PENN WHARTON
UNIVERSITY of PENNSYLVANIA
Budget Model

Inflation Reduction Act: Comparing CBO and PWBM Estimates

Click here for analysis of Senate-passed version of this Act.

Summary: PWBM and CBO find an almost identical impact of the Inflation Reduction Act of 2022 ("IRA") on the budget, with small differences stemming from the timing of the corporate minimum tax revenue. The impact on inflation is statistically indistinguishable from zero for either estimate.

Key Points

- PWBM estimates a $248 billion reduction in accumulated deficits over the 10-year budget versus $305 billion for CBO. This difference is less than 0.1% (one tenth of one percent) of projected total revenue and is due to differences in the corporate minimum tax provision.

- CBO and PWBM use different economic baselines, with CBO's baseline from July 2021. CBO's estimate, therefore, might change once they update their baselines to reflect more recent economic conditions. Other differences are related to PWBM's estimates of the level and timing of financial ("book") statement income, the reporting of which is more discretionary than taxable income under current law.

- The impact on inflation is statistically indistinguishable from zero for either estimate. Over the first five years (2022 – 2026), CBO estimates only $21 billion in accumulated deficit reduction. Over the same period, however, payments to liquidity constrained households, including Affordable Care Act subsidies, exceed total deficit reduction, with the sum mostly paid by entities and households that are not liquidity constrained. The impact on inflation could be positive or negative; regardless, it would be too small to be detectable in PCE inflation estimates that the Bureau of Economic Analysis reports to the first decimal place.

Introduction

Last week, PWBM released a preliminary analysis of the Inflation Reduction Act of 2022 (IRA), finding that the spending and revenue provisions of the bill would reduce deficits by a cumulative $248 billion from 2022 to 2031. On Wednesday of this week, the Congressional Budget Office (CBO) released its own estimate of $305 billion, which includes revenue estimates from the Joint Committee on Taxation (JCT).[1]

Annual Comparisons

Figure 1 compares PWBM's and CBO's estimates of the IRA's deficit impact by year. PWBM projects that the legislation would have no significant effect on the deficit in 2023 and would add around $25 billion to deficits in 2024 and 2025. By contrast, CBO projects $20 billion of deficit reduction in 2023 and no significant effect on deficits in 2024 and 2025. Over the first five years (2022 – 2026), CBO estimates only $21 billion in accumulated deficit reduction.

Figure 1. Budgetary Effects of the Inflation Reduction Act of 2022

Net deficit reduction (+) or increase (-) from spending and revenues

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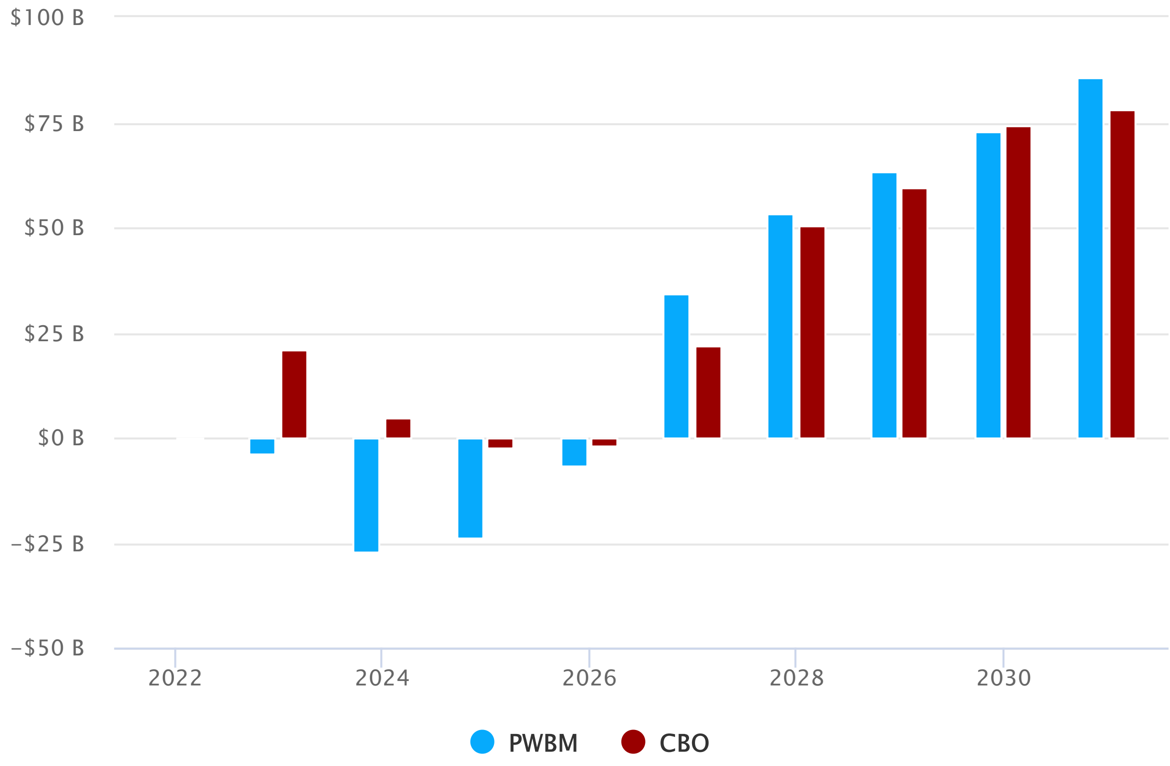

