

Trumponomics and Taxation

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Key Points

- At the end of 2017 President Trump signed into law the Tax Cuts and Jobs Act which Republican supporters argue would transform the US economy and stimulate an enduring increase in the rate of economic growth.
- The motivation behind the legislation appears to be the belief that a reduction in corporate taxation will release a flood of entrepreneurial initiative that will increase investment and, as a consequence, lead to higher wages and sustained faster economic growth.
- The Reagan administration tried tax cuts before to stimulate growth; not in a conventional neo-Keynesian way aimed at raising aggregate demand, but as a means of strengthening the supply side of the economy.
- As an economic philosophy, Trumponomics is a rather high-risk strategy. Compared to the early 1980s there is a smaller output gap, a much higher level of national debt and less fiscal space.

Introduction

Donald Trump was elected President of the United States in 2016 by espousing and marketing a broad populist agenda. This exploited the dissatisfaction that existed, particularly in the mid-western and southern states of the USA, with aspects of contemporary economic performance. Many voters believed that the economic recovery that had occurred in other parts of the country following the global economic and financial crisis in 2008/09 had passed them by. Jobs were scarce and unfulfilling, and wages were stagnant. Infrastructure was failing. There was little prospect of things improving. Perhaps as a consequence of this, the Washington-based political system was seen as elitist, self-serving and unresponsive to their needs. Although heavy on slogans, such as ‘Make America Great Again’ and ‘Drain

the Swamp’, and light on specifics, Trump’s rallying calls hit a nerve and generated a response that carried him to electoral victory.

In so far as the Trump campaign articulated a portfolio of policies designed to achieve the ambitions that lay behind the slogans, it was essentially anti-globalization in nature. Trump’s message was one of economic and political nationalism. Migration was to be much more tightly controlled. Its focal point was to ‘build a wall’ between the southern border of the USA and Mexico. Trade deals were to be renegotiated (North American Free Trade Agreement, NAFTA) or abandoned altogether (the Trans-Pacific Partnership).

Many of the anti-globalization aspects of the Trumpian prospectus, and certainly the rhetoric that was adopted, sat uneasily with conventional Republican thinking. The apparent hostility towards unrestrained international trade more closely aligned with the views of Democratic contender, Senator Bernie Sanders, than the leaders of the Republican Party. But in other ways Trump’s economic policy preferences gelled better with long-standing Republican ideas; in particular the opposition to big government. In principle, reducing the size of government involvement in an economy embraces cuts in both taxation and government expenditure, combined with a reallocation of government expenditure away from entitlements, as well as a reduction in regulation. Having initially encountered strong Congressional resistance to dumping the Affordable Care Act (Obamacare), and thereby reducing expenditure on health care, the new administration set its sights on rewriting the US tax codes.

While it is difficult to define in detail the specifics of Trumponomics, or to present it as an internally consistent economic philosophy and strategy, it is possible to assess the tax bill that the President signed on December 22 2017 and which takes effect from January 1 2018. This article attempts to provide just such an assessment of the Tax Cuts and Jobs Act (TCJA).

At the outset it is intriguing to see the tax bill in the context of the continuing evolution of fiscal policy in the aftermath of the 2008/09 global economic and financial crisis.¹ After a short period of time when there

¹ Graham Bird (2016), Fiscal policy and the global economic crisis. *World Economics* 17, 1 summarises the evolution of fiscal policy in the aftermath of the global economic and financial crisis. The article contains a fairly

appeared to be a broad global consensus around the need for fiscal stimulation to encourage economic recovery, attention shifted to fiscal consolidation and even fiscal austerity.² Within the economics profession, neo-Keynesians and left-leaning politicians argued that fiscal stimulation should not be reversed until the recovery was better established. It was the new classical macroeconomists and right-leaning politicians who argued for fiscal retrenchment. Where does the TCJA fit into this story and why has it been proposed and supported by those who were previously fiscal conservatives?

