



CIGS Professor Jay K. Rosengard Seminar
**“Dream or Delusion? The Promises and
Pitfalls of Trumponomics”**
(Summary)

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Today, I will talk about what President Trump promised, what is his vision of a future America, and specifically what is Trumpenomics. Also, I will talk about some of the pitfalls of Trumpenomics. The delusion is if Trump is successful in implementing what he promised, the results will be opposite of the intended because of the ramifications of his policies. I will also talk about in current state of US economy. Finally, I'll give you two scenarios: what happens if he is successful in implementing it and if he is unsuccessful.

The grand vision of President Trump is he would like to generate annual growth rate between 3.5% and 4% from the present 2%. He would like to create 25 million net new jobs over the next decade. He would also like to bring back lost manufacturing jobs, revive the coal industry, generate a net trade surplus, and make America great again.

What is Trumpenomics?

Lower Taxes

- Reduce individual income tax from 7 to 3 tax brackets with tax rates of 12%, 25%, & 33%
- Reduce corporate tax rate from 35% to 15%
- Reduce corporate tax on repatriation to 10%
- Repeal estate and gift taxes

Increase Expenditures

- National defense (e.g., 350-vessel navy fleet)
- Border security (e.g., "The Wall")
- Domestic infrastructure (e.g., \$1 trillion PPP)

Deregulate Business

- Complete regulatory overhaul
- Moratorium on new federal regulations

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Decomposing his vision, Trump would like to reduce the individual income tax rate from seven brackets to three brackets and reduce statutory and marginal tax rate for the personal income tax to 12%, 25%, and 33%. Presently, the top marginal rate is 39.6%. He would also like to reduce the statutory corporate tax rate from 35% to 15%. Further, he would like to reduce the corporate tax on repatriate earnings to 10%. Presently, they

pay it at a nominal rate of 35%. There is about \$1 trillion in corporate profits overseas, which he'd like to bring back to create investment in new jobs. He would also like to repeal estate and gift taxes.

On the expenditure side, he would like to increase national defense expenditure and increase border security. He would also like to increase investment in domestic infrastructure. He thinks most of the money will come from private sector in the form of PPP if they are given proper incentives. He would also like to deregulate business with a complete regulatory overhaul and a moratorium on all new federal regulations.

In terms of trade policy, he wants America-first trade policy with no Trans-Pacific Partnership. He would like to re-negotiate NAFTA with Canada and Mexico, and he has accused China of being a currency manipulator. He would also like to unleash American energy and attain energy independence. Further, he would like to increase coal production and fracking and increase drilling energy production on protected federal lands. Then he has "Penny Plan," where he would like to reduce non-defense, non-safety net spending annually by 1% of the previous year's total, which will lead to expenditure reductions of \$1 trillion over 10 years. Other than the protectionist part, Trump's domestic economics looks like Reaganomics.

What is the likely impact of Trumponomics if they are implemented as proposed? Now, in US, there is no strong association between tax rates and economic growth. For example, Reagan in the 80s reduced tax rates across the board, Bush kept the rates low, and Clinton came in and raised it to 39.6%. However, the average annual growth under Clinton was 3.9%, Reagan was 3.5%, and was Bush 1.1%.

The next thing is what is good for Wall Street is not necessarily good for the mainstream economy. Trumponomics is trickle-down economics, that is, if wealthy have incentives to invest, they will invest and create jobs. However, that that hasn't worked in the past. The alternative strategy is a sustainable and inclusive growth. A lot of it has to do with the timeframe and distributional concerns. There will also be a lot of negative consequences of these policies.

One delusion is if he is successful in implementing this program, it won't have the intended results. Then, there is the question of whether they will be implemented given the political economy of reforms in the US and the current state of US politics. There are controversies over the kind of mandate Trump might have, the support he would

have in Congress, and his schizophrenic leadership style. These are the factors to understand when looking at Trumponomics.

Now, if Trumponomics is successfully implemented, what are the consequences? He underestimates the political constraints of Congress, rule of law, power of the courts, and the power of the bureaucracy to kill anything you propose without saying no. I will talk in terms of six components should he be successful in implementing his policies.

First is if he lowers taxes; a micro-simulation model developed by the Brookings Institution and the Urban Institute projects that tax cuts would increase budget deficit by \$7.2 trillion and raise Federal debt to GDP ratio by 26% over 10 years. In the US, half of the personal income tax file has zero net income tax or get a tax refund because of the earned income tax credit. That means our tax space is highly concentrated at the top, and the rich pay the majority of the taxes and majority of the benefits will accrue to the wealthier taxpayers. Further, the Congressional Budget Office has projected that the combining the tax cuts with increased spending would increase budget deficit by about \$10 trillion over a decade. Interestingly, half of the benefits in reduced tax liabilities will go to top 1%.

