The Daily Dish

Politics Trump Policy

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It is done. The Senate has passed the Inflation Reduction Act (IRA) using reconciliation procedures. Outside of the political imperative to "get something done," there is little in the IRA to commend. It won't reduce inflation. As a stand-alone, the health provisions are incoherent. And "historic" investment in combatting climate change is part of a larger strategy that never made sense, is chump change compared to the cost of the problem, and has been badly warped by the administration's fealty to unionization efforts. It's all bad enough.

That includes the tax policy – especially the book minimum tax. The basic idea was that a large firm ($1 billion in financial income) would pay the greater of 21 percent of its taxable income or 15 percent of the income reported in financial statements (book income). This was never a good idea.

It was tried in 1986 and eliminated in 1989. It was too complex to administer and comply with – nothing has improved on either front with the passage of time. It provided an incentive to distort the financial reporting for tax purposes; why would the United States want to do a U-turn on the progress made on this front in the aftermath of the Enron and Worldcom scandals? It also punished the wrong firms. The only legal way to get the effective rate down is to take advantage of things that Congress itself wrote into the tax code – accelerated depreciation and expensing, research and development tax credits, and so forth. Even advocates of the IRA acknowledged this was not good policy. It was softened to acknowledge depreciation deductions to reduce the hit on manufacturers and defended on the grounds that it would affect only 100 to 200 firms.

The Senate even tried to make it worse. On Saturday when the legislative text for the tax provisions was finally, and for the first time, made public, it contained a huge "gotcha." Suppose that there were four firms, each with $300 million in book income, each of which had as a common majority investor an investment fund like a private equity. Under the IRA, these four firms would be deemed a $1.2 billion single firm, and subject to the 15 percent book tax.

This would have increased the number of affected firms dramatically, perhaps by as many as 15,000 to 20,000. But more important, it would have distorted much more economic activity and raised the headwinds to growth considerably. Fortunately, the provision was dropped during the debate, limiting the impact of the book tax.

In sum, the IRA won't reduce inflation, is anti-growth, assaults innovation in the biopharma sector of the economy, and its climate provisions are poorly designed and puny relative to problem. As years pass, the IRA will appear less and less appealing. There may be political celebrating, but it is not a policy win.