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Is the Inflation Reduction Act Effective? A Forward-Looking Review of the IRA

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Abstract

This paper conducts an in-depth examination of the Inflation Reduction Act (IRA), significant legislation aimed at addressing a series of critical economic and climate issues in the United States. It introduces the concept of inflation and discusses the key provisions of the IRA across four major areas: climate change, energy security, prescription drug prices, and tax reforms. Additionally, the paper analyzes the Act's overall impact on inflation separately, providing a comprehensive review of its effectiveness. The study evaluates the IRA through an analysis of economic data and news reports, considering the policy's broader implications and offering suggestions for future research.

Keywords

Inflation Reduction Act, Climate Change, Tax Reform, Energy Security, Pharmaceutical Price Reform, Clean Energy, Energy Tax Credit

1. Introduction

This paper critically evaluates the Inflation Reduction Act (IRA), legislation pivotal in shaping the United States' economic and environmental strategies. Despite mixed perceptions about its impact on inflation, the IRA encompasses a broad spectrum of economic concerns. Our examination focuses on the Act's provisions, aiming to provide an insightful assessment of its multifaceted effects.

2. Analysis of the Inflation Reduction Act (IRA)

Inflation refers to the overall increase in the prices of goods and services within an economic entity. (Note 1) It can be understood as a rise in prices, where the purchasing power of the currency diminishes. The resulting increase in the cost of living will have negative effects on standards of living. It complicates corporate planning, investment, savings, and borrowing, thus being a critical concern for policymakers, businesses, and the public.

In the last three years, inflation rate has reached nearly a 40-year high. (Note 2) In response to this challenge, the U.S. government enacted the "Inflation Reduction Act" (IRA) on August 16, 2022.

The Inflation Reduction Act is a large legislative package passed by Congress and signed into law by Biden aimed at fighting inflation, lowering the deficit, reducing the price of prescription drugs for seniors, and lowering the country's carbon emissions. (Note 3)

This bill encompasses various areas, including climate change, energy security, and drug prices, and tax reforms. The bill plans to invest $369 billion in the fields of climate change and energy security and is widely considered to be the largest climate bill in U.S. history. In addition, the bill allocates $64 billion for the extension of the Affordable Care Act, which was passed in March 2010.

3. Provisions of the Inflation Reduction Act

This section discusses the IRA's major provisions: climate change, energy security, pharmaceutical prices, and tax reforms.

3.1 Climate Change

The central focus of the "Inflation Reduction Act" is on addressing climate change. It funds the EPA for a greenhouse gas reduction fund and adds to the 1970 Clean Air Act, supporting measures to reduce greenhouse gas and methane emissions from household power and waste.

Moreover, the legislation offers financial support for economic decarbonization efforts in other sectors, including various tax credits, grants, and loans for decarbonization in the industrial and transportation sectors. It places a strong emphasis on addressing environmental and climate justice issues, particularly in disadvantaged areas. (Note 4) Investing in farmers and landowners integrates them into the growing climate solutions, ensuring that rural and community areas can better adapt to the rapidly changing climate, thereby supporting resilient rural communities.

The bill provides funding to the United States Department of Agriculture (USDA) for conservation-related programs such as the Environmental Quality Incentives Program and Conservation Stewardship Program. It also allocates funding to the Natural Resources Conservation Service for providing technical assistance and controlling greenhouse gas emissions. In the forestry sector, the bill provides funding to the National Forest System for activities related to forest restoration, wildfire prevention, environmental reviews, and related initiatives.

The bill provides funding to the National Oceanic and Atmospheric Administration (NOAA) for the protection, restoration, and conservation of coastal habitats, marine habitats, and fisheries. This funding supports research in weather and climate forecasting, particularly focusing on the impact on marine species and coastal ecosystems. It promotes technological advancements within the Department of Transportation to reduce aviation emissions and encourage the use of sustainable aviation fuels for emission reduction.

3.2 Energy Security

The IRA also emphasizes energy security as a facet of climate change mitigation. Reducing reliance on foreign oil imports is vital for national stability, especially during international conflicts.

Energy security is a key pillar of the overall objectives of the bill, with specific sections dedicated to energy security and other energy-related provisions. The legislation provides a series of economic incentives to promote clean energy manufacturing and investment, including the creation or extension of production and investment tax credits for renewable resources in areas such as clean electricity, clean fuels, clean transportation, personal clean energy, clean vehicles, and investments in clean energy manufacturing and energy security. These energy resources encompass wind energy, biomass energy, geothermal and solar energy, landfill gas, marine, and hydropower energy.

