CLIMATEWIRE

APPROPRIATIONS & 6 OTHERS

Don't let inflation 'hijack' climate bill, economists warn

BY: **AVERY ELLFELDT** | 12/22/2021 06:57 AM EST

Luis Sanabria puts plywood over the windows of a New Orleans business in anticipation of 2020's Hurricane Sally. A growing number of financial analysts say that a failure by the U.S. government to prepare for climate change would add additional risk and cost to the private sector. | Joe Raedle/Getty Images

CLIMATEWIRE | Sen. Joe Manchin cited inflation and other economic concerns as reasons to oppose President Biden's signature climate bill, but several experts argued that its potential failure poses more serious economic threats.

One of their key points is that the derailment of the $1.7 trillion "Build Back Better Act" means the United States won't see an infusion of public dollars that could have boosted the economy amid a tumultuous recovery from the Covid-19 pandemic.

That concern was the main reason Goldman Sachs on Sunday lowered its gross domestic product growth forecast for the United States.

Another worry is the implications for social and environmental issues with major economic consequences — including climate change. Absent sweeping federal investments to confront global warming, rising temperatures in the coming decades are expected to wreak economic havoc.

"It is pretty clear that the sort of investments that are necessary to cut CO2 emissions, to do all of the other things of course that are part of Build Back Better ... are in fact good for economic growth," said climate economist Gernot Wagner, a clinical associate professor at New York University.

"Of course it costs money," Wagner added. "But it costs much, much less than unmitigated climate change."

Manchin sent shock waves through Washington on Sunday when he said he was a no on Biden's "Build Back Better" bill. His reasoning was that the package would render the United States more vulnerable to threats such as inflation — which climbed 6.8 percent in November over the previous year, the largest 12-month increase since 1982.

Manchin said he isn't willing to take that risk given the "staggering debt of more than $29 trillion and inflation taxes that are real and harmful to every hardworking American at the gasoline pumps, grocery stores and utility bills with no end in sight."

Several groups and experts agree that elements of Manchin's concerns have credibility. According to the nonpartisan Committee for a Responsible Federal Budget, the legislation could spur a "small and temporary" increase in inflation driven by a front-loaded influx of cash into the economy.

Clifford Rossi, a former chief risk officer at Citigroup Inc., echoed that point and voiced concern that the massive spending bill would expand the federal deficit.

Rossi said that scenario could happen because elements of the package have "very short timelines" that would require periodic renewal. "If you start to bake in that this is [happening] over a 10-year period of time, that price tag then starts to balloon," he said.

Rossi acknowledged that there are critical and positive pieces of "Build Back Better" — especially as it relates to climate change. But as an economist, he said it's important to consider inflationary pressure and the "long-term impact that this has from a budget standpoint or debt standpoint."

Other economists agreed that the legislation faces several challenges, including inflation. But many of them also argued that an increase in consumer prices would be minimal —

and shouldn't be used to stifle a historic package meant to address a swath of major economic issues.

Daniel McFadden, a Nobel laureate and an economist at the University of California, Berkeley, is in that camp. He said the bill's social and economic benefits outweigh the risks. And he warned against letting "the short-run problems of finance and inflation" prevent major federal investments that would have significant benefits.

According to Goldman Sachs, those would include boosting U.S. economic growth in the near term. On the same day that Manchin thwarted Biden's climate plan, the firm dimmed its economic outlook in a note to clients. It said the failure to pass "Build Back Better" would have "negative growth implications."

The firm predicted that the nation's GDP would grow by 2 percent in the first quarter of next year — down from 3 percent predicted previously — as a result of the likely expiration of the child tax credit and lack of other new spending.

Wagner, of NYU, emphasized that GDP is a measure of economic activity, not a "perfect measure of overall welfare."

But he added that Goldman's assessment is a "very deadpan analysis of what are the financial implications of 'Build Back Better.' And yes, one implication would have been to raise GDP by quite a bit."

Inflation risk vs. long-term benefits

The potential economic ramifications of Manchin's announcement don't stop there.

McFadden, of the University of California, is among those who said the bill's investments in social and environmental initiatives would positively impact the economy long term.

"From the standpoint of the future of the economy," he said, "the [provisions] that concern childhood education and the ones that concern climate are the ones that will have the biggest future economic payoff."

The importance of accelerating the clean energy transition, preparing the next generation to enter the workforce and more is "highly desirable for the country, even if some 'inflation tax' is part of their funding," McFadden added. He thinks that should be reason enough for lawmakers to sit down and hammer out a "responsible way to pay for it."

That could entail, for example, passing the bill — but first specifying that the spending won't begin until certain benchmarks related to consumer prices or unemployment are met.

Biden made a similar argument yesterday. He acknowledged during a press briefing that inflation is a "devastating thing for working-class and middle-class folks; it really hurts."

But he said "Build Back Better" aims to address those costs directly. "All the things in that bill are going to reduce prices and costs for middle-class and working-class people," he said.

Michael Klein, a professor of international economic affairs at Tufts University, agreed that "Build Back Better" has the potential to address issues including poor child care and health outcomes, which he said are uniquely severe in the United States when compared to other wealthy nations.

But he warned against letting Manchin, the White House or anyone else “hijack” the debate by focusing narrowly on the legislation's implications for inflation — rather than for the economy and the nation more broadly.

“That argument treats inflation as the most important thing above everything else,” Klein said.

That thinking would be appropriate if the bill were likely to expand the deficit by a large margin or send consumer prices soaring. But Klein said he doesn’t think that's a realistic outcome — and that the potential benefits for children and the environment are too important to lose sight of.

On climate specifically, Robert Litterman, a founding partner of Kepos Capital and former head of risk management at Goldman Sachs, said that while he’s disappointed in Manchin’s announcement, he remains optimistic that Congress will find a way to pass comprehensive climate policy.

In his view, its success is critical because the transition away from fossil fuel-based energy — as well as the financial sector's growing focus on facilitating that shift — will depend on clear financial incentives that steer capital in a greener direction.

“If it turns out to be much worse than that, and there's actually going to be a serious delay [in policy], then that's going to be bad news, because then this flow of capital is going to look like it won't be rewarded," Litterman said. "And valuations will reflect that.”

“That's not what I'm predicting," Litterman added. "I’m just saying that's a risk that’s out there.”

YOUR ACCOUNT MANAGEMENT TEAM

Grant Moore-Sargent
Pro Business Development Associate
gmoore-sargent@politico.com