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I have been asked to talk about last year’s federal tax bill, Public Law 115-97. It’s official name is “An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018” but I’ll refer to it as the 2017 Tax Act.

I’ll talk about some aspects of the Act that have received a lot of attention in the media, especially in New Jersey. That’s expected. But I also want to talk about some aspects of the act that have received a lot less attention but are probably more important in the bigger picture. These aspects are more remote and more complex. In New Jersey, especially, people have concentrated on the wrong things because they are more tangible and easier to see.

It’s like getting on an airplane and worrying about whether the guy in front of you is going to lean his seat back into your knees (which is what I worry about because it’s more immediate), when the real story is that somebody drained half of the fuel tanks. With the Tax Act, there’s a story about the seat back in front of you, and a story about the fuel tanks being emptied, and I’ll tell both of them.

Start with the seat back in front of you whacking your knees. In New Jersey, that’s SALT—the limitation on the deductibility of state and local taxes to \$10k. For many of us in New Jersey, that gets our attention immediately and painfully because we’ve been using this deduction.

What really makes this limitation annoying is the way that it was done. Everybody knows the motivation: because blue states use this deduction a lot more than red states, taking the deduction away was a way of wreaking political vengeance, with a little bit of anti-government and education seasoning thrown in. There are good arguments against the SALT deduction, (the benefits go primarily to people in the top half of the income distribution and they may contribute to over-investment in housing), but that’s not why they did it.

Of course, the Tax Code before 2017 was no marvel of impartial non-partisan wisdom. But most sections had pretty wide support, or at least little widespread opposition. To see whole states singled out because they were on the wrong side of a presidential election is a new and bad precedent. Most other large provisions have had at least a veneer of respectability.

The precedent creates instability in the Tax Code. Stability in a tax code is good because it lets people plan their lives, and minimizes the number and size of windfall gains and losses. We know that the SALT provisions are not going to be stable. We don’t know when they’re going to go, or what will take their place, but ten years from now we will all have forgotten what they were in 2018. That’s not good.

In conjunction with other new provisions, the SALT changes have some other implications, too. For instance, with the new standard deduction, they do a good job of gutting charitable giving, in New Jersey especially. If you used to be deducting your charitable

contributions, you may not be doing so in the future. For a married couple filing jointly, the new standard deduction is \$24k. Since the SALT deduction is going to be \$10k, unless you have a lot of medical bills (and we'll get to that) or really big mortgage you'll probably take the standard deduction and no longer get a tax deduction when you give to charities. This is not good for synagogues and churches and food banks and mosques and animal shelters and orchestras and non-profits generally.

Fortunately, you can get around this with some planning. Two ways: bunch your donations (give a lot in one year, enough to beat the standard deduction, and then nothing for a while and take the standard deduction) or use a donor-advised fund like NJ Community Foundation or Fidelity Charitable. You also may be able to get around some of the SALT provisions if you can treat your house as a business expense of a corporation, for instance, if you work at home. I'm not in the tax advice business.

Possibly other provisions here: health insurance mandate removed in 2019 (probably raises rates on the exchanges by 10% but it could be more); become a corporation like the coach of the U Kansas football team; opens the Arctic National Wildlife Refuge to oil drilling

Those are the seatback on your knees issues. What about emptying the fuel tank?

Here, the big issue is that the Tax Act gives a lot of money to people who support the Republican Party, but except for a few vengeance provisions like SALT, doesn't say where the money is coming from. To the tune of something well over a trillion dollars. That's how they're emptying out the fuel tank. It's like somebody took all of the credit cards from the people in this room, used them to buy Jaguars for themselves and their friends, and to buy some Jaguar souvenir baseball caps for us. They don't tell us that they bought everything with our credit cards, but they expect us to be grateful for the souvenir baseball caps.

You can't really say whether you gain or lose from the tax package until you know how the credit card bill will be paid—how much of the Jaguar they charged to your card and how much they charged the other people in this room. With the Tax Act, you're not going to know who will pay for it for many decades. And nobody else knows either. But somebody will pay for it.

What could happen? Anything the federal government does could be cut—Social Security or Medicare or Medicaid or National Weather Service or scientific research or air traffic control or motor vehicle safety or highways and trains, national parks, education or arts funding, etc. Or taxes could go up again or FICA or fees for passports or National Park entry or using carbon or tariffs. Or a large portion of the debt could be inflated away but that means that if you are living on fixed income in some form you will be eating dog food when you're 90. Maybe something of everything.