Second, if you take increase in Navy expenditure and increase in personnel, the estimate is that increase in defense and veterans' expenditures would be about \$950 billion over 10 years. He also has childcare tax credit, which will be up \$600 billion over 10 years. Also, it's very hard for people to cut domestic security and infrastructure cost because of private participation. All these together project a huge increase in deficit and debt.

Third, there is some consensus between Democrats and Republicans that business regulations should be reduced. However, if you reduce wrong regulations, then you decrease competition providing opportunities for monopoly rents. Further, many regulations are to protect the consumer, to ensure fair and competitive marketplace, and to internalize negative externalities. If you deregulate that, you will have the possibility of increased social and environmental costs.

Fourth, on America-First Trade Policy, if you start slapping tariffs on exports to your country, other countries will retaliate with a possibility of a trade war. There will also be WTO challenges as many of his proposals would go against WTO Conventions. In the end, you are increasing trade deficits, because when you have war, trade goes down.

Fifth, in terms of Unleash American Energy, if you make nonrenewable cheap, it damages the environment and people won't use renewable energy. In the long term, it will leave us more vulnerable.

Six is the Penny Plan. The US budget is very big at \$4 trillion, but very little of the budget is discretionary, less than 10%. If you take entitlements such as Social Security, Medicare, Medicaid, they are closer to two-thirds of our budget. People in principle agree to cut waste and inefficiency and reduce spending but do not agree to cut their budget. Also, everybody agrees for the need to lower tax rates and expands the base, but don't want their incentives taken away. So, it's difficult to remove expenditures and broaden the base. Interestingly, Make America Great Again assumes that we have an economy that's a disaster, but Trump is inheriting a strong economy.

What is the Current State of the U.S. Economy?

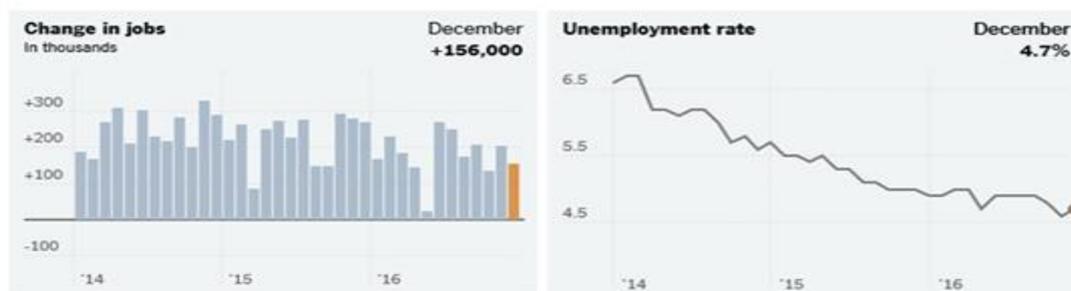
First, the good news: strong aggregate performance

- Budget deficit/GDP (2017 est.): 2.6% (9.8% in 2009)
- Fed. debt/GDP (2017 est.): 104.4% (105.2% in 2016)
- Unemployment Rate (12/16): 4.7% (9.9% in 2009)
- Net Jobs Created (2016): +2.2 m (180,000/month) (-5.1m, -423,000/month in 2009)
- Positive Net Jobs Created 75 consecutive months
- Hourly Pay (2016): +2.9% (best since 2009)
- 19 states increased minimum wage (eff. 1/17)
- Urban CPI thru 12/16: 2.1% (0.7% in 2015)

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The real problem in the US is not aggregate performance; it's the distributional aspects of the US economy. The estimate this year of budget deficit to GDP is about 2.6%, which has come down from almost 10% from 2009. The guideline is if it is 3% or less, it's prudent fiscal management. The federal debt to GDP is 100%, but it's hard to stabilize this because the GDP is growing and the deficit has already been stabilized.

Current State of the U.S. Economy? (2)



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Next, unemployment rate for December 2016 is 4.7%, which was 9.9% in 2009. Basically, when you start to get below 5%, we get full employment in the United States. That means it's difficult to grow much more without considerably increasing productivity or labor force size. Net jobs created last year was at 2.2 million. At the height of Great Recession in 2009, over 5 million net jobs were lost. Also, net jobs created have been positive for the last 75 months, which is one of the longest sustained periods of job growth in recent US history. We are also seeing wage pressure, which is another indication of full employment. Furthermore, CPI in 2016 went up 2.1%, that's triple of the 2015 rate. Because of all of these numbers, the consensus among the mainstream economists and the Fed is this is about as good as we can do right now.