Sources: Penn Wharton Budget Model, Congressional Budget Office

During the second half the 10-year budget window, PWBM expects slightly more deficit reduction than CBO in most years, but the projections are very close. Overall, the difference of $57 billion in cumulative deficit reduction over the full 10-year period ($248 billion versus $305) is small: less than 0.1% (one tenth of one percent) of total projected revenues for the decade.

Differences by Provision

Table 1 compares PWBM's and CBO's estimates of the cumulative deficit impact from 2022 to 2031 of major components of the IRA. Most of the $57 billion total difference is attributable to a single provision: a new corporate alternative minimum tax based on the book income of large corporations. PWBM expects this provision will raise $260 billion over 10 years, $53 billion less than CBO.[2] Due to a lack of information about the methods and assumptions underlying CBO's estimate, PWBM cannot assess the reasons for this difference. Some possible explanations include:

- Differences in economic assumptions: CBO's estimates are based on an economic baseline from July 2021, which has not been updated to reflect recent economic conditions. Technical and economic updates can have a material impact. For example, in its April 2018 technical and economics update, the CBO concluded that the 2017 Tax Cuts and Jobs Act cost $433 billion more than originally estimated in December 2017 by JCT using CBO's baseline. The updated estimate almost fully closed the difference relative to PWBM's December 2017 estimate.

- Different assumptions about recent and future corporate behavior, especially related to foreign income and profit shifting: PWBM estimates that major multinationals have shifted substantial amounts of income from low-tax foreign jurisdictions to the U.S. in recent years, which would reduce revenue from the minimum tax. Because of data lags, the extent of such income shifting remains uncertain.

- Different views of the responsiveness of book income to the new tax: Corporations have significant discretion over their reported financial ("book") income and hence, over the tax base for the new minimum tax. The extent to which taxpayers would use this discretion to avoid the minimum tax is highly uncertain and PWBM's estimate of the impact may be larger.

Table 1. Budgetary Effects of the Inflation Reduction Act of 2022 by Major Provision

10-year net deficit reduction (+) or increase (-) from spending and revenues, billions of dollars

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Provision	PWBM	CBO	Difference
Extension of expanded ACA subsidies	-70	-64	6
Climate and energy provisions	-369	-368	1
Minimum tax on book income of certain corporations	260	313	53
Carried interest tax reform	13	13	0
Prescription drug pricing and other health provisions	266	288	22
IRS funding	147	124	-23
Total	**248**	**305**	**57**

Sources: Penn Wharton Budget Model, Congressional Budget Office

PWBM's estimates diverge from CBO's for two other components of the IRA: provisions related to prescription drug prices and other health care reforms, and additional revenues from increasing funding for the IRS. These differences are both concentrated in the later years of the decade and roughly offset one another.

Inflationary Impact

Over the first five years (2022 – 2026), CBO estimates only $21 billion in accumulated deficit reduction. Over the same period, however, payments to liquidity constrained households, including enhanced subsidies for the Affordable Care Act, exceed total deficit reduction, with the sum mostly financed by entities and households that are not liquidity constrained. The impact on inflation could be positive or negative under CBO's estimate. Regardless, any change would be too small to be detectable in PCE inflation estimates that the Bureau of Economic Analysis reports to the first decimal place.

Statistically, even ignoring its composition, CBO's estimated $21 billion in total deficit reduction amounts to less than 0.018% (2/100th of one percent) of cumulative projected GDP over the same years. That is a tiny fraction of its (single) standard deviation of variation. The impact on inflation is statistically indistinguishable from zero.

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1. All estimates of changes in deficits presented here include "nonscored" revenue resulting from increased resourcing of the Internal Revenue Service. ↩

2. Estimates for tax provisions are prepared by the staff of the Joint Committee on Taxation and not by CBO, but they are released by CBO as part of its cost estimates. For convenience, we refer to them here as CBO estimates. ↩