Additionally, the bill allocates funding to the Department of Energy (DOE) for various programs related to energy rebates, building energy efficiency, power transmission, advanced industrial facilities, and other energy affairs. The bill provides over $60 billion for onshore clean energy manufacturing in the United States. (Note 5) Through this array of incentives, the bill encourages consumers to purchase energy-efficient appliances, clean vehicles, rooftop solar panels, invest in home energy efficiency, and reduce consumer energy costs, thereby enhancing energy security and reducing greenhouse gas emissions.

3.3 Pharmaceutical Prices

The "Inflation Reduction Act" has been described as a historic victory for the 38 million members of the American Association of Retired Persons (AARP). (Note 6) It introduces a negotiation program for drug pricing, enabling the Health Secretary to select and negotiate prices for specific drugs annually.

Negotiations for the first batch of drugs are set to begin in 2023, with the resulting prices becoming effective in the 2026 plan year. Medicare prescription drug benefits must cover 10 drugs. In 2027 and 2028, they must cover 15 drugs, and from 2029 onwards, they must cover 20 drugs each year. It also implements mandatory price caps, tying them to the Non-Federal Average Manufacturer Price (AMP). While providing flexibility for most selected drugs, it imposes penalties on manufacturers who do not comply with the legislative timetable and requirements.

Furthermore, the proposal prohibits judicial and administrative review of drug selection in pricing plans, the determination of prices, and various other core components of the new system, making stakeholders unable to appeal. The bill imposes comprehensive price controls on physician-administered drugs and retail prescription drugs in nearly all markets, requiring manufacturers to limit price increases to the general inflation rate or below.

3.4 Tax Reform

The "Inflation Reduction Act" encompasses various tax reform strategies aimed at addressing fiscal challenges and reducing government deficits. This comprehensive reform is reflected in several key areas.

In the realm of corporate tax reform, the legislation imposes a minimum tax rate of 15% of companies' income. It also introduces a 1% consumption tax on stock buybacks and allocates over $79 billion in mandatory long-term additional appropriations to strengthen tax enforcement and fund various projects.

In the prescription drug pricing reform, if pharmaceutical manufacturers do not comply with negotiation requirements, such as failing to provide the necessary information during negotiations or not reaching an agreement by the specified deadline, the above-mentioned taxes will not apply, and the manufacturer can withdraw their drugs from Medicare and Medicaid programs.

In the field of energy security, the bill expands tax credits for clean energy production and investment, extending some tax credits until 2024, and providing more credits for facilities that meet current wage and apprentice requirements. It also extends tax credits for individual clean energy expenditures, such as extending tax credits for non-commercial (residential) energy property expenditures until 2032. New tax credits are created for clean vehicles and clean electricity production to reduce costs. (Note 7)

On the other hand, the bill permanently restores the financing rate for the Superfund for hazardous substances from domestic crude oil and imported petroleum products in 2023, and permanently increases the coal consumption tax rate. This is achieved by restoring and increasing the tax rates on energy sources that produce hazardous substances, thus providing an incentive for the use of clean energy.

4. Is the Inflation Reduction Act Effective?

Assessing the effectiveness of the IRA requires a comprehensive analysis of its impact on various aspects, including reducing inflation, addressing climate change, enhancing energy security, regulating drug prices, and implementing tax reforms. In this section, we will evaluate the effectiveness of IRA based on relevant reference data and insights from news sources.

4.1 Reducing Inflation

Addressing the ongoing issue of rising inflation in the United States is a significant goal of the IRA. Data from the U.S. Department of Labor on October 12, 2023, indicates an annual inflation rate of 3.7%, a substantial decrease from the 6.5% inflation rate in 2022 (see Figure 1). (Note 8) While data on inflation show a decrease in 2023 compared to 2022 after the implementation of the IRA, it must be acknowledged that there are multiple factors influencing inflation, including Federal Reserve policy and the global economic situation. The IRA contributes to this trend, attributing the entire decrease to it would be an overstatement.

