



**Expensing =  $MC^2$  = Economic Growth<sup>2</sup>**

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It does not take an Einstein to figure out that high oil prices are not going away anytime soon - even if the enviro and NIMBY lobbies finally wake up to reality. The best solution to high oil prices is an economy strong and productive enough to "outgrow" them in the short term. In the long term, the economy must also pay for bringing on line new petroleum supplies as well as new higher-cost "green" technologies. And it needs to do all this while providing higher disposable incomes even after taking into account \$3 gasoline.

Right now, the economy is still drawing extra power from the Bush tax cuts on capital in 2003. But those tax cuts were modest relative to the high double taxes on capital investment that continue to exist. And even though the economy grew at a remarkable 4.8 percent rate in the first quarter of this year, it is not clear how much longer it can keep up the pace.

The recipe for high GDP growth in the future is the same as it was in 2003-04, when the combination of lower tax rates and "bonus depreciation" caused a spurt in investment that helped lead the economy out of recession and toward its current strong standing. With the economy needing to pay for both high-cost energy and expensive entitlement programs already promised to the baby-boomer and other generations, the time has come to completely remove the destructive double taxes on business machinery and equipment.

Standard neoclassical econometric models confirm what common sense and experience suggest: Replacing old-fashioned tax depreciation with immediate first-year expensing would add more than \$200 billion to GDP, boost wage incomes, and add upwards of 750,000 jobs. Because the static revenue cost of first-year expensing quickly phases out after four years, it is also in the long term the cheapest, most bang-for-the-buck, and most growth-oriented tax change the Congress could make. When you use dynamic scoring that takes into account induced economic growth, first-year expensing costs nothing.

Expensing is also a high-performance tax reform of vital national importance from an energy-specific perspective. It would decrease capital costs in petroleum exploration by 2.3 percent and in the vital petroleum refining sector by 4.4 percent, and could be used in the oil and natural-gas transmission industry to reduce capital costs by 6.7 percent. In electric-utility production and transmission, the reduction in capital costs would be in the area of 9.3 percent. It also would be important to "green" technology where first-year expensing, in combination with other factors not of a purely financial nature, can often tip the balance.

Newer and energy-efficient technologies, products, and processes have higher initial costs than out-dated, less-efficient versions, especially when they are first introduced to the market. Examples include combined heat and power (CHP) systems, vehicle efficiency technologies such as fuel cells, advanced energy engines, electronic drive-train technologies, and sophisticated electricity-use sensors and climate controls for manufacturing factories and buildings. By reducing the cost of investment, first-year expensing would provide a strong incentive for manufacturers and farmers to use newer, higher-cost technologies and equipment instead of relying on readily available products.

The best and quickest way to promote high growth and better living standards is to accelerate investment in new and efficient capital stock. Even if there were no energy crisis, Congress would still be justified in immediately enacting first-year expensing. After all, it is their duty to help the economy grow and make the American people better off - and expensing will clearly do just that.

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