Current State of the U.S. Economy? (3)

Now, the bad news: structural inequality (12/16)

- Standard aggregated unemployment: 4.7%, 7.5 m
- Long-term unemployment: 1.8 m, 24.2% of unemployed
- Unemployment by race
 - Whites: 4.3%
 - Hispanics: 5.9%
 - Asians: 2.6%
 - Blacks: 7.8%
- Unemployment by education
 - < High school: 7.9%
 - Some college: 3.8%
 - High school: 5.1%
 - ≥ Bachelor's: 2.5%
 - Continued decline in factory jobs: -63,000 (since January 2016)
- Unemployment more broadly defined
 - With involuntary part-time: -459,000 in 2016, 5.6m → 8.2%
 - With marginally attached: 1.7m → 9.3%

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But it's important to understand that Trump got elected due to the distributional aspects of who is winning and who is losing. Standard desegregated unemployment rate is at 4.7% or 7.5 million people. If you look at long-term unemployment, 24.2% have been without a job for 27 or more weeks. This is problematic because they are often senior people who are being replaced with younger and cheaper people. If you desegregate by race, if you're white or Asian, your unemployment rate is less than the national average and if you're Hispanic or black, it's higher than the national average. If you desegregate by education, for less than high school education, unemployment rate is 7.9%; for high school graduates, it's higher than the national average; but for some college and for bachelor degrees and above, it's below the national average. Also, semi-skilled factory jobs are in decline with 63,000 of these net jobs lost last year.

Unemployment numbers also hides up some discontent. We have 5.6 million involuntary part-timers. This would increase the unemployment rate to 8.2%. Then, we have another 1.7 million marginally attached people. Taking these two together, that almost doubles the unemployment rate.

Current State of the U.S. Economy? (4)

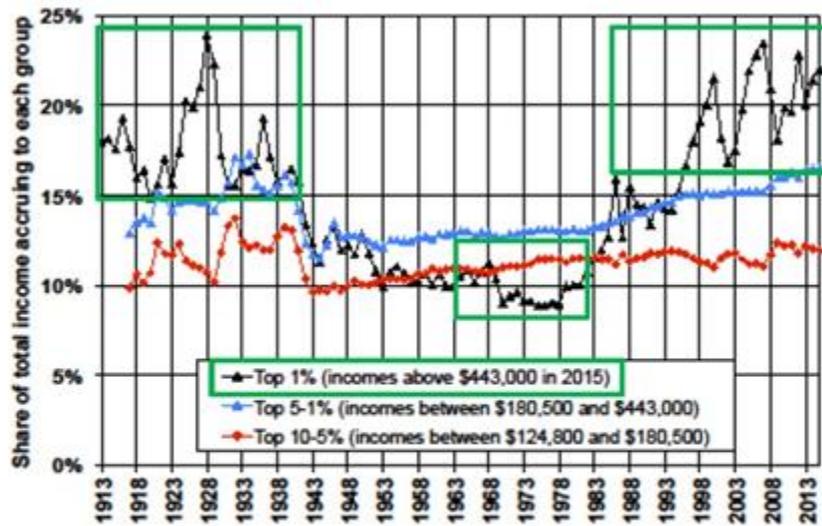


FIGURE 2
Decomposing the Top Decile US Income Share into 3 Groups, 1913-2015

Source: Emmanuel Saez, *Striking it Richer: The Evolution of Top Incomes in the United States* (Updated with 2015 preliminary estimates), June 30, 2016.

Current State of the U.S. Economy? (5)

Table 1. Real Income Growth by Groups

	Average Income Real Growth (1)	Top 1% Incomes Real Growth (2)	Bottom 99% Incomes Real Growth (3)	Fraction of total growth (or loss) captured by top 1% (4)
Full period 1993-2013	15.1%	62.4%	7.3%	59%
Clinton Expansion 1993-2000	31.5%	98.7%	20.3%	45%
2001 Recession 2000-2002	-11.7%	-30.8%	-6.5%	57%
Bush Expansion 2002-2007	16.1%	61.8%	6.8%	65%
Great Recession 2007-2009	-17.4%	-36.3%	-11.6%	49%
Recovery 2009-2012	6.9%	34.7%	0.8%	91%
Top tax increase 2012-2013	-3.2%	-14.9%	0.2%	106%

Source: Emmanuel Saez, *Striking it Richer: The Evolution of Top Incomes in the United States (Updated with 2013 preliminary estimates)*, January 25, 2015.