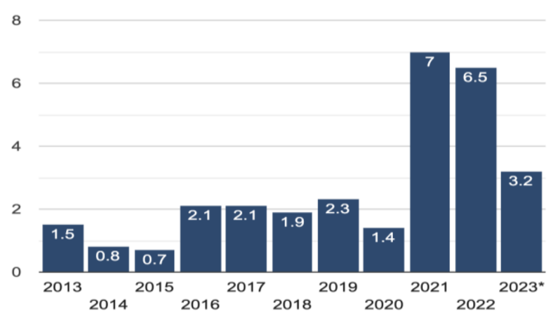

Figure 1. United States Annual Inflation Rates (2013 to 2023)

Source: US Inflation Calculator: Current Inflation Rates.

In analyzing the factors influencing recent inflation trends, economist Gary Burtless points to the IRA's role, highlighting its specific measure of capping insulin costs for Medicare beneficiaries at $35 as a modest contributor to inflation reduction. This aspect, as covered in Jacobson's PolitiFact article, aligns with broader policy impacts attributed to President Biden's administration. (Note 9) Therefore, limiting the cost of insulin is a modest but significant step in controlling inflation.

Grover M. Hermann, a researcher at the Federal Budget Center of the Heritage Foundation, presents a contrasting view, asserting that the IRA could potentially escalate inflation. He argues that the Act's approach of heightened deficit spending and the introduction of new energy taxes, far from curbing inflation, might inadvertently fuel it. Hermann's argument is rooted in the theory that increased government spending, particularly when not balanced by equivalent revenue gains, could escalate national debt, potentially leading to greater inflation.

Additionally, the imposition of new energy taxes could elevate operating costs for businesses, potentially leading to higher consumer prices, offsetting the intended inflation-reducing effects of the IRA. (Note 10) Grover M. Hermann raised valid concerns about the IRA potentially exacerbating inflation. Although increased government spending could heighten inflationary risks, the actual impact will depend on the efficiency in the utilization and management of the funds.

It bears mentioning that the Federal Reserve Bank, America's central bank, has raised interest rates numerous times over the last several years. On March 16th, 2020, it lowered the federal fund target rate to 0-0.25% (see Table 1). Since then, the Fed has raised rates to the point where, as of July 26th, 2023, the target rate, then and as of this writing, stands at 5.25-5.50% (see Table 2). Raising interest rates has a dampening effect on economic activity. Higher rates make it more costly for businesses to borrow and for citizens to acquire mortgages. The effect of these circumstances serves to reduce inflation.

Table 1. FOMC's Target Federal Funds Rate or Range, Change (Basis Points) and level, 2020

Date	Increase	Decrease	Level (%)
March 16	0	100	0-0.25
March 3	0	50	1.00-1.25

Source: Board of Governors of the Federal Reserve System: Open Market Operations.

The adjustments to the federal funds rate in 2023 further underscore the Federal Reserve's response to ongoing economic challenges. The next table provides a comparison of the target rates for 2023, offering insight into the central bank's strategies to stabilize the economy.

Table 2. FOMC's Target Federal Funds Rate or Range, Change (Basis Points) and Level, 2023

Date	Increase	Decrease	Level (%)
July 27	25	0	5.25-5.50
May 4	25	0	5.00-5.25
March 23	25	0	4.75-5.00
February 2	25	0	4.50-4.75

Source: Board of Governors of the Federal Reserve System: Open Market Operations.

In reviewing the IRA's impact on inflation, although certain provisions such as the insulin cost cap show promise, the overall effect remains partially obscured by other economic factors. The conclusion drawn from this section's analysis is that, despite its intentions, the IRA has had a limited impact and has yet to demonstrate a significant and direct influence on the current inflation rate.

4.2 Climate Change

The IRA includes provisions related to mitigating climate change. While climate change initiatives in the IRA primarily aim at environmental sustainability, their indirect influence on economic stability and inflation cannot be ignored. It has been estimated that the clean energy and climate provisions of the IRA have already created over 170,000 clean energy jobs in just the past year, with companies announcing investments of over $110 billion in clean energy manufacturing. (Note 11) The law is providing billions of dollars to protect communities from the impacts of climate change.