The article is organized in the following way. The second section provides a brief summary of the key elements of the tax bill. It also describes the motivation for change as explained by its Republican advocates. The Congressional debate about the bill was entirely partisan. No Democratic congressman/congresswoman or senator voted for it. Clearly they found the arguments used in its favour unpersuasive. The third section therefore assesses the underlying issues associated with the bill. It examines the way in which the changes in taxation that are incorporated in the bill may affect important economic variables including economic growth, unemployment, inflation, the fiscal deficit, debt, the balance of payments, wages, income distribution and the exchange rate. The section also considers how the provisions in the bill may influence the probability of there being another economic crisis in the USA and the form that this could take, as well as offering a brief comparison between the tax cuts in the 2017 bill, previous tax cuts implemented by the Reagan administration in 1981 and 1986, and the Bush tax cuts of 2001 and 2003. It reveals significant differences. The fourth section speculates on the political aspects of the tax bill. If many of the economic arguments for tax cuts are unconvincing and uncertain, can the motivation be better explained from a political point of view? The final section offers a few concluding remarks.

comprehensive list of references that are not repeated here. It also contains information relating to the empirical effects of fiscal policy.

² In the USA it should be noted, however, that there were partisan divisions concerning fiscal stimulation. The Republican Party was strongly opposed to the American Recovery and Reinvestment Act of 2009. In the US Senate only three Republicans voted for it and in the House of Representatives no Republicans voted for it.

The Tax Cuts and Jobs Act (TCJA): A Brief Summary

The tax bill approved by both houses of Congress and signed by President Trump at the end of December incorporates a number of changes to previous legislation. Although the new act has many components, its main impact will be to reduce tax rates on individuals and companies, but also to remove some of the exemptions and credits for which they were previously eligible. It reduces marginal tax rates for individual taxpayers across the board with the highest marginal rate being reduced from 39.6% to 37%. Moreover, whereas the highest rate applied to incomes of more than \$418,401 for single people, under the new law it will start for those with incomes above \$600,000. The bill nearly doubles standard deductions and personal exemptions, from just over \$6,000 to \$12,000. However, while the tax cuts for individuals will begin in 2018, they will expire after 2025. Meanwhile the new law permanently reduces the corporate tax rate from 35% to 21%. Other corporate measures relate to deducting the cost of equipment, repatriating income held abroad, and so-called ‘pass through deductions’. All of these measures are aimed at reducing the rate of tax paid by companies. The bill also reduces estate tax, by doubling the threshold at which the tax applies, to more than \$10 million.

Alongside the tax cuts, the permissible deductions that individuals can make from their federal taxation to cover state and local taxes, mortgage interest and some medical expenses have been reduced. On top of this, the speed with which adjustments can be made to allow for inflation has been reduced by switching to using the ‘chained CPI’ to measure inflation.

The justification made by the advocates of the tax changes draws on familiar territory. Part of it relates to efficiency. This claims that it is more efficient to have lower taxes and fewer exemptions than higher taxes and more exemptions. This is the least contentious part of the justification. Democrats have also argued that the US tax system needed to be made more efficient and less complex. The unproductive time spent on filling out tax forms should therefore be reduced.

Much more contentious is the other part of the justification that has been made by supporters of the bill. It claims that excessively high marginal tax rates stifle entrepreneurship, innovation and investment and that this in turn

leads to low rates of productivity growth and economic growth. By changing the structure of incentives and reducing marginal tax rates the argument is that economic growth will accelerate significantly and that this will then benefit all sections of the economy and society. It is also claimed that the increase in tax revenue that is associated with accelerated economic growth will offset any adverse effect on the fiscal balance. This is hardly a new idea. In many ways it represents a reincarnation of the so-called Laffer curve, a concept that received considerable notoriety in the early 1980s, stressing the potentially negative effect of high marginal tax rates on incentives. However, when the idea was adopted by then presidential candidate, Ronald Reagan, his Republican competitor George H. W. Bush referred to it as ‘voodoo economics’, implying that it was a fabrication based on magic rather than sound and objective analysis. The question then is whether Trumponomics, as represented by the TCJA, represents a return to voodoo economics.

In addition to the tax cuts, the TCJA also has important, yet surprisingly relatively little discussed, implications for the future of Obamacare, since it removes the tax penalty that would previously have been incurred by not having medical insurance; the so-called individual mandate. This will have the effect of reducing the amount that the federal government spends on insurance subsidies and on Medicaid. It is likely that fewer people who might qualify for subsidies will enrol in the exchanges and that people who would have been eligible for Medicaid may now opt not to enrol. To many observers this means killing off Obamacare by the back door, since the viability of medical insurance schemes relies on relatively healthy people cross-subsidizing the relatively unhealthy, in much the same way as safe drivers are mandated to purchase automobile insurance and thereby keep premiums down for the unsafe ones.

