EUROPE NEW (GREEN) DEAL - THE NET ZERO INDUSTRY ACT

1. Introduction

High energy prices persistent across the European Union after the pandemic are weakening the competitiveness of a number of commodities and products on non-European markets, but also in some other EU Member States that had more favourable conditions in terms of energy prices.

Growing European regulation or the active policies of other global players result, and may further result, in the gradual shutdown of capacities in a number of European industry sectors, departing from the goal of a "self-sufficient EU". On the contrary, there is a risk of deepening Europe's dependence on imports of inputs and products.

As a consequence, Europe is facing a risk of deindustrialization and loss of competitiveness compared to other major economies, like the United States. The US is aiming to establish itself as a competitive, autonomous player in what are considered to be major growth sectors by the record package of $369 billion in spending on climate and energy policies granted under the 2022 Inflation Reduction Act. This includes tax credits and other financial incentives for the production of electric vehicles, renewable energy, sustainable aviation fuel, and hydrogen which would essentially boost US competitiveness and businesses.

Such a massive package of subsidies has put centre stage Europe’s concerns that European industries will consider moving their operations to the US, leaving behind a de-industrialized Europe.

In response to such concerns, the European Commission published this year on 16 March, a proposal for the Net Zero Industry Act (NZIA) in the context of the EU Green Deal Industrial Plan. The NZIA proposal has entered the ordinary legislative process with the aim of formal adoption by the European Parliament and the Council. The European Parliament Environment Committee (ENVI) will vote its opinion on the file in September 2023, followed by the Industry Committee’s (ITRE) deliberation on its position in October. The Council is due to agree on its negotiating position (general approach) by early December 2023. It is to be mentioned that the NZIA proposal did not pass through the usual ex-ante exercise done by European Commission services to assess the likely impact of the proposal compared to alternatives. It was only followed-up by a working document discussing NZIA investment needs and funding options.

The NZIA aims at promoting investment in the production of products that are key in meeting the EU’s climate neutrality goals.

By accelerating the development and production of net-zero technologies, the NZIA also aims to reduce the risk of replacing EU reliance on Russian fossil fuels with other strategic dependencies on key technologies and components for the green transition.

Overall, this initiative should contribute to strengthening European self-sufficiency and the resilience of net zero manufacturing technologies in the EU, in order to meet REPowerEU objectives, which will make up the backbone of an affordable, reliable, and sustainable clean energy system.

2. Overview of the NZIA

The NZIA is built on the following pillars: (i) setting enabling conditions (for example, simplifying permit-granting processes); (ii) accelerating CO2 capture, (iii) facilitating access to markets (i.e., sustainability and resilience criteria in public procurement/renewable energy sources (RES) auctions), (iv) enhancing skills; (v) fostering innovation (for example, through regulatory sandboxes); and (vi) facilitating the coordination between the Commission and the Member States through a Net Zero Europe Platform.

The proposal contains a specific list of technologies, mainly from the energy sector, which are to be supported in the coming years, which can be problematic from the point of view of innovation and industry, but are necessary for manufacturing net-zero technologies.

The list differentiates between net-zero technologies and strategic net-zero technologies, the latter of which will make a significant contribution to decarbonization by 2030 and are commercially available or soon to enter the market, as follows:

- Solar photovoltaic and solar thermal technologies
- Onshore and offshore renewable technologies
- Battery/storage technologies
- Heat pumps and geothermal energy technologies
- Electrolysers and fuel cells
- Sustainable Biogas/Biomethane technologies
- Carbon Capture and Storage (CCS) technologies
- Grid technologies

Other net zero technologies are also supported by the measures proposed in the NZIA, to a various degree, including sustainable alternative fuel technologies, advanced technologies to produce energy from nuclear processes with minimal waste from the fuel cycle, or small modular reactors.

Because strategic net-zero technologies will have a significant contribution towards the path to net zero by 2050 and also play a key role in the EU's open strategic autonomy, they enjoy additional benefits under the NZIA, such as benefitting from the resilience criterion in auctions and the possibility to become Net-Zero strategic projects, and they may be granted priority status so that they can benefit from shorter timelines.

The selection of such technologies on the NZIA list has drawn upon three main criteria:

- the level of technological readiness,
- the contribution to decarbonization, and
- competitiveness and security of supply risks.