If you want to know how the Tax Act affects you, figuring out how your taxes change this year is an almost completely worthless exercise. It's like figuring out whether your souvenir Jaguar hat fits well. The most obvious reason why this tax year's bill will tell you almost nothing is that there are provision in the Tax Act that raise personal income taxes in the future:

the way that brackets are indexed against inflation is weakened forever, and the personal income tax provisions are scheduled to sunset and go away in 2025. The lower estate taxes also end in 2025. So almost everyone is scheduled to pay more taxes in 2026 and thereafter because the inflation correction provision is permanent but everything else expires in 2025. For humans, those of us who are not corporations, this is really not a tax cut act; it's a delayed act to raise taxes.

Will these sunsets actually happen? Who knows? The Republicans wink and nod, but this is one more source of uncertainty. The sunsets were inserted so that the projected revenue losses over the next decade would be below the cap that would allow the bill to be passed without Democratic votes, but this was not the only way that the targets could have been hit.

Think about the corporate income tax, where the cuts have no sunset provisions. The ostensible reason for lowering the corporate tax rate, and an argument that many economists would accept, is that lower marginal rates encourage investment. How much is controversial. But only the cuts that are in the future encourage investment, because the only investments that can be encouraged are those that are expected to pay off in the future. Corporate tax cuts that take effect right this minute don't encourage investment, because all the investments that affect profit right this minute have already been made. A corporate income tax cut that was really designed to encourage investment would be phased in over a few years. That would have saved money, instead of the personal income tax sunset. A corporate tax cut that was designed to reward donors would start immediately. And that is what we got.

So how much fuel does this take out of the tank and what are the consequences likely to be?

The measure I want to use is called the Fiscal Gap. Not as popular as the things like deficits that people generally talk about, but more useful, really. It's a measure of sustainability, or lack thereof. The Fiscal Gap looks at current spending practices and asks what it would take to continue business-as-usual into the far future. It takes current revenues and asks what they yield if you continue business-as-usual into the far future. And it takes current debt, and puts all three of these things together in one question. Pick some date in the far future and take a goal for debt at that point: say, today's ratio of debt to GDP. If we continue business-as-usual, how far will we be from that goal? That's the Fiscal Gap.

The Fiscal Gap tells us whether the way of life that we're engaged in is sustainable or not, and if it's not, how far from sustainable it is. It tells us the difference between the amount of fuel in the tank and the amount we would need to get to Los Angeles, if we keep burning at the presently expected rate.

So some numbers.

These are all from Alan Auerbach of UC Berkeley and William Gale of Brookings. Not radicals. Very respected, pretty objective public finance economists.

At the start of the Trump administration, the US debt/GDP ratio was about 77%--pretty high for peacetime, but the markets were still treating US government debt as pretty safe. The Fiscal Gap for 2047, hitting 77% debt/GDP ratio was 2.75% of GDP. That meant that in the long run, if things went as planned, government expenditures would have to go down by 2.75% of GDP, or taxes would have to go by 2.75% of GDP; or some combination.

Fast forward to today, after the tax cut and the budget of 2018. With Aaron Krupkin, they now estimate the Fiscal Gap to 2048, hitting a 76% debt/GDP ratio at 4.0% of GDP. To 2093 the Fiscal Gap is 5.2% of GDP.

So Trump in one year, mainly with the Tax Act, has increased the Fiscal Gap by half, from 2.75% of GDP to 4.0% of GDP. The longer you wait to start dealing with it, the worse it gets. If business-as-usual continues to 2021, the Gap grows to 4.44% of GDP, to 2025, 5.18% of GDP. The hole gets deeper if you do nothing.

What does this mean? GDP now is \$20 trillion. 4% is \$800 billion.

So things are \$800 billion per year from being sustainable. There has to be an adjustment of \$800 billion in tax increases or spending cuts or some combination of both. (Inflation can reduce the debt, but current debt is a small part of the problem.) Some comparisons, from FFY 17:

Personal income tax revenue: 1.59T

Corporate income tax revenue: 297B.

Social security payroll taxes 1.16T.

