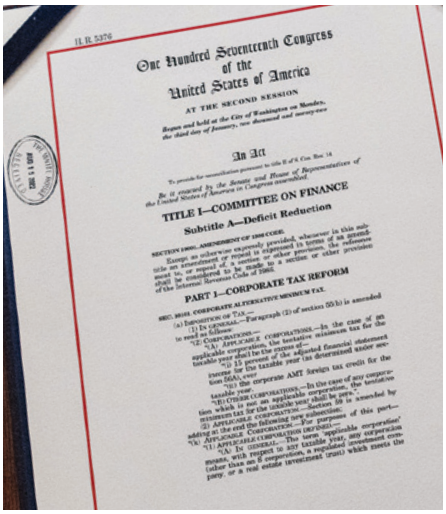
BY SAM LOUIS TAYLOR

Understanding the Inflation Reduction Act

In August, President Biden signed into law a spending, revenue, and deficit reduction bill titled the Inflation Reduction Act (IRA). Born out of the never-enacted Build Back Better Act, a $1.8 trillion stimulus and revenue package proposed at the beginning of the Biden administration, the IRA is the result of extended negotiations that changed the bill from a broad social and economic stimulus bill into one focused on clean energy, health care, and deficit reduction. These changes secured the final votes needed to pass the legislation on a party-line basis. It represents one of the largest legislative efforts to reduce the deficit in recent years and has been touted by the administration as an important tool to help bring down inflation.

The IRA is estimated by the bill's authors to create over $737 billion in budget savings and new revenues. Its proponents argued it will do this in a number of ways: lowering health care costs by allowing Medicare to negotiate prices for certain prescription drugs and capping the price paid for insulin by Medicare; imposing a minimum income tax rate of 15 percent on large corporations; boosting the IRS' ability to pursue uncollected taxes; and imposing surcharges on corporate stock buybacks. The IRA also authorizes significant expenditures, over $437 billion, to combat climate change and lower energy costs by boosting domestic clean energy production, encouraging new clean-energy technology development, and retrofitting homes for greater energy efficiency and conversion to clean energy. The remaining savings and new revenues, which Democrats and the Biden administration have estimated to be $300 billion over the next decade, will go toward deficit reduction. Subsequent reviews by the Congressional Budget Office (CBO) have lowered that deficit reduction estimate to $238 billion over a decade.

Supporters of the legislation, such as Sen. Joe Manchin, D-W.Va., and former chair of the White House Council of Economic Advisers Jason Furman, have based their claims of inflation reduction on two ideas. The first is that by reducing the deficit, the law will put downward pressure on demand and, thus, be anti-inflationary. The second is that the spending



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provisions in the bill will lower the cost of certain inflation-driving goods, like energy and health care, over time. The Committee for a Responsible Federal Budget (CRFB), a nonpartisan group that analyzes the effects of fiscal policy, has argued that most of the provisions in the bill will have a disinflationary effect on the economy in both the short and long term and that the actual deficit reduction resulting from the bill could be greater than expected.

Others, however, have argued that the legislation will not have such an effect. Economic analyses conducted by the CBO and by researchers with the Penn Wharton Budget Model program at the University of Pennsylvania's Wharton School of Business found that the short- and long-term effects on inflation would be negligible at best. The Tax Foundation found that revenue increases contained in the IRA will reduce long-term growth by creating new disincentives for businesses to invest in new operations and by reducing long-run American incomes. According to that analysis, the results would put upward pressure on inflation. Political opponents of the legislation, such as Sen. Pat Toomey, R-Pa., have also argued that the bill's spending provisions do nothing to address inflation and will only worsen any potential economic downturn.

Given that the IRA is a complex piece of legislation that is just beginning to be implemented, there will likely be continued debate over the efficacy of the legislation for some time. It will take time for Medicare to negotiate drug prices and for clean energy projects to be designed and funded. The Penn Wharton Budget Model researchers determined that the immediate influx of new spending may in fact put upward pressure on inflation in the short term. The CBO found that the legislation's deficit reduction is spread out over 10 years, with much of the proposed reduction occurring in the last five years, so the main leverage for lowering inflation won't be felt for several years. On the other hand, the Roosevelt Institute, a progressive-leaning think tank, has suggested that the IRA may boost private industry action to bring down energy costs and decrease overall demand in the short term, helping to lower inflation expectations and making it easier for other policy measures to bring inflation down. What is clear is that the effects of the legislation will take years to be fully felt in the day-to-day economy. **EF**