Technological readiness concerns those technologies that are commercially available and have a good potential for rapid scale-up, using a classification developed by the International Energy Agency.

The second criterion identifies those net-zero technologies that are projected to deliver a significant contribution to the EU's legal commitment to reduce net greenhouse gas emissions by at least 55% by 2030, relative to 1990 levels.

Finally, the third criterion relates to the EU's heavy or growing dependence on imports as regards the manufacturing capacity of certain components or parts in the net-zero technology value chain, particularly in the case of dependencies on a single third country.

The proposal includes a number of actions and instruments to strengthen the competitiveness of Europe's net-zero technology manufacturing ecosystem, centred on:

- **Setting enabling conditions**: streamlining permitting processes for net-zero technology manufacturing projects as well as single points of contact in EU Member States. Net-Zero Strategic Projects, for the priority technologies listed above will benefit from even faster permitting procedures.

- **Accelerating CO2 capture and storage:** reaching an objective of 50 million tonnes of annual CO2 storage capacity by 2030. Oil and gas producers are subject to an individual contribution to this target, making them directly responsible for building and operating the newly mandated CO_2 injection capacity.
  The contributions will be calculated based on a "pro-rata" basis, accounting for their share of oil and gas production within the EU during 2020-2023.
  One of the key aspects in this respect is the transparency of CO_2 storage capacity, including the obligation for Member States to make publicly available data on sites that can be permitted on their territory, as well as reporting on CO_2 capture projects in progress, and their needs for injection and storage capacity.

- **Facilitating access to markets:** boost diversification for net zero technologies by introducing sustainability and resilience criteria in public procurement and auctions, as well as actions to support private demand.

- **Enhancing skills:** ensure the availability of a skilled workforce for the clean energy transition by supporting the setting up of specialized European Academies. The Commission aims to work with Member States, industry, social partners and other stakeholders to design training courses to reskill and upskill workers.

- **Fostering innovation:** proposal to EU Member States to set up regulatory sandboxes to test innovative net-zero technologies in a controlled way for a limited time period, but without implementation details.

- **Building Industrial Partnerships:** The NZIA foresees that the EU may collaborate and engage in Net-Zero Industrial partnerships which will help to diversify trade and investment in net-zero technologies.

The NZIA outlines a set of policy instruments, mostly at the national level, to support selected NZIA projects:

- Acceleration of permitting and the related administrative procedures, within the time limits pre-set by the EU, including by identifying a one-stop-shop national authority in charge of these projects.

- Coordination of private funding. The Commission estimates that meeting the headline 40 percent target by 2030 will require €92 billion in investment, with the bulk (around 80 percent) coming from the private sector, to be facilitated by a "Net-Zero Europe Platform fostering contacts and making use of existing industry alliances".
- Limited public subsidies, mainly at the national level.
- Public procurement procedures and auctions, which are to include "sustainability and resilience" criteria, which can be given a weight of up to 15-30 percent.

3. Problematic aspects

Despite the fact that the NZIA marks the EU's recognition of the need to act in response to anti-competitive measures that are increasingly threatening its industry, it remains insufficient to protect European industry at least on the following counts:

3.1 Technological scope is overly selective

The NZIA promotes a pre-defined set of technologies, and within these, specific projects are considered "strategic" for the transition to net-zero.

While the list of the NZIA technologies contains most of the major technologies currently in use or close to commercialization, it excludes others.

This can lead to two problems: policymakers may end up backing the wrong technology, and this backing may generate unnecessary and damaging costs.

For example, while the proposal recognizes that "advanced technologies to produce energy from nuclear processes with minimal waste from the fuel cycle, small modular reactors, and related best-in-class fuels" are net-zero technologies, it does not include them in the list of strategic net-zero technologies, thus preventing them from becoming NZSPs.

An additional concern arises even when the selected technology is in fact the right one. The proposed NZIA asks EU countries to promote projects based solely on their propensity to advance or commercialize that technology. However, many such projects may not need public support. In rare cases, such support could be costless (for example, if it consists of waiving a bureaucratic requirement that has no merit in the first place). Mostly, however, support involves a cost, whether in the form of public money, lighter environmental checks or a distortion of competition (tilting the playing field against projects and companies that are not selected). As a result, NZIA promotion may, in some cases, do more harm than good.