The TCJA and Basic Economics

A fundamental challenge with any aspect of macroeconomics is that everything tends to influence everything else in some way. With regards to tax cuts it is therefore a matter of identifying the main routes through which they may exert an impact, and then quantifying the likely size of these

impacts. This is not easy since there are various ideas and theories about how tax cuts work and influence decision makers. Moreover, it is unlikely that a change in taxation is the only thing that is going on, and this makes it difficult to identify causality.

Another part of the problem is that not all impacts will work in the same direction. There can therefore be disagreement about both the size and the direction of the impacts. It is this theoretical and empirical ambiguity that allows politicians to adopt what appear to be fairly diametrically opposed positions on tax cuts. As noted above, this has certainly been a feature of the debate surrounding the TCJA, which has followed strict, partisan political lines.

In what follows we examine what basic economic theory has to say about the likely effects of the tax cuts embedded in the TCJA, both on aggregate demand and on aggregate supply. This allows us to assess the impact of the Act on conventional macroeconomic performance indicators such as economic growth, unemployment, inflation and the balance of payments. We then move on to examine some of the other key issues associated with the TCJA that may have been overlooked or underemphasized in the preceding analysis.

The TCJA and aggregate demand

Aggregate demand comprises consumption, investment, government expenditure and net demand from abroad. Consumption is conventionally viewed as being positively related to disposable income. Since tax cuts increase disposable income they might be expected to increase domestic household consumption; although the question remains by how much? This depends on the value of the marginal propensity to consume. If it is less than one, then it follows that a proportion of the tax cuts will be saved and this will reduce their overall effect on aggregate demand. In analyzing the consumption function, however, the permanent income hypothesis claims that consumption will only increase where tax cuts are seen as being permanent. If it is believed that a subsequent administration will reverse policy and raise taxes, or if, as is the case with the individual tax cuts incorporated in the TCJA, the cuts are scheduled to be removed at some later

date, it may be that a substantial part of the additional disposable income associated with the cuts will be saved, and this will minimize their impact on near-term aggregate demand.

A more permanent component of disposable income comes from wages. Supporters of the TCJA argue that corporate tax cuts will increase wages. The argument is based on two assumptions. The first is that reduced corporate taxation will encourage investment, that, in turn, this will increase labour productivity, and that this will then raise the marginal revenue product of labour and hence wages. The second is that with economic expansion the labour market will tighten and that, with an increasingly inelastic supply curve of labour, wages will rise. This, so it is argued, will further stimulate economic growth by increasing consumption.

Critics of the TCJA argue that these assumptions are unrealistic and that wages are unlikely to be much affected. They are not sanguine about the effects of the Act on investment and are similarly unconvinced that it will have a positive impact on productivity growth; a phenomenon that is not well understood by economists.³ Indeed, an increase in labour productivity could reflect a situation where less labour is required to produce any given level of output. This would not be good news for wages. Should there be an increase in the demand for labour, and should wages begin to rise, this will simply encourage greater substitution of machines for workers, particularly in the case of relatively low-skilled workers. Furthermore, technical progress that is embodied in new machinery will also moderate the demand for labour. The argument goes on to point out that it has not been low corporate profits in the USA that have held back the growth of wages.

Instead, critics of the TCJA argue that an increase in corporate profits will lead to higher executive compensation, with this resulting in greater income inequality and a further asset market boom that may then increase the probability of a stock market crash as the stock market value of companies

³ Part of the reason critics are not sanguine relates to the empirical evidence following previous experience with tax cuts. For example the investment rate in the USA in 1981 prior to the first round of Reagan tax cuts was 24%. By the end of the decade it had fallen to about 22%. In a similar way the Bush tax cuts of the early 2000s did not seem to have much sustained impact on the investment rate. Much the same may be said for wages, where neither set of tax cuts seemed to modify the established trends in the path of wages.

rises above their value based on economic fundamentals. The crash would represent a discrete and dramatic market correction.