In August 2023, the U.S. Department of Energy (DOE) released the latest research affirming the transformative climate progress driven by the IRA and the Bipartisan Infrastructure Law, with expectations that these two laws will reduce U.S. greenhouse gas emissions by 40% from 2005 levels by 2030 (Note 12) (see Figure 2), resulting in a reduction of approximately one billion tons of greenhouse gas emissions by 2030 (Note 13). Furthermore, researchers predict through model-based studies of the IRA provisions that U.S. greenhouse gas emissions will decrease by 43-48% by 2035, below 2005 levels. (Note 14)

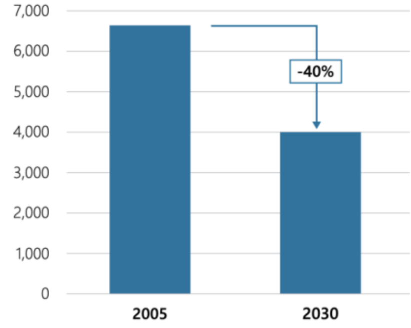

Figure 2. Net Economy-Wide GHG Emissions Over Time (MMT CO2E)

Source: Office of Policy: The Inflation Reduction Act Drives Significant Emissions Reductions and Positions America to Reach Our Climate Goals [PDF].

Additionally, the National Oceanic and Atmospheric Administration (NOAA) announced proposed funding of approximately $562 million, with $477 million dedicated to high-impact natural infrastructure projects totaling 149 projects. (Note 15) Simultaneously, they allocated $575 million to establish resilience in coastal communities to extreme weather and other climate change impacts. (Note 16)

The data above demonstrate that the IRA's relevant provisions for addressing climate change are indeed accelerating progress toward U.S. climate goals. The connection between these climate change initiatives and inflation is more indirect. By investing in clean energy and taking steps to mitigate climate change, the IRA aims to create a more stable and sustainable economy. This stability, in turn, can influence inflation rates. These climate change initiatives contribute to long-term economic and environmental stability, which is crucial for maintaining consistent and predictable inflation rates.

4.3 Energy Security

The focus on energy security in the IRA is pivotal for inflation reduction. By promoting clean and domestic energy sources, the Act aims to decrease reliance on imported energy, which can be subject to price fluctuations and thus contribute to inflation. The IRA expands tax credits for clean energy production and investment, reducing energy costs and decreasing reliance on fossil fuels, contributing to energy security. These incentives encourage the development and adoption of renewable energy sources.

The Department of Energy found that the IRA and the Bipartisan Infrastructure Law are driving new clean electricity generation, making it possible for the United States to reach 80% clean electricity by 2030 and reduce net oil imports by nearly 60%. (Note 17) Just a few years ago, the nation was a net exporter of oil. This enabled the country to bring in foreign currency. Importing oil is contrary to the inflation reduction goal.

Mentioned in the "Annual Energy Outlook for 2023" (AEO2023), government subsidies, including the IRA program, are driving the rise of renewable energy technologies such as solar and wind power. Renewable energy generation capacity is growing in all regions of the United States. Solar generation capacity is expected to grow by approximately 325% to 1019% by 2050 compared to 2022, and wind power generation capacity is expected to grow by approximately 138% to 235%. Renewable energy is replacing fossil fuels in the electricity sector, with coal-fired electricity generation capacity expected to sharply decrease to around 50% of current levels (approximately 200 gigawatts) by 2030. (Note 18)

Furthermore, the U.S. Department of Agriculture (USDA) allocates $9.7 billion for the Empowering Rural America (New ERA) initiative, aimed at assisting rural America in transitioning to clean, affordable, and reliable energy. (Note 19) The Department of Energy has established Energy Savings Hub, offering tax credits and refunds for energy-efficient appliances, electric vehicles, and home renovations, reducing household energy costs. (Note 20)

Tax savings from clean energy production companies are also being passed on to consumers who purchase clean energy. For example, Florida Power & Light (FPL) saved nearly $400 million in tax credits due to the legislation, which is being returned to its 5.8 million customers. (Note 21)

The relevant incentives provided by the IRA have been promptly responded to by the Department of Energy, playing a crucial role in promoting clean energy production and reducing clean energy costs. The IRA's focus on energy security through clean energy incentives is a progressive step. However, its effectiveness in reducing inflation in the short term is limited. The transition to renewable energy is a long-term investment, the inflation-reducing benefits of which may not be felt immediately.

4.4 Pharmaceutical Prices

The IRA's focus on pharmaceutical prices targets inflation control by negotiating drug prices and capping out-of-pocket expenses. This strategy aims to lower the healthcare portion of the Consumer Price Index. Notably, the IRA caps insulin costs at $35 for Medicare beneficiaries, aiding 1.5 million patients and yielding significant savings (see Table 3). (Note 22) Such measures directly lower healthcare-related consumer spending.