We understand that some raw materials are dealt with under the Critical Raw Materials Act (CRMA), however it is still not clear if the NZIA applies to the entire supply chain, if production technologies and processes are included, for example, for components from RES and low carbon sources (typically, e.g., production of steel for components (masts) of wind turbines, components for hydroelectric power plants, nuclear power plants, etc.). Renewable sources and energy, like hydrogen, cannot be viewed separately. An example of good practice can be the US Inflation Reduction Act, which addresses entire value chains and is technologically neutral, for example, with respect to hydrogen.

In sum, the procedure for determining NZSPs seems unlikely to balance properly the risk of government failure against the market failures it is trying to address. In the presence of technological path-dependency, it may even exacerbate market failures.

3.2 The 40 percent benchmark is problematic

The NZIA adopts a 40 percent self-sufficiency benchmark for domestic manufacturing as the only relevant indicator of "strategic autonomy". This is problematic for several reasons.

In terms of implementation, the Act remains vague: if it is foreseeable that the target will not be met, the European Commission is only to consider whether it is feasible and proportionate to propose further measures.

It disregards the costs of promoting self-sufficiency in particular technologies, compared to the use of cheaper imports. As a result, it is unclear whether meeting such a target would accelerate or slow EU decarbonization and whether it would in fact advance resilience. No impact assessment, whether on cost, emissions reductions or resilience objectives, was performed to justify the 40 percent domestic manufacturing target.

Even if an import substitution target is viewed as necessary for achieving strategic autonomy, it is unclear why this benchmark should apply across all NZIA technologies, which differ in many ways: in terms of their current domestic manufacturing capacity, the costs of expanding domestic manufacturing in the EU compared to alternatives, and the lead times for expanding production.

The extent to which the target applies to component parts of the identified net-zero technologies is also unclear. Several of these components are very important and represent a major bottleneck for domestic manufacturing in Europe.

3.3 The focus on fast-track permitting is misplaced

The NZIA makes an important distinction between "net-zero strategic projects" and "net-zero manufacturing projects", both in art. 1 and then between art. 6 and art. 13, whereby strategic projects benefit from speedier permitting timelines than those not deemed strategic (those that do not meet the qualifications described in art. 10).

Although the Commission goes to great lengths to lay out the necessary and sufficient qualifications for a project to be deemed a "net-zero strategic project" in art. 10, there is much less clarity on what can be considered a "net-zero manufacturing project" and thus benefit from the permitting timelines as per art. 6.

While improving permitting procedures is always a good idea (not only for strategic projects), its relevance as a determinant of investment in this context is not clear. Permitting times are a significant drag on the deployment of renewable energy projects, but not normally for the manufacturing industry.

Thus, it is unlikely that fast-tracking of permitting and administrative procedures will provide a significant boost to cleantech investment in Europe.

Unfortunately, the initially envisaged silent procedure, according to which approvals would be granted automatically after the expiry of the deadlines, is now only included in a very weakened form.

Thus, when deadlines expire, specific intermediate steps are still to be considered approved, but not the entire project.

3.4 Governance is light

EU-level oversight of national decisions is envisaged to be minimal, although projects supported by Member States will generally receive preferential treatment (whether financial or non-financial).

European Commission monitoring is supposed to focus on whether manufacturing capacity in the EU grows in line with the 40 percent self-sufficiency target.

There is no mechanism to check the selection of NZIA projects by EU countries with respect to their effectiveness in meeting climate or resilience targets, their proportionality and their impact on the level playing field.

The proposal mentions the Net Zero Europe Platform as a governance tool, but its purpose seems to be the coordination of public instruments and links to private investment sources, not to ensure that the right projects are selected and that the NZIA meets its ultimate objectives at an acceptable cost. This does little to address the fragmented state of cleantech industrial policymaking in the EU and risks worsening this fragmentation further.

In terms of monitoring progress and evaluating impact, the proposal mentions that an evaluation will be done by the European Commission after three years and then regularly thereafter. But it is unclear how this process will be organized and implemented, running the risk that it will be little more than a nominal exercise. And it remains unclear what will happen if the EU is not on track on certain technologies.

