Fiscal Policy:
“Nobody Knew It Was This Hard”

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The Policy Pivot of Trumponomics

Stimulus  Secular Stagnation  Structural Reform

Resetting expectations is key.
The Policy Pivot (cont.)

- Diagnosis in the aftermath of the financial crisis
- Fiscal versus monetary policy
- Structural reform
  
  *Structural reform is back, though the devil’s in the details.*
Fiscal Policy?

- **Near-term deficit?**: Defense build-up, infrastructure (likely)

- **Tax reform?**: Cuts in business, tax rates, broaden the tax base (*harder than it looks*)

- **Broader discussion?**: Tax and entitlement reform (*more likely discussion than one might think*)
Tax Reform

• Growth effects can be large (as much as 0.5 percent per year for a decade with a consumption tax replacement)

• Gains arise from lower business tax rates and attenuation of financial and intersectoral distortions

• *Hard, because…:* Meaningful rate cuts on business income (to 20 percent in the current discussion) require a new tax (or significant long-term expenditure cuts)
Ryan-Brady Plan as an Illustration

• Many strong elements of reform; embraced as avoiding difficult trade-offs

• But… in reality… a new tax: *border adjustment*

• Revenue? Exchange rate effect? Wealth losses? WTO?

*Prognosis: Not good*
Trump Administration Alternatives

- *Initial work*: Broaden the base, lower the rates (Camp plan rathole)

- *New tax?*: Partial border adjustment… carbon tax… subtraction-method VAT instead of cash flow tax

- *Likely landing*: corporate rate cuts and reform, but with deficit impact/sunsetting; open issues include ‘middle-income tax cuts’ and ‘work supports’
Near-Term Bumpy Ride

- Lack of experience
- Nasty intra-party and inter-party dynamics
- Bill unlikely by August recess (original market expectation)
The Long-Term Still Looms

Math has a habit of not going away.
Broader Discussion Could Assist Chance of Major Reform

• … particularly if near-term changes are consistent with a reform path

• 10-year budget window is artificial; longer-term reforms (e.g., entitlement reform and/or additional revenue) give room for bolder near-term action

• VAT and progressive entitlement reform offer promising alternatives