Table 3. Excerpt of Estimated Out-of-Pocket Savings If Inflation Reduction Act $35 Out-of-Pocket Insulin Cap Had Been in Effect in 2020, by State

State	Total Number of Enrollees in Part D and B Who Would Experience Savings	Projected IRA Savings ($)	Average Annual Out-of-Pocket Savings Per Enrollee ($)
Alabama	29,127	$12,800,687	$439
Alaska	1,026	$613,867	$598
Arizona	28,124	$14,545,058	$517
Arkansas	15,559	$8,395,598	$540
California	108,164	$36,622,758	$339
Colorado	16,085	$8,288,613	$515
Connecticut	11,444	$6,749,195	$590
Delaware	6,066	$2,707,378	$446
Florida	90,181	$42,920,606	$476
Georgia	45,625	$21,764,218	$477

Source: U.S. Department of Health & Human Services: New HHS Report Finds Major Savings for Americans Who Use Insulin Thanks to President Biden's Inflation Reduction Act.

Source: This table is an excerpt from the full data set on Estimated Out-of-Pocket Savings If Inflation Reduction Act $35 Out-of-Pocket Insulin Cap Had Been In Effect in 2020, by State.

The IRA has acted to reduce out-of-pocket cost for patients in at least two important areas. In 2021, 3.4

million Medicare patients paid $234 million in out-of-pocket costs for vaccines covered by Medicare Part D. Thanks to the IRA, as of January 1, 2023, out-of-pocket costs for vaccines covered by Medicare Part D have been eliminated, saving each beneficiary approximately $70 (see Table 4). (Note 23) In June 2023, the U.S. Department of Health and Human Services (HHS) through the Centers for Medicare & Medicaid Services (CMS) announced a list of 43 prescription drugs for which the IRA has reduced the out-of-pocket costs under Part B. (Note 24)

Table 4. Out-of-Pocket Costs for Medicare Part D Enrollees on Part D Covered Vaccines in 2021, by State

State	Number of Enrollees	Total OOP ($)	Average OOP ($)
Alabama	46,572	$2,608,021	$56.00
Alaska	4,668	$219,176	$46.95
Arizona	69,793	$5,458,900	$78.22
Arkansas	23,029	$1,993,391	$86.56
California	403,144	$20,485,565	$50.81
Colorado	56,425	$4,443,029	$78.74
Connecticut	48,313	$2,953,012	$61.12
Delaware	12,224	$934,702	$76.46
District of Columbia	5,038	$164,954	$32.74
Florida	227,344	$17,871,526	$78.61

Source: ASPE analysis of the CMS 2021 Medicare Prescription Drug Event (PDE) and Medicare enrollment data files.

Note. This table is an excerpt from the full data set on Out-of-Pocket Costs for Medicare Part D Enrollees on Part D Covered Vaccines in 2021, by State

In August 2023, due to the new power granted by the IRA for Medicare to negotiate prescription drug prices, HHS announced the selection of ten drugs covered by Medicare Part D for the first round of negotiations, with participation from ten pharmaceutical companies. (Note 25) Negotiated prices will take effect starting in 2026.

The IRA will also have a significant impact on the pharmaceutical industry. On the one hand, pharmaceutical companies are compelled to operate within the confines of price limits, which may result in profit reduction. Reduced profits may prompt companies to seek cost-cutting measures, leading to a decrease in research and development funding. This could raise concerns within the industry about the sustainability of their revenue models under these new regulations.

On the other hand, the improved affordability and accessibility of medications for consumers may lead to increased sales, partially offsetting the impact on profit margins. On the consumer side, the anticipated cost savings on prescription drugs, especially for Medicare beneficiaries, could be substantial, suggesting that consumer interests may outweigh the financial challenges faced by pharmaceutical companies. (Note 25) It is evident that striking a balance between consumer interests and the financial health of pharmaceutical companies remains a complex interplay.

The reduction in drug prices can indirectly impact the Consumer Price Index (CPI), which is a primary measure of inflation, as healthcare costs are a significant component of the CPI. The IRA's impact on healthcare costs, particularly pharmaceutical prices, is evident and is an effective step in controlling inflation. The impact of the IRA on drug prices may not immediately reflect in the broader inflation trends. However, over time, a reduction in healthcare costs can lower inflation rates by decreasing a substantial portion of consumer expenses.

