases.[61] Buy American provisions are the equivalent of a 25 percent tariff on federal government purchases (and thus a 25 percent surtax on American taxpayers).[62] And even when jobs are supposedly "saved," the costs to taxpayers are often much larger than the incomes earned at the saved jobs. The Peterson Institute for International Economics estimates that every job saved by the legal requirement to Buy American when making government purchases costs American taxpayers roughly $250,000.[63] With such harmful effects from Buy American requirements in public purchasing, why would we Americans want to impose such requirements on private purchasing as well?

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Organization. Article XXIV(8)(b) of the General Agreement on Tariffs and Trade speaks of a "free-trade area" and states that one "shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories." These terms have not, however, been clarified in WTO dispute settlement, nor is there any mention in the Marrakesh Agreement of a free trade agreement nor what would comprise one.

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54. An open question in WTO jurisprudence, however, is whether Article XX of the GATT can provide a defense to what would otherwise be an illegal subsidy under the SCM Agreement. The question turns on the extent to which the obligations in the SCM Agreement can be seen legally as elaborations of obligations relating to subsidies and to the application of countervailing duties under the GATT and therefore as a legal part of the GATT Agreement for the purposes of GATT Article XX. The Appellate Body has touched on this unresolved legal issue obliquely, but to date this legal issue has not been raised squarely on appeal, and thus there is no definitive WTO ruling. See Appellate Body Report, *US—Shrimp (Thailand)*, WTO Doc. WT/DS343/AB/R; WT/DS345/AB/R (adopted July 16, 2008); Appellate Body Report, ¶ 229, China—Publications and Audiovisual Products, WTO Doc. WT/ DS363/AB/R (adopted January 19, 2010); Appellate Body Report, *China—Rare Earths*, ¶ 5.53–5.55, WTO Doc. WT/DS431/AB/R; WT/DS432/AB/R; WT/DS433/AB/R (adopted August 7, 2014); and Appellate Body Report, *Argentina—Footwear (EC)*, ¶ 97, WTO Doc. WT/ DS121/AB/R (adopted January 12, 2000).

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CITATION

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