American green subsidies change the investment landscape

Huw van Steenis

To be an investor is to live constantly at the intersection of story and uncertainty, Third Point founder Dan Loeb once said. Energy security and climate policy are starting to reshape the global investment narrative.

America's massive new green subsidies, including those in the Inflation Reduction Act, should be a game-changer for renewables. Not only could the act boost lower carbon sectors, it could also help the US leapfrog Europe in some key growth sectors. But energy security and green policies have had many false dawns. How much is this likely to change the investment landscape?

History offers a possible guide. Five decades ago, France pioneered another energy security programme, the Messmer plan, which until now has been the world's most successful energy security and decarbonisation plan. The experience has some important lessons for investors and bankers trying to figure out how revolutionary the IRA could be.

On the back of the first Opec oil shock and the Yom Kippur war, French prime minister Pierre Messmer in 1974 ordered construction of 44 nuclear power plants to be under way within seven years, with at least 120 operational by the year 2000.

One key innovation of Messmer's plan was that it leveraged private finance from US capital markets at scale, backed by government guarantees. Likewise, the IRA includes private incentives to accelerate transition. While the figure for the subsidies is officially $370bn, the money at stake is probably far higher. There is closer to $1tn of tax measures and related lending incentives to support energy security and a faster rollout of renewables from all programmes, according to Kaya Advisory.

This leads to another key lesson from Messmer. While France's energy security was the motto, a handful of international firms also benefited. France chose Westinghouse technology from the US as the foundation of its programme. Uranium was imported.

Similarly, the IRA incentivises domestic production, including of critical minerals, to reduce America's dependence on China. A critical question is whether European companies will be able to capture such opportunities from a more balkanised energy system. My conversations suggest European firms are looking at how they can benefit from the IRA, including expanding or creating new operations in the US.

> France's Messmer plan has some important lessons for investors and bankers

The Messmer plan wasn't all plain sailing, though; it met with widespread opposition, especially from coal unions, as well as citizens living near proposed reactor sites. Today, we should expect permitting to also be an issue, although critical to unlock full value.

In the end, the Messmer plan never hit its targets, just as Richard Nixon's 1973 Project Independence to build 1,000 reactors didn't. Nixon's plan ran foul of economics, as oil prices fell in the 1980s. It also met a public backlash after the Three Mile Island accident in 1979. Policy alone cannot trump science, economics and public opinion, so investors will need to weigh up the limits to growth, too.

Other countries didn't follow France's lead. A pivotal question now is whether the IRA will create competition for similarly attractive clean tech regimes in Europe and Asia. This question should be a focus of discussion at the World Economic Forum in Davos later this month. The repricing of the cost of capital will be a headwind. But European regulation is also a problem. Windfall taxes have led to an uncertain environment and companies investing less, while many European countries have a history of moving the goalposts on renewable subsidies.

Many policies, such as RePowerEU, the European Commission's plan to reduce Europe's dependence on Russian fossil fuels, have been too focused on long-term goals without short-term incentives. In contrast, the IRA offers 10-year money and policy clarity. In this way, Europe and the UK have much to learn from both the IRA and Messmer's plan.

Investors will need subtler frameworks that reward decarbonisation winners and unlock investment. It would be ironic if many of today's ESG funds failed not only to pivot their portfolios to the clean-tech names, but also to invest around the critical "khaki" industrial companies getting progressively greener.

The bottom line is energy security, and decarbonisation policy programmes are now at such scale that they will accelerate and shift the transition to a lower-carbon future. The complex transition will be bumpy and create clear winners and losers as the market narrative shifts.

The writer is vice-chair at Oliver Wyman