As far as investment is concerned, the impact of tax cuts depends on the specification of the investment function. Upon what does corporate investment depend? It is reasonable to assume that in a market economy it will depend on expected profitability. Tax cuts may not only increase post-tax profits, but, by so doing, also provide finance for investment since a part of the extra profit is ploughed back into investment. On top of this, the rate of return needed to justify investment may be lower when it is financed by retained profits rather than by new borrowing. These arguments suggest that investment will tend to increase in tandem with the reduction in corporate taxation.

However, there are counter-arguments that may mute this impact. Expected profits are affected not only by tax cuts but also by expectations about the future performance of the domestic economy, as well as other economies that represent the markets in which firms sell their goods and services. If a change in economic policy is viewed as having potentially negative effects on future macroeconomic performance, perhaps increasing the probability of there being an economic crisis, then it may have a negative impact on contemporary investment which, after all, is a decision made by firms now about the future. If the corporate sector thinks that the TCJA will increase fiscal deficits and that these will result in unsustainable levels of sovereign debt, this may discourage them from investing, in spite of the increase in their post-tax profits.

There is also the point that where the tax cuts lead to an increase in the size of the fiscal deficit, increased government borrowing will force up the rate of interest; this will in turn discourage investment. Once again the effect on domestic aggregate demand via the investment route could be more (or much more) limited than some of the most outspoken advocates of the TCJA have claimed.

Indeed, taken to extremes the expansionary contraction hypothesis that argues that contractionary fiscal policy leads to improved market confidence and an increase in aggregate demand could be turned on its head. A contractionary expansion hypothesis could be posited suggesting that

expansionary fiscal policy will undermine confidence and lead to a decline in aggregate demand. This would be in stark contrast to the traditional Keynesian view of fiscal policy and its role in stabilizing the economy.

From a Keynesian perspective, the timing of the TCJA certainly seems perverse. Many indicators suggest that the US economy has already recovered from the worst excesses of the global economic crisis. Unemployment has fallen close to what might be the natural rate, and, in association with this, the output gap has narrowed to the extent that it may have been almost eliminated. There are clear signs that the Federal Reserve will continue to tighten monetary policy in 2018 and that interest rates will rise. If one believes that tax cuts and larger fiscal deficits will be expansionary, as supporters of the TCJA do, then it seems that they could also be destabilizing. Expanding aggregate demand when an economy is at, or close to, its full productive potential runs the risk of causing inflation. Moreover, since the impact of fiscal expansion is likely to be lagged, and since it seems probable that the economic recovery in the USA would have continued over the next few months even in the absence of the TCJA, the destabilizing nature of the tax cuts incorporated in the Act could be even greater than if the effects were immediate.

Conventional Keynesian arguments for fiscal expansion argue that it should be timed to coincide with a cyclical trough and not a cyclical peak. It follows that while the TCJA may accelerate recovery for a short period of time by stimulating aggregate demand, it may do little to affect positively the longer-term determinants of economic growth. There may be a short-term growth spurt but it is unlikely to be sustained. Such an outcome may, of course, serve a political purpose for the incumbent administration. We return to consider the politics of the TCJA in a subsequent section.

The TCJA and aggregate supply

In the era of Reaganomics in the early 1980s there was a belief that, while fiscal policy was an ineffective way of managing aggregate demand, tax policy could still have an important bearing on aggregate supply. If tax policy could be used to increase the rate of productivity growth it could have a lasting impact on the rate of economic growth and national welfare. The logic

behind Reaganomics was based on supply-side economics. Building on the notion of the Laffer curve, the belief was that marginal tax rates had become excessive and represented a major disincentive to entrepreneurial initiative, innovation and investment.

Similar arguments have been put forward by supporters of the TCJA. They also suggest that, with higher post-tax profits, firms will be better able to finance research and development and that this will have a positive impact on future aggregate supply.

The logic of the Laffer curve is, from one narrow point of view, unassailable. If marginal tax rates were 100%, there would be little commercial incentive for firms to earn more income. Reducing tax rates below this level might indeed have a positive effect on entrepreneurial activity. The question is whether a similar effect exists, and to what extent, when corporate tax is reduced from 35% to 21%; particularly where the reduction in the rate of tax is accompanied by the removal of certain tax exemptions and tax breaks, so that the effective reduction is considerably less than 14%. The theoretical issue relates to what factors influence entrepreneurial activity, innovation and investment. Just how important is the marginal tax rate in explaining them?

