Weekly Briefing

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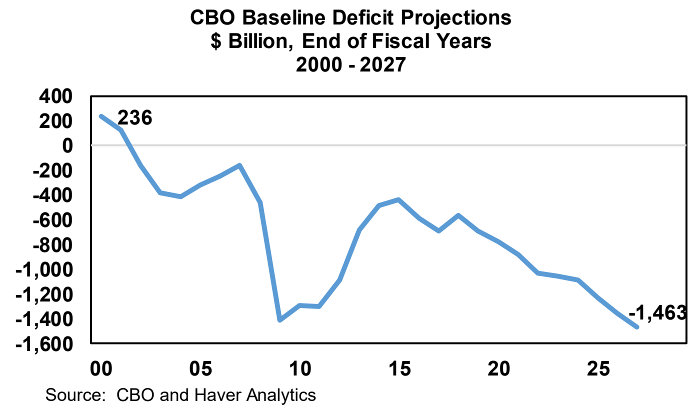

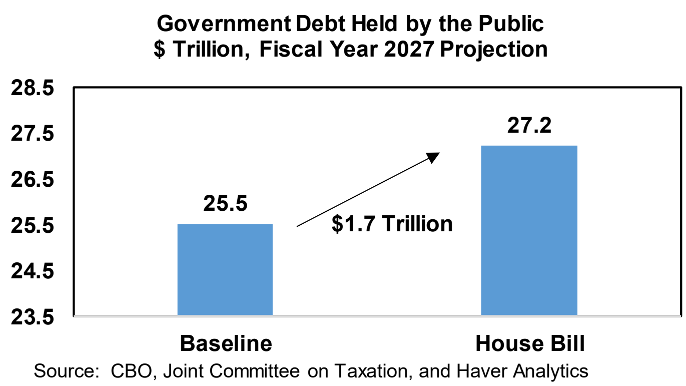

Debt and Energy: Joints In The Tax Legislation

- *The tax reform bill was passed in the U.S. House of Representatives and the Senate is working toward a vote on their version.*
- *Both bills, if enacted, would add $1.5-2.0 trillion to the nation's debt over the 10-year period.*
- *With such an overhang, there are consequences for other policy challenges ahead.*

The early November weekly briefing found here described the energy provisions of the House bill. Since that time, some modifications have been made to bill passed by the House. The Bipartisan Policy Center has provided a concise summary of the energy related provisions of both the passed House and the Senate bills. There are major differences in the bills which will require reconciliation before it is ready for the President's signature. The House bill, for example, repeals the $7,500 tax credit for the purchase of an electrified vehicle, while the Senate bill currently retains it. The Senate bill currently retains more renewable energy tax benefits as compared to the House bill. But both bills allow for immediate expensing of capital equipment, which is favorable toward all investment activity, including energy-related capital outlays.

Hidden beneath the surface of the tax legislation winding its way through Congress are the indirect effects of yet another layer of government debt. The Congressional Budget Office has weighed in on the debt and deficit implications of these bills.

- The top chart shows that the CBO baseline projections show a marked deterioration in the budget deficit to $1.5 trillion.
- The second chart shows that CBO projects the Senate bill would prompt a further deterioration in the deficit, resulting in a cumulative debt burden increase of $1.7 trillion. The nation's debt would rise to $27.2 trillion or about 97% of GDP.

In 2013, following an exhaustive and contested study conducted by Carmen Reinhart and Ken Rogoff, most economists agreed in the period following the financial crisis that fiscal stimulus was warranted, i.e., that we needed to tolerate high deficits for a while. Even so, Reinhart and Rogoff asserted that high debt has consequences: "There is a scholarly debate about the risks of high debt. We remain confident in the prevailing view in this field that high debt is associated with lower growth. Certainly, let's not fall into the trap of concluding that today's high debts are a non-issue. Keynes was not dismissive of debt. Why should we be?"

At the time of this quote, government debt represented 73% of GDP. CBO projects that the House tax reform bill will result in a debt ratio of 97% of GDP by 2027.

Key Takeaways

- With additional costs of debt financing (i.e., interest rates are difficult to forecast), this means that fiscal policy optionality is constrained. Why do we need such optionality? For many reasons, including the fact that the current economic expansion is getting long in the tooth at 8+ years old.
- The likelihood of recession during the 10-year budget horizon is very high, arguably near 100%. The higher debt burden produced by the tax legislation will constrain policy makers in the future as we struggle to address the GDP gap.
- Our obligations to entitlement program funding remains intact, and these liabilities grow substantially in the next 10 years. **Further, we have matters of energy infrastructure which needs updating, new technologies to research and grow to support electrified vehicles, autonomous vehicles, and new education programs to train our workers, and attention to climate policies for a sustainable future.**