CLEAN CAPITALIST
LEADERSHIP COUNCIL
Turning Capitalism Into Clean Capitalism

Policy Brief 3: Tax-Exempt Clean Asset Bonds & Loans (CABLs):

Ideal CTC mechanism for expanding clean capital markets, accelerating deployment of profitable low/no pollution property, plant & equipment at scale: Of all Clean Tax Cut mechanisms developed to date, federally tax-exempt private debt would offer the most powerful, cost-effective, broad-based mechanism to accelerate deployment of profitable, scaleable clean infrastructure. Where conventional tax credits and muni bonds constrict markets, CABLs incent all kinds of investors, large and small, and many kinds of clean solutions, across far bigger capital markets, with greater benefits, that any other green incentive.

Clean Asset Bonds & Loans apply policy leverage (a clean tax cut) to financial leverage (private debt). Specifically, these would be tax-exempt private debt securities (green bonds and loans) designed to finance pre-qualified pollution-reducing assets with guaranteed impact (e.g., a zero emission power source or a plastic recycling plant, for instance). This unique design guarantees green impact and public benefit – without complicating easy, low-cost debt issuance. CABs are also the only tax-exempt bonds optimized to attract investors across the entire $19 trillion US private bond market – the market that actually finances the most commercial scale infrastructure, being 950 times larger than the average state bond market. That private market placement also makes Clean Asset Bonds unique, different from all existing tax-exempt bonds – uniformly government bonds: on the other side of such debt is government – so no leverage effect. But CABLs are private bonds and loans: on the other side of that debt is equity. That, we can leverage, with powerful impacts.

Clean Asset Bonds & Loans *magnify* leverage effects, to attract both debt and equity investors. Financial leverage (cheap debt driving down cost of capital) is widely used to *leverage up* profits and return on equity. Tax-exemption on private debt drives down interest rates even further, reducing cost of capital and cost for clean energy and products by between 15% to 25%, while leveraging up growth rates, GDP and return on equity. That means, not only do CABLs drive both supply and demand, they also incent not just tax exempt debt investment (nationally, not just in one state), <u>but also attract ALL equity investors – large and small, US and global, taxable and non-taxable – to invest in the leveraged up equity returns.</u> One incentive attracts both debt and equity investment, the latter taxable(!).

Clean Asset Bonds & Loans expand markets cost effectively: CABL leverage effects greatly expand the universe of potential clean investors, and do so more cost effectively than other incentives. US return on debt averages 4%, compared to average US return on equity of 13.6%. CABLs give up tax revenue where the revenue is low, but attract investment to the equity, where the returns and tax revenue are high. If we assume a CABL project capital stack is 50% CABs, 50% equity, with average returns, then equity-side tax revenues will be 340% higher than debt-side tax expense for the project.

For clean energy projects, CABLs will generate NEW tax revenue, to the extent CABLs displace fossil fuel extraction projects. Extraction is subsidized by use of Master Limited Partnerships (MLPs) which pay no taxes on business income. Clean energy generation will pay business taxes, which, together with gains taxes, will raise federal and state tax revenues by more than the CABL tax expense.[1]

CABLs are cheaper that tax credits or municipal bonds, in terms of tax expense as a percentage of total investment. In the above 50/50 debt/equity scenario, tax expense would be roughly 12% of total investment, incurred over time. Municipal bond tax expense is roughly 30% of total investment, assuming 100% debt finance. Federal tax expense for the solar Investment Tax Credit historically also runs at 30% of total investment, but is incurred immediately, so is even more expensive than muni bonds, considering present value.

To the extent CABLs displace use of existing conventional subsidies like MLPs, tax credits or municipal bonds, federal tax expense will shrink and tax revenues will rise.

CABLs offer ideal instruments for expanding big clean free markets. CABLs would create large markets characterized by low taxes and low barriers to clean capital flows and popular participation in clean free enterprise. That is why CABLs form the core of a model policy proposal called the Clean Free Market Act. This exists in two forms: a federal proposal, and an international proposal. The key difference being that the international proposal makes that clean free market as big as possible via plug-and-play legislation any state or nation can adopt. It allows tax reciprocity for CABLs between cooperating countries: citizens of any such country can invest in CABL financed clean enterprise projects in other countries on a tax-exempt basis. It is hard to imagine a more powerful mechanism to unlock the trillions of dollars of international capital flows needed to finance sustainable development and low pollution infrastructure.

Politically, CABLs offer an incentive, not just for clean solutions, but for freedom itself. CABLs attract voters and politicians toward policies that expand, not shrink, freedom. Internationally, this will be even more pronounced, especially if basic economic freedoms and rule of law are a condition of participation in the Clean Free Market Act. Less-free or corrupt countries will allow greater economic freedoms in order to qualify to participate in the huge international capital flows unlocked by CABLs. This aspect of the proposal however, will need further refinement by collaborative working groups of policy scholars with expertise in free market principles and local conditions. Think tanks interested in participating in or leading such policy development work are invited to contact the Grace Richardson Fund.

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[1] For any viable energy project, business income will logically be more than interest expense, so any taxes on such business income will be more than the federal tax expense of tax exemption on the interest.