While supporters of the TCJA argue that there is empirical evidence to support their case that tax cuts will have a significant positive effect on aggregate supply and long-term economic growth, their interpretation of the evidence may not be completely balanced and objective. In assessing the impact of the Reagan and Bush tax cuts on the supply side of the US economy, it is difficult to distinguish their impact from that of the other factors that were at work at the time. Moreover the 1981 Reagan tax cuts, in particular, were much bigger, involving an overall reduction of about 23 percent in marginal tax rates. The top rate of income tax was, for example, reduced from 70 percent to 50 percent. The rate was further reduced to just below 40 per cent in the next round of cuts in 1986. Most objective observers remain unconvinced that the TCJA will have a significantly large impact on the supply side of the US economy. This is in part because they do not believe that, at the levels involved, investment, innovation and entrepreneurship are significantly influenced by changes in marginal tax

rates. But it is also that they do not find compelling the evidential support for the supply side claim based on previous experience with tax cuts in the USA. In the case of both the Reagan tax cuts in the early 1980s and the Bush tax cuts in the early 2000s, a reasonable argument can be made that the apparently positive growth effects had more to do with the Federal Reserve's relaxed monetary policies. There is little to suggest that there were strong productivity gains. In the 1980s labour productivity remained at historically low levels, according to Bureau of Labor Statistics, and in the years following the Bush tax cuts it actually fell.

The TCJA and the fiscal balance

If there is sharp disagreement across the political divide about the strength of the supply side consequences of the TCJA, there appears to be a strong consensus amongst economists, and even amongst many Republican politicians, that it will lead to a larger fiscal deficit and to increasing sovereign indebtedness.⁴ This is an area where the Act seems to sit uneasily with the conventional Republican position that has argued for much firmer fiscal conservatism. The underlying maths is relatively straightforward. If tax revenue is determined by the tax rate and the level of income, then with no increase in the level of income and a reduction in the tax rate, tax receipts will clearly fall. It is then possible to calculate by how much income will need to rise in order to sustain or increase tax revenue. A hypothetical example may help. With a tax rate reduction from 30% to 20% and an initial level of national income of (say) \$1,000 million, national income would need to increase by a relatively massive 50%, to \$1,500 million, in order to sustain tax revenue at \$300 million. It seems very unlikely that tax cuts in the USA will induce a multiplier of the size needed. Even where national income rises as a consequence of the tax cuts incorporated in the TCJA, so-called 'dynamic scoring' will only serve to modestly moderate the consequential impact on the fiscal deficit.

⁴ The prospect of a burgeoning fiscal deficit has been highlighted further as a result of the Consolidated Appropriations Act, also known as the Ommibus Spending Bill, passed in March, 2018. This envisages a substantial increase in government expenditure covering both defence and non-defence spending.

Part of the seductive appeal of the original Laffer curve was that it offered a prospectus suggesting that reduced tax rates would lead to larger tax receipts and a smaller fiscal deficit. In principle, improved fiscal performance might also result from reduced government expenditure on unemployment benefits and other welfare payments that would be associated with stronger economic growth.

But does an increase in the fiscal deficit matter? Much depends on its size and the economic circumstances in which it occurs. Keynesians would generally argue in favour of a larger deficit when the economy is in a cyclical trough; in any case automatic fiscal stabilizers will mean that fiscal deficits get bigger when the economy is in a downturn.

More recently the answer to the question would tend to focus on 'fiscal space'. Countries that have been running large fiscal deficits for a lengthy period of time and that have accumulated large amounts of sovereign debt have less fiscal space than those with small (or no) deficits and less debt. Fiscal space is difficult to measure precisely because it depends on debt thresholds and on the point at which the level of debt becomes unsustainable. The problem for the USA is that fiscal deficits have been an enduring feature of the economic landscape over recent years and debt levels are relatively high. The size of the fiscal deficit rose sharply in the aftermath of the global economic crisis as the Obama administration pursued a policy of fiscal stimulation. The argument for some degree of fiscal consolidation has been to 'reload the fiscal cannon' so that there is scope to use fiscal policy should another crisis occur. The TCJA may have the opposite effect and run down all the remaining fiscal ammunition. Again, the consequence of this may be that market confidence is damaged in a way that makes a crisis more likely.