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Current State of the U.S. Economy? (6)

Table 1. Real Income Growth by Groups

	Average Income Real Growth (1)	Top 1% Incomes Real Growth (2)	Bottom 99% Incomes Real Growth (3)	Fraction of total growth (or loss) captured by top 1% (4)
Full period 1993-2015	25.7%	94.5%	14.3%	52%
Clinton Expansion 1993-2000	31.5%	98.7%	20.3%	45%
2001 Recession 2000-2002	-11.7%	-30.8%	-6.5%	57%
Bush Expansion 2002-2007	16.1%	61.8%	6.8%	65%
Great Recession 2007-2009	-17.4%	-36.3%	-11.6%	49%
Recovery 2009-2015	13.0%	37.4%	7.6%	52%

Source: Emmanuel Saez, *Striking it Richer: The Evolution of Top Incomes in the United States (Updated with 2015 preliminary estimates)*, June 30, 2016.

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Current State of the U.S. Economy? (7)

Table 1: Thresholds and average wealth in top wealth groups, 2012

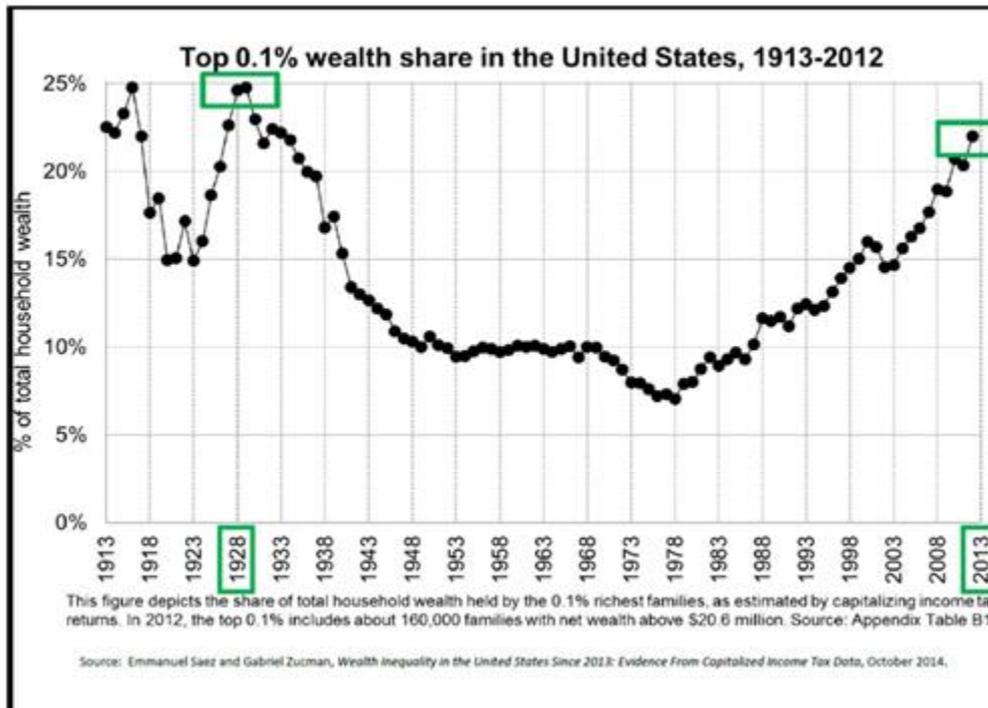
Wealth group	Number of families	Wealth threshold	Average wealth	Wealth share
A. Top Wealth Groups				
Full Population	160,700,000		\$343,000	100%
Top 10%	16,070,000	\$660,000	\$2,560,000	77.2%
Top 1%	1,607,000	\$3,960,000	\$13,840,000	41.8%
Top 0.1%	160,700	\$20,600,000	\$72,800,000	22.0%
Top .01%	16,070	\$111,000,000	\$371,000,000	11.2%
B. Intermediate Wealth Groups				
Bottom 90%	144,600,000		\$84,000	22.8%
Top 10-1%	14,463,000	\$660,000	\$1,310,000	35.4%
Top 1-0.1%	1,446,300	\$3,960,000	\$7,290,000	19.8%
Top 0.1-0.01%	144,600	\$20,600,000	\$39,700,000	10.8%
Top .01%	16,070	\$111,000,000	\$371,000,000	11.2%

Notes: This table reports statistics on the wealth distribution in the United States in 2012 obtained by capitalizing income tax returns. The unit is the family (either a single person aged 20 or above or a married couple, in both cases with children dependents if any). Fractions are defined relative to the total number