Total revenue 3.3T

Defense spending: 590B

Medicare 702B

Nondefense discretionary spending 610B

Social security 900B

And 4% of GDP forever is in some sense a best-case scenario. It assumes no big recessions, no major wars, no major costs to avoid climate change or to respond to the damage it does, no big earthquakes in California or the Pacific Northwest, no need for major investments in infrastructure either because it fails or becomes obsolescent, no need for major new cybersecurity initiatives, no epidemics of flu or Ebola or anything we haven't heard of yet, and continuing immigration of large numbers of the smart, hardest-working individuals. 30 years ago was 1988. Blockbuster was a rising new disruptive company, the wave of the future, and google was a sound that babies made. Nobody was thinking of cybersecurity, Al Qaeda, Ebola, subprime mortgages, or the Great Recession.

So what's going to happen? Who's going to pay for the tax orgy of 2017? Again, I don't know.

What happens when you get on a plane for Los Angeles and the fuel tanks have enough in them to get you only to Iowa? It could crash. Crash in the Fiscal Gap case means that capital markets start dumping US debt. Not impossible: in the Great Recession, the US debt/GDP ratio went up 35 points. Put together a war in the Middle East and another recession and the capital markets could get very jumpy, especially after the debt/GDP ratio rises to around 100% in the mid-2020s. But I'm not in the scare business.

One thing for sure about the plane for Los Angeles with only half the required fuel—the flight won't be what you expected it to be, and you're not going to get to LA on time, if you get there at all.

Similarly, in this case, my wife and I sat down with a financial adviser a year or so ago and she drew up a great plan for our retirement. But to do that, she assumed current tax laws stayed in place for the next 30 years and so did Social Security and Medicare as we know it. But it's highly unlikely that both of those things will happen; the plan is really inconsistent.

The tax orgy has made it much harder to plan for retirement or your kids' education or anything else. Some people's lives will be ruined because they made plans based on inconsistent information and those plans failed. Some people will get lucky. Other people will hedge against fiscal disasters, but give up many opportunities because they are hedging.

Many things in life cannot be forecast and planned, and we have to live with uncertainty: our own life spans and those of our loved ones (furry and otherwise), diseases, technological change and obsolescence, weather. But the federal government should be reducing these uncertainties not increasing them. Paul Krugman once described modern democracies as insurance companies with armies, not casinos with armies.

It's as if NJ didn't just legalize sports betting this month but made it mandatory that people bet 4% of their income every year that the Mets win the World Series.

In passing, while I'm on the subject of inconsistency, there is one consequence of the 2017 tax orgy that every economist is sure of, and it just shows the inconsistency and intellectual shallowness of this president. The immediate consequence of the tax cut will be a large and continuing increase in the US trade deficit, which this president is fond of blaming on everybody else.

This result is pretty close to simple arithmetic. If our household decides to consume more than it produces, then it has to get some of the stuff that it consumes from somebody else outside the household. The greater our consumption is relative to our production, the more we have to get from other people. The amount of stuff we get from other people without giving them any goods and services in return is our trade deficit.

The same thing for the federal government and the US. Trump's federal government has not (at least, not yet) cut spending even as it has significantly decreased the amount it collects in taxes, especially from corporations. That difference has to come from somewhere. Mainly it won't come from US households consuming less. So overall, the difference between what the US consumes and what it produces will grow. That's the US trade deficit.

Donald Trump can erect as many tariff walls as he wants. He can't negotiate with arithmetic. The trade deficit will go up. Agriculture and manufacturing in the Midwest will probably tank. This is what happened with Reagan as a result of his tax cuts.

I don't want to emphasize this too much because the trade deficit by itself is not a very important number, and bilateral deficits, which Trump has built his foreign policy around, are even less important.

Finally, let me note that the problem of the Fiscal Gap is in many ways like the problem of climate change. The word "sustainability" applies to both. Both problems slowly become worse over time. The precise consequences of both problems are unknown, and with both there is a probability of a disaster at any time. Both need to be treated with patience and resolve, and for both of them, the longer you wait the greater the cost of dealing with them. Donald Trump and the Republican Congress have made both of them much worse. And the two problems are probably about the same size.

Many of you intend to be alive in 30 or 40 years. Many of you have kids and grandkids, nieces and nephews, friends and students who will be alive even longer than that. If any of you saw an adult with a baseball bat about to break a kid's arm, you would intervene immediately. Through the Tax Act of 2017, and through pulling out of the Paris accords and pushing the consumption of fossil fuels, Trump is doing a lot worse, not just to one kid, but to tens of millions of them. Probably billions. Don't let him.