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Impacts of Trump Tax Reforms on Growth, Inequality and Debt

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Reforming the tax system of the US has become a major policy agenda of the Trump administration. After months of negotiations the "Big Six", including the Treasury Secretary, National Economic Director, Republicans in the House and the Senate are gradually converging on the degree and scale of tax reforms. What will be the impacts of such reforms on growth, efficiency and redistribution of income among households is an issue of immense interest among the American people. We provide summary of findings of study conducted by a team of economists in the University of Hull in England and Suffolk University in Boston for the National Centre for Policy Analysis that have also been published in refereed journals.

The tax reforms proposed by Donald Trump as a presidential candidate would be as extensive as those carried out through President Reagan's tax reforms in 1981 and 1986 (better.gop). He proposed to reduce the corporation income tax from 35 percent to 15 percent but the consensus is emerging towards bringing down to 20 percent with pass-through business rate to 25 percent. It is hoped lower tax on corporate income in this way would bring back more multinational corporations to the United States. Seventeen of the 20 largest multinationals had headquarters in the United States in 1960. Only six out 20 had headquarters there in 2015. Many moved to tax-haven countries because of the higher U.S. corporate income tax rate. Trump argued that the lower rate of 15 percent on corporate income would bring these corporate headquarters back to the United States. This would create more jobs and expand the corporate sector in the United States.

Another more radical tax reform relates to individual income taxes. Trump proposed replacing the existing complicated tax system with four brackets. Initially Trump had proposed a zero percent tax rate on income up to $25,000, a 10 percent tax rate on income between $25,000 to $50,000. Then a 20 percent tax rate on income between $50,000 to $150,000 and a 25 percent tax on income about $150,000. The "Big Six" is considering 0, 12, 25 and 35 percent tax rates maintaining the progressive structure of the income tax in the US.

In a recently published research article, Bhattarai et al. (2017a, 2017b) and Haughton et al. (2017) found significant positive impacts on output, investment, capital formation, employment and household well-being of such corporate and individual tax reforms in the U.S. economy. Using a dynamic CGE model built for the National Center for Policy Analysis in Dallas, Texas, they found that the corporate income tax and income tax reforms would bring about economic growth and create more jobs. The macroeconomic impacts of a reduction in the corporate tax rate from 35 to 15 percent, combined with the cuts in individual

rates, would be very powerful. Real GDP would expand relative to the benchmark, initially by 1.6 percent and ultimately by 4.3 percent. This increase in output would be made possible by an increase in investment and capital accumulation and an associated increase in the level of employment in the economy. More saving lowers the growth rate of consumption initially, but consumption rises to 3.5 percent above the counterfactual benchmark (of no cut in the corporate or individual tax rate) by 2042. Real GDP increases by $230 billion, or by 1.32 percent. Personal income increases by 4.14 percent and business investment by 2.19 percent. The trade balance "improves" by $6 billion. The trend continues in 2026 with the creation of 3.85 million private sector jobs (a change of 1.99 percent) over baseline. Income tax reforms also will have similar impacts. Real GDP will increase by 2.61 percent, and the trade balance will improve by 0.74 percent. Every sector grows faster with the reforms in the corporate income taxes than without reforms, at least by the end of the 25-year period covered by the simulation. The machinery and instrument, and computer sectors grow faster than any other. These sectoral growth rates come mainly from the increased stock of capital across sectors and the creation of more jobs across sectors. The demand and supply for products in the markets increase because of the rise in the income of households and more investment by firms, leading to expansion across all sectors. The sectors that are more efficient attract more capital and create more jobs and grow faster. The underlying elasticities of substitution in consumption, production and trade also matter for the flexibility of markets and growth rates across these sectors.

Economic growth will be higher if the tax rates were reduced according to the Trump tax plan (TTP). Replacing the higher tax rates under tax structure inherited from the previous administration will raise the incentives to work, save and invest and bring more prosperity to the United States.

These studies also warn that there will be two side effects of Trump tax reforms. First while tax cuts will support a more market driven capitalist economy, they will raise the income gap between rich and poor households in America. Another consequence of the policy with no cut in the level of public spending will be seen in a huge amount of budget deficit of the U.S. government. Haughton et al. (2017) estimate such debt to be 26 trillion in the next ten years (from 2017 to 2026) and the ratio of debt to GDP to be as high as 120 percent. They show that the Trump tax plan that includes social security taxes, excise taxes, trade duties, certain other taxes and state and local taxes would diminish federal revenue by $673.68 billion (a decrease of 21.4 percent) in 2017.

One of the main economic targets of the federal government is full employment. There will be two opposite effects of Trump tax reforms on this. The public sector is expected to be smaller, which is consistent to the Republican agenda of deregulation and privatization. Up to 597,000 jobs will disappear in the public sector. However due to favorable policies, the private sector is expected to expand. The Trump proposal would create more jobs in the private than those lost in the public sector. The US DCGE model results show that the Trump plan would create about 3.59 million private sector jobs, a change of 2.42 percent against the baseline. The DCGE model does better than the forecasting Tax and Growth (TAG) model of the Tax

Foundation as it has more decentralization on households and production sectors and is based on intertemporal optimization and general equilibrium of the whole economy.

From months of negotiations it appears now that President Trump will propose a new tax reform measure that differs substantially from the one he proposed towards the end of his campaign. It is safe to say, however, that this new measure will include a combination of cuts in individual and corporate tax rates and the impact assessments we did still will be relevant in process of policy analyses.

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