ICYMI: The IRA's Vanishing Deficit Reduction

West Virginia Senator Joe Manchin was credited last year with forcing the Biden administration to take fiscal restraint seriously by insisting on deficit reduction while negotiating the Inflation Reduction Act (IRA). As the senator has now discovered, the supposed pivot he thought he engineered had some loopholes. While the IRA is less expensive than the Build Back Better (BBB) plan he blocked, it is now expected to increase federal borrowing instead of lessening it because of expensive implementation decisions by the Biden administration and the absence of any hard limits on the law's climate-related subsidies.

Manchin has been in the center of each of the multiple plot twists that took place as the administration and Congress worked through the various initiatives championed by the president during his first two years in office.

The first key moment occurred soon after the president's inauguration, with Manchin deciding to lend his support to the administration's [$1.8 trillion American Rescue Plan Act (ARPA)]. Congress approved ARPA just three months after having passed the final COVID response law of the Trump era, [which itself cost $1.0 trillion] over ten years. Manchin's vote was crucial as the Senate was at that time divided equally between Democrats and Republicans. Vice President Kamala Harris's tie-breaking votes allowed the president's party to control the chamber and thus also advance budget-related legislation (which can pass with simple majority support).

By the fall of 2021, it was becoming clear that the combined cost of the COVID response measures was exacerbating inflation caused by supply disruptions and the war in Ukraine. Inflation over the full 12 months of 2021 was [7.0 percent].

By December, Manchin had seen enough. He announced his decision to pull his support for the president's Build Back Better (BBB) plan, which effectively blocked its passage in the Senate. The Congressional Budget Office had [estimated] that the House-passed version of BBB would increase federal spending and tax breaks by $2.4 trillion over ten years, with offsets of $1.9 trillion in tax hikes and $0.3 trillion in spending cuts over the same period. The net effect of the plan would have been to add $0.2 trillion to future deficits.

In the months after BBB was shelved, the pressure on Manchin from other Democrats never abated. By the summer of 2022, he was expressing openness to a measure that would cut the deficit by combining savings from prescription drug price negotiations, strengthened tax enforcement, and selected tax hikes with new spending and tax breaks focused on mitigating climate change. He was also advocating more liberalized use of fossil fuels during the energy transition.

With those terms established, Congress was able to assemble and pass the IRA, which Manchin supported and President Biden signed into law in August.

CBO's original cost estimate for the IRA credited it with about $0.3 trillion in deficit reduction over a decade, which is small relative to run-up in debt expected over this period. Still, it was a start, and enough for Manchin to get behind it. About $0.2 trillion of the deficit reduction was credited to a bump in revenue from a substantial new investment in the Internal Revenue Service's enforcement budget.

What Manchin did not fully grasp was the degree to which the law's provisions were subject to administrative discretion. With hundreds of billions of dollars now on the table for eligible companies and individual consumers, the demand for tapping this "free" money has been far outpacing what was assumed when the law was enacted, as analysts at the Tax Foundation and elsewhere have noted.

Specifically, the Joint Tax Committee now estimates that repealing certain tax breaks in the IRA would narrow deficits by $570 billion over a decade, which is roughly $300 billion more than the tax loss assigned to these same provisions last year. That re-estimate by itself is enough to eliminate the deficit reduction CBO projected for the IRA last August.
Further deterioration is likely, however. Goldman Sachs estimates the federal subsidies for the law's climate-related provisions will reach $1.2 trillion over ten years, while analysts at the Brookings Institution estimate the cost, though highly uncertain, could reach $1.0 trillion.

One factor in these expanded subsidy estimates is the increase in the expected take-up of the law's $7500 tax credit for electric vehicles (EVs). At enactment, it was believed that the IRA limited eligibility for the subsidy to households with incomes below $300,000 annually, and to the purchase of vehicles meeting requirements that designate them as North American products. However, the administration has stated that these rules do not apply when EVs are leased, which means many more households and vehicle types are likely to qualify for financial support.

While the final bill for the IRA remains uncertain, it is clear that the absence of any upper bound on its key subsidy provisions has opened the Treasury up to spending that will be determined almost entirely by market demand.

Manchin now says he will not sit by and let the terms of what he thought he had agreed to get re-written without his consent. To show he is serious, he has pledged to support the full repeal of the IRA unless the administration reverses course.

It is an idle threat at the moment (Biden would veto such a measure), but one that could signal that this story is not over just yet.

An additional factor is the continued erosion of the federal government's fiscal position. CBO recently updated its forecast to show that the federal government will borrow more than $20 trillion over the period 2024 to 2033. If Manchin remains an active participant in the political process after 2024 (his term expires at the end of next year), he might still have an opportunity to bend the policies now in dispute in his direction, especially if outside factors once again push reducing future deficits back onto the national agenda.