It is partly in this regard that a policy of tax cutting in 2018 is significantly different from what it was in the first part of the 1980s and in the early 2000s when US indebtedness was much lower, and the fiscal deficit was less large. In 1980 US national debt was about 32% of GDP and in 2000 it was about 56%. In 2017, it was close to 106%. In 1980 the federal deficit was less than 2% of GDP and in 2000 it was in surplus. In 2017 it was about 3.5%. The implication is that tax cuts during the Reagan and Bush eras occurred at times

when there was much greater fiscal space. Moreover, the empirical evidence associated with these previous rounds of tax cuts fails to provide support for the claim that cuts in marginal tax rates lead to significant increases in tax revenue. For example, following the Bush tax cuts tax revenue fell. While it remains difficult to establish precise causality, nonetheless casual reference to the empirical evidence does not conveniently and clearly support the claims made by those who favour tax cuts as a means of strengthening fiscal performance; just the opposite.

The TCJA and the US balance of payments

A popular but misplaced argument is that fiscal deficits and current account deficits necessarily go together and constitute almost conjoined ‘twin’ deficits. The analysis underlying the twin deficit hypothesis is that an increasing fiscal deficit leads to a real increase in national income or inflation and that in either case imports will increase relative to exports. However the theory of the twin deficits is based on restrictive assumptions. At least to some extent, the expansionary effects of fiscal relaxation may be offset by an associated increase in private sector saving or a reduction in private sector investment. Moreover, the empirical evidence has not provided strong support for the twin deficits hypothesis. For example, the shrinking fiscal deficit in the USA in the late 1990s was matched by an increasing current account deficit, while the large increase in the fiscal deficit in the immediate aftermath of the global economic crisis in 2008/09 occurred alongside a narrowing in the current account deficit. Clearly other factors are at work that may interrupt any direct and proportionate relationship between the fiscal deficit and the current account deficit. Having said this, and given the likely macroeconomic effects of the fiscal expansion embedded in the TCJA, it does seem very probable that the US current account will weaken.

From the point of view of balance of payments accounting, where the private sector savings rate is low (as it is in the USA) and the TCJA is intended to raise investment, an increase in the extent to which government expenditure exceeds tax revenue can only have a negative effect on the current account balance of payments.

Moreover, to the extent that the measures in the Act attract capital into the USA, a strengthening capital account could dominate the weakening current account and drive up the dollar's value. This in turn would reduce US competitiveness and further damage the current account. Enhanced capital inflows into the USA could be associated with the higher post-tax profits associated with US investment, with the rising rate of interest to which an increasing fiscal deficit will lead (even putting to one side the monetary tightening conducted by the Fed), and with foreign investors believing that the TCJA will result in stronger economic performance in the USA and an increase in stock prices.

The first round of Reagan tax cuts in 1981 was associated with just such a set of balance of payments consequences, as the current account weakened, the capital account strengthened and the dollar appreciated in a way that further damaged US competitiveness. Changes in the US balance of payments will have consequences for other countries, but we do not pursue them here.

It is somewhat ironic that the words used by both candidate Trump and President Trump have involved a strong mercantilist element, with considerable emphasis being placed on the need to strengthen the US current account, when the actual consequences of the tax bill may be exactly the opposite. There therefore appears to be a significant inconsistency between the fiscal and balance of payments components of Trumponomics.⁵

The TCJA and the probability of a future economic crisis

Economists have a relatively poor track record in forecasting economic crises. As the above analysis shows the measures incorporated in the TCJA could in theory have a range of outcomes. Advocates argue that the Act will lead to a sustained increase in economic growth in the USA and a related increase in the standard of living of the US population as a whole. However, a measured assessment of the underlying assumptions upon which this is based, as well as the available empirical evidence, suggests that this is overly optimistic.

⁵ Changes in trade policy and the introduction of tariffs on some imported goods from some countries since the enactment of the TCJA are also likely to have consequences for the US current account.

There may be a relatively brief growth spurt, but this is unlikely to be sustained. There is an alternative and much more pessimistic scenario.

