

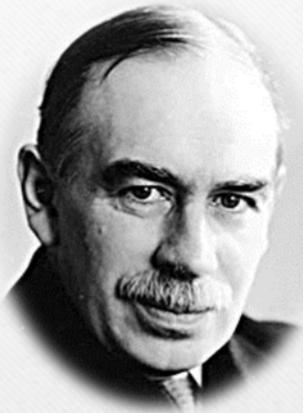
Fiscal Policy:
“Nobody Knew It Was
This Hard”

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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

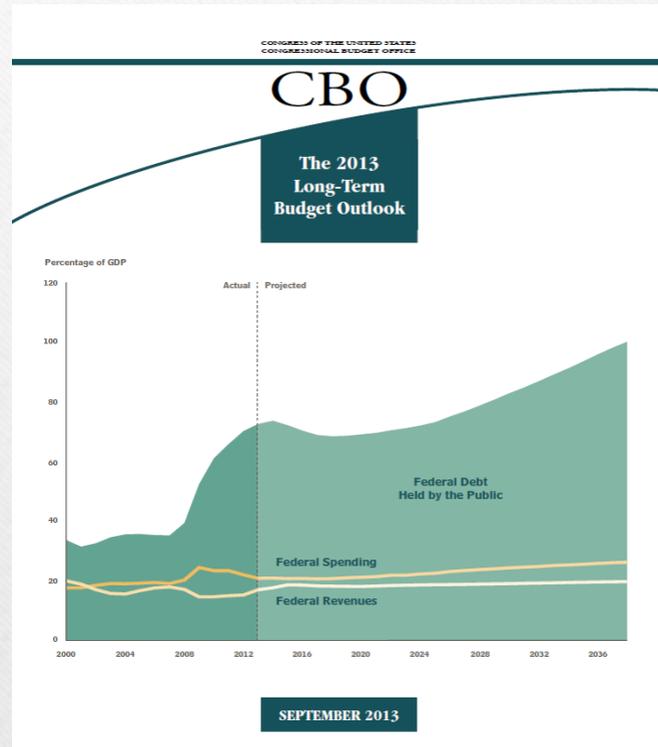
Trump Administration Alternatives

- *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