4.5 Tax Reform

The tax reforms in the IRA are designed to have a multifaceted impact on inflation. By implementing a minimum corporate tax and excise tax on stock buybacks, the Act aims to generate revenue and reduce the deficit, which can exert downward pressure on inflation.

The tax reforms introduced by the IRA, including a minimum 15% tax on corporate profits, a 1% excise tax on stock buybacks, and clean energy tax credits, aim to stimulate economic growth while addressing fiscal challenges. In January 2023, the U.S. Internal Revenue Service (IRS) announced its intention to issue proposed regulations to address the application of the Corporate Alternative Minimum Tax (CAMT) added to the tax code by the IRA in 2022. (Note 26) These tax provisions will take effect this year.

The IRS, benefiting from the resources provided by the IRA, has significantly improved its service during the 2023 tax filing season, achieving a service level of 87% and ensuring that high-income taxpayers pay what they owe. In the months following the enactment of the IRA legislation, the IRS recovered $380 million. (Note 27)

Furthermore, through the IRA's provisions, residents of various U.S. states have seen an increase in tax credits for clean energy. For example, the total cost of purchasing and installing heat pumps can qualify for federal tax credits of up to 30%. (Note 28) In the case of clean vehicles, the IRA of 2022 changed the tax credit rules for vehicles purchased between 2023 and 2032. Purchasing a qualifying electric vehicle (EV) in 2023 or later can qualify for a tax credit of up to $7,500 (Note 29), while used EVs can receive a maximum tax credit of $4,000 (Note 30). As businesses and individuals adapt to these new tax incentives, their impact on the economy will become more evident over time.

In summary, the IRA's implementation of a minimum tax rate for corporations is strategically designed to ensure a more equitable contribution to government revenues. This approach is pivotal in managing the national deficit, a crucial factor in inflation control. Notably, high deficits are often associated with increased inflation, implying that reducing the deficit could help in mitigating inflationary pressures. Additionally, the IRA directly tackles a key inflation component – pharmaceutical prices – by curbing excessive drug price hikes, which is particularly relevant when government expenditure outstrips tax revenue. The tax reforms encapsulated in the IRA are geared towards fostering long-term fiscal stability. By advocating for a more equitable tax system and reining in major economic cost drivers, the Act lays the groundwork for a stable economic environment, thereby facilitating more effective inflation management.

5. Summary/Conclusion

The IRA represents a major legislative effort aimed at addressing several key economic challenges in the United States. It addresses issues related to reducing inflation, climate change, energy security, pharmaceutical prices, and tax reform. The main objective of this paper is to understand the content of the IRA, and to analyze and evaluate its effectiveness. Assessing the IRA requires a multi-faceted approach and needs to be re-evaluated periodically. Reference data and news reports used in this paper indicate positive trends in areas such as climate change, energy security, drug prices, and tax reform, suggesting that the IRA has a supportive and indirect impact on reducing inflation. The direct influence of the IRA on the current inflation rate may take some time to become evident, as its effectiveness in inflation is part of a larger and more complex economic picture.

Suggestions for Future Research

Going forward, there are several issues that bear further examination. These issues are listed below.

1) Long-Term Inflation Impact: Future research should focus on analyzing the extended impact of IRA on inflation trends beyond 2023 to determine whether its provisions will have had a critical effect on reducing inflation.

2) Climate Policy Evaluation: Further studies can assess the specific outcomes of the IRA's climate-related provisions, including tracking greenhouse gas emissions reduction and clean energy job creation to gauge the legislation's contribution to clean climate goals.

3) Energy Security Metrics: Research could explore the metrics and indicators for measuring energy security in comparison to the IRA's clean energy incentives. These two ambitious goals may be at odds with one another and will require monitoring.

4) Pharmaceutical Negotiations: Ongoing research should closely monitor the pharmaceutical price negotiations under IRA and evaluate their outcomes, as well as the compliance of drug manufacturers, to assess the legislation's effectiveness in controlling healthcare costs.

5) Tax Incentive Impact: Future studies can delve into the economic impact of IRA's tax incentives, examining how they influence business decisions, economic growth, and clean energy adoption.

These research suggestions will contribute to an ongoing and comprehensive assessment of the IRA's effectiveness, and its long-term implications on the U.S. economy.

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