3.5 Insufficient provisions regarding financing

The proposal was essentially limited to the targets for hydrogen storage, the exchange of information and knowledge and the simplification of permitting for certain types of technology, but it does not address the most important issue about how to ensure sufficient funding.

If new funding is not secured, it is necessary to ensure flexibility with existing sources so that individual Member States are not prevented from receiving support from, e.g., European sources thanks to mandatory rules of thematic concentration, indicators, etc.

Rather, the proposal should be open to various funding sources and should not contain a final list of possible funds, for the future flexibility of the system and consideration of current needs.

3.6 Missing points from the NZIA

The NZIA's premise is that cleantech in the EU can and should be promoted by improving the business environment specifically for cleantech.

However, cleantech investors face many of the same barriers that constrain other categories of private investment in Europe, including lack of access to finance, high energy costs, policy fragmentation and scarcity of critical skills. Addressing these barriers may be more useful, even from the narrow perspective of promoting cleantech, than giving preferential treatment to cleantech projects.

Reducing these obstacles would require much more comprehensive reforms than proposed in the NZIA.

These include a more integrated European electricity market that would help to lower energy costs structurally, an EU-wide strategy to develop and improve (green) tech skills, and the creation of a banking and capital markets union to overcome Europe's highly bank-dominated and fragmented financial system and mobilize private capital for cleantech. Furthermore, those reforms would promote not only cleantech investment, but would foster growth and competitiveness in the EU more broadly.

The proposed NZIA is also too narrow in that it does not tackle the central problem plaguing EU green industrial policymaking: lack of coordination. Europe has a multitude of green industrial policy initiatives at the EU level, adding to the multitude of policy initiatives at national and regional levels. These initiatives are generally not coordinated and may even conflict.

Finally, and related to the need for a consistent EU-wide industrial policy, the proposed NZIA lacks a solid EU-level funding instrument. A Strategic Technologies for Europe Platform (STEP) proposed by the EU on 20 June 2023, does not provide new fresh EU resources but rather repackages existing ones. This initiative also has a much broader scope than the NZIA, covering all sorts of "strategic technologies", including clean, digital, and biotechnologies.

Public financial support for cleantech would thus need to come mainly from the regular budgets of EU countries, which risks jeopardizing the single market's level playing field.

The NZIA could have been an opportunity to streamline and unify EU funding tools that could be used for cleantech manufacturing, to create a new EU funding instrument if needed and to better coordinate with, and between, national funding tools.

4. Conclusions

The Net Zero Industry Act is a response to the Inflation Reduction Act in the United States, which was in and of itself a response to Europe choosing that the ecological transition would serve as the basis for their future economic growth.

The document contains proposals, which taken together, move the EU closer to defining an industrial policy that boosts Europe's manufacturing base for green technology.

There is much to unpack in the document, and certain elements that need to be further expanded upon, such as ensuring that administrative and permitting procedures stop being a hindrance to the rapid scaling up of renewable energy projects.

The proposals do not address any of the real underlying problems facing Europe's competitiveness: high energy costs, high borrowing and labour costs, the limited base for innovation, and the limited raw material deposits available in Europe.

Preferably, the EU should seek solutions on a systemic instead of a technology specific level and address regulatory barriers, which significantly contribute to slow permitting processes.

Besides clean tech permitting, the cumulative administrative and regulatory burden of existing legislation must be addressed to improve the overall business environment.

Funding is set to be one of the most contentious issues in the debate, as richer countries would benefit from looser state aid rules and be better positioned to support their companies, while poorer states are interested in more and new EU-funding.

As any draft legislation proposed by the Commission, the NZIA will undergo during the coming months the regular adoption process, which entails long negotiations in-and-between the Parliament and the Council of Member State governments. Therefore, the current draft proposal could further evolve and be improved with more provisions to be included from the Parliament and the Member States' sides during the negotiations.

It is recommended that businesses monitor developments closely and understand how the main pillars of the NZIA proposals align with business objectives and plans. In the end, the success rate will depend on how this proposal and the following funding support measures will be perceived by the companies that are leading in technological development and innovation and how quickly they will be able to benefit from these new provisions.

PETERKA & PARTNERS Romania remains at your full disposal to provide more information and any related legal assistance connected to this topic.

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