The Effect of U.S. Climate Policy on Financial Markets: An Event Study on the Inflation Reduction Act by Bauer Offner and Rudebusch

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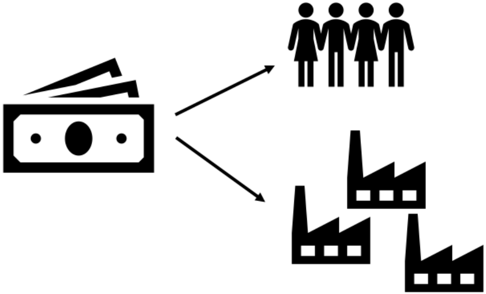
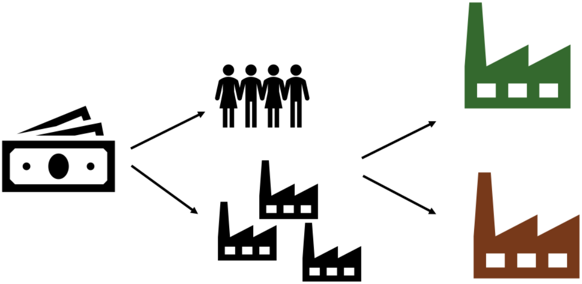
Overview

- **Research Question**: How did financial markets respond to the Inflation Reduction Act?
- **Use of event-studies methods to study transition risk**:
  1. Stock market response to the IRA across firms and industries
  2. Relationship between measures of firm's greenness and heterogeneity in stock market response
- **Results**:
  - Clean energy indices had negative abnormal returns following the brown event and then rebounded after the green event
  - Results consistent with clean vs. brown industries / using different measures of firm's greenness
  - **Mechanism**: Increased demand and reduced costs (via subsidies and tax credits)
    - News about IRA impacted expected future dividends and stock prices

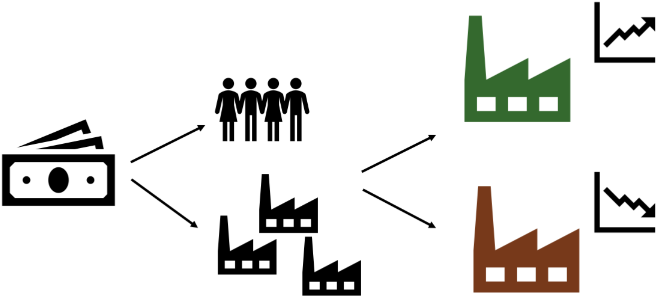
Setting (1)



Setting (2)



Setting (3)



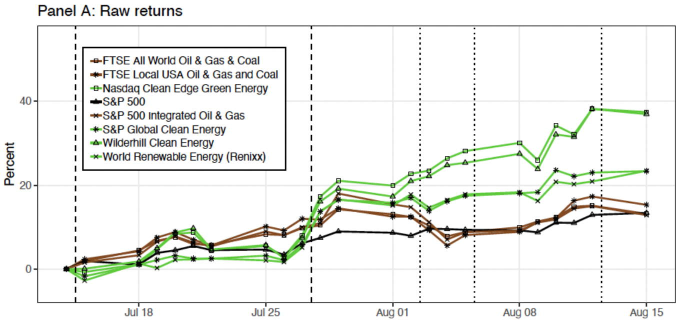
Comment 1: Conceptual Framework

$$V_E = f(Earnings; \mathbf{Dividends}; DiscountRate) \quad (1)$$

- Main hypothesis: $\uparrow$ carbon price paths $\rightarrow \uparrow$ profits for green firms (and higher expected dividends)
- Short- vs. long-term effects of the IRA on financial markets.
  - Green vs. brown defined ex-ante: while fine for the (short-term) event study, firms and industry will adapt through time
  - To what extent financial markets' response to the the passing of IRA maps into medium- and long-term effects?
  - Including measures of climate responsibility (as in Ramelli et al., 2021) beside greenness.

Comment 2: Event Study

Figure 1: Performance of green and brown indices after climate policy events



- Showing pre-trends for the July 14 event (may explain why some of the results are less clear-cut?)
- Something going on already before the July 27 event?

Comment 3: Transition Risk

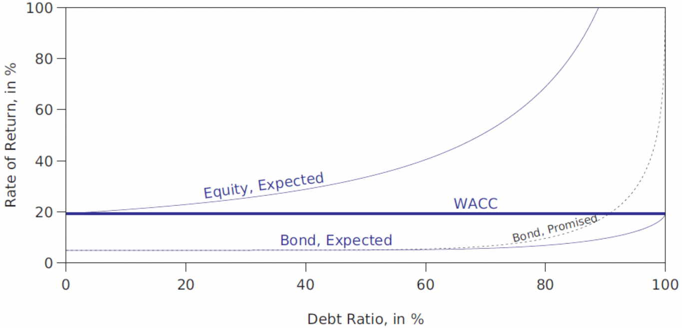
- Key to assess transition risk is the extent of stranded assets that in turn will influence financial solvency
- Lack of dramatic repricing interpreted as lack of increased transition risk
  - While true, how about in the longer run (especially given that IRA came into effect in early 2023)?
- Among others, use of industry-level greenness indicators to measure transition risk exposure.
- Measures of green patents or broadly investments/innovations in green technologies (thinking of Degryse et al., 2022)?
- Minor on Table 5: Potential issue of power given there are only 17 industries?

Comment 4: Specifics of the Inflation Reduction Act

- Very comprehensive reform containing both supply- and demand-side subsidies that favor green transition
- As of now, the paper is agnostic about which specific measures drive results
- Perhaps helpful to try to isolate some industry-specific reform packages to estimate stock market reactions to specific aspects of IRA?

Comment 5: The role of debt

- The analysis focuses on stock market reaction; yet stock returns and price also depend on reliance on debt financing



- Use of Market Leverage (EBIT divided by interest expenses) as control. Perhaps also financial leverage and related measures?

To sum up...

- Very interesting paper on how financial markets responded to the IRA
- Maybe a bit more work to rule out any potential confounding factors
- Would also be interesting to say more about the distributional effects of IRA
- It created value for shareholders... but *who* did ultimately benefit from increased returns?