This involves the following components: a large increase in the fiscal deficit; an increase in indebtedness taking it beyond a level deemed to be sustainable; a sharp deterioration in US current account balance of payments performance; an acceleration in the rate of inflation leading to an increase in the rate of interest; an asset market bubble; and declining confidence in the US dollar. Although not all of these outcomes may happen, even a limited combination of them could increase the probability of there being some form of economic crisis. There could be legitimate debate about the probability of a crisis and its timing, but there appears to be sufficient reason to believe that the probability is above zero and perhaps significantly above zero. How much importance should be attached to even a low probability of an extreme negative event? As with global warming, another component of Trumponomics, much depends on the rate of discount used. Here at least there does seem to be some internal consistency between some of the components of Trumponomics since both tax policy and Trump's policy on global warming imply a high discount rate and an inclination to attach almost zero probabilities to future extreme and potentially catastrophic negative events.

The TCJA and Basic Politics

Whether focusing on the demand side or the supply side, fiscal policy and its constituent components, government expenditure and taxation, are not only about economics. There is a strong, and sometimes overwhelming political dimension. Generally, it is claimed that left-leaning politicians favour increasing government expenditure during cyclical troughs and increasing taxes during cyclical peaks, whereas right-leaning politicians favour exactly the opposite; cutting taxes during troughs and cutting government expenditure during peaks. The political motivation of rightist politicians is to shrink the role of the government over the course of economic cycles.

As noted earlier, the American Recovery and Reinvestment Act (ARRA) in 2009 was driven exclusively by the Democrats in Congress. Although the

Act involved important tax relief measures, about half of its intended stimulatory effects occurred via increases in federal spending programmes. The purpose of the Act was to increase aggregate demand in the aftermath of the economic crisis when it was believed that demand coming from the private sector in the form of consumption and investment would fall short of the economy's productive potential and create a large output gap, with adverse consequences for employment and living standards.

In sharp contrast, the TCJA of 2017 has been proposed and supported exclusively by Republicans. Its intent, as presented by them, was not to manage aggregate demand in a neo-Keynesian way but to strengthen the supply side of the economy. As its title suggests, the mechanism through which it was argued that this would be achieved was to be by cutting taxes, particularly on the corporate sector. However, as the above discussion suggests, there are severe doubts about the power of this effect, and also a strong probability, based both on theory and empirical estimation, that the Act will have adverse effects on both the fiscal balance and the current account balance of payments. If there is a strong case that the net economic consequences of the TCJA will be negative, why would President Trump and Republican politicians support it, and how could they defend their support in a way that would not reduce their own credibility?

Much of the answer hinges on the distribution of the gains and losses to which the TCJA gives rise, across time, income groups and political constituencies.

In terms of timing, and as noted earlier, if the US economy still possesses some spare productive potential an argument can be made the TCJA will have a short-run positive impact on the rate of economic growth. The negative effects are more likely to be felt once any output gap has been closed. Politicians are notoriously myopic. Moreover, it is well known that economic policy is often associated with a political cycle. One can therefore see that a short-term burst in economic growth and in living standards will be attractive to Republicans in advance of the Congressional elections in 2018. It is interesting to observe that the Republican Party is supporting fiscal expansion at just the same time as an essentially non-political and more technocratic Federal Reserve is opting for tighter monetary policy. The

myopia of politicians may at the same time be accommodated where voters are also relatively ill-informed or short-sighted. Of course, if the output gap has already been closed and if the economy is operating at full productive potential, even this short-term benefit may turn out to be illusory and any expansionary effects associated with the TCJA may lead to over-heating.

In terms of income groups and political constituencies, there is little doubt that the TCJA will confer most benefit on the corporate sector and the relatively wealthy. It may be that the USA has become a plutocracy where the wealthy elite in effect run the economy. Perhaps the tax cuts are a reward to political donors designed to sustain their financial support in upcoming elections. Perhaps the political advocates of the tax bill believe that they can persuade low-income, blue collar workers that it will work to their advantage in both the short and long term. Perhaps the Republicans who have in many ways had doubts about President Trump still hold in high regard his ability to market a product. They may see him as a modern-day medicine man who is able to sell the fiscal elixir contained in the TCJA even when its chemical contents may be harmful to the health of the American economy. Republican politicians may believe that what is in fact a plutocratic regime may still be able to gain populist support. Or perhaps it is just that by the end of 2017 the Republicans felt the need to demonstrate that they could indeed pass a piece of legislation, following their failure to reverse the Affordable Care Act and 'repeal and replace' Obamacare.

On top of this, there is the simple point that the combination of tax cuts with the removal of certain tax credits associated with property taxes and mortgage relief mean that it will be voters in California, New York and New Jersey who on balance lose from the TCJA while, at least in the near term, voters in the mid-west benefit. The Republican calculus may be that the voters who lose are the ones who were in any case most likely to vote for the Democratic Party. Republicans and President Trump may believe that their 'base' is more strongly anti-Democratic than it is pro-Republican. They may believe that it has no particularly strong antipathy towards wealth, but retains some degree of admiration for those who have acquired wealth. They may believe that they will be able to continue to market the view that it is globalization that explains low wages and stagnant living standards rather

that any inappropriateness in the design of economic policy. Moreover, it may be that there is some political mileage in questioning the views of ‘so-called’ experts who forecast adverse consequences; a phenomenon that was also evident during the Brexit vote when the UK opted to leave the European Union against the advice of many economic forecasters.

Finally, there is the possibility that the Republican Party is playing a long game rather than exhibiting myopia. This is the ‘starve the beast’ scenario. It claims that the Republican Party’s real agenda is to cut entitlements to Medicare and social security, but that it is acknowledged that there would be difficulties in achieving these political ends in the absence of a fiscal crisis. Thus the strategy is to create such a crisis by supporting tax cuts now in order to be able to cut government expenditure in the future.⁶

Concluding Remarks

The rhetoric of Trumponomics differs from its reality. In many of its dimensions, such as trade policy, it is often difficult to distinguish the ‘signal’ from the ‘noise’. However, in terms of taxation policy, the Tax Cuts and Jobs Act signed into law by President Trump at the end of 2017 provides a much clearer indication of what Trumponomics actually embodies. The motivation behind the legislation appears to be the belief that a reduction in corporate taxation will release a flood of entrepreneurial initiative that will increase investment and, as a consequence, lead to higher wages and sustained faster economic growth. Certainly the very name of the Act, linking tax cuts and jobs, reveals the way in which the legislation has been presented by its Republican advocates.

This is not the first time that such a strategy has been adopted in the USA. Indeed, in many important respects Trumponomics is the modern-day version of what George H. W. Bush described as voodoo economics. Tax cuts have been tried before as a way of stimulating growth; not in a conventional neo-Keynesian way aimed at stimulating aggregate demand (where it is

⁶ Once again it can be noted that the Omnibus Bill passed in March, 2018, involves increasing government expenditure in many areas. This seems likely to bring forward the prospect of a fiscal crisis. If the TCJA involves a long game of ‘starving the beast’, the short game seems to involve feeding it.

generally argued that increased government expenditure is more effective), but as a means of strengthening the supply side of the economy. Although the advocates of the TCJA claim that these previous experiences show how successful the strategy has been in the past, most neutral observers are much less convinced by it. Moreover, contemporary circumstances are significantly different. The US economy is already well established in its recovery from the global economic crisis. The output gap is smaller than in the early 1980s and early 2000s, the level of national debt is much higher and there is less fiscal space.

This implies that the TCJA represents a rather high-risk strategy. Uncertainty surrounds whether the assumed relationships actually hold, and, perhaps more importantly, the quantitative strength of the relationships. The greater certainty relates to the policy's downside; larger fiscal deficits, accumulating debt, bigger current account deficits and widening income inequality. Rather than helping to 'make America great again', the TCJA could herald an era of economic malaise and ultimately crisis. A boom induced by the short-term effects of the Act may be followed by the proverbial bust; particularly if another element of Trumponomics is to loosen regulation of the financial sector. After all, plenty of the economic crises observed in the world have been associated with excessive accumulations of sovereign debt. While the position of the US dollar as the premier international currency may alleviate the problem to some degree, it does not mean that the USA will be exempt from debt-related crises. In a similar way, the rise in stock market values that the Trump administration presents as providing evidence of the success of its policies and the business confidence that they generate, could turn out to be not much more than an asset market boom that will eventually bust.

Clearly this is a risk that President Trump and the Republican Party have been prepared to take. Either they are genuinely persuaded by their own rhetoric, or they believe that at least a short-term political pay-off will enable them to retain power. An answer favoured by President Trump to many questions both large and small is to say 'we'll see what happens'. In terms of the effects of his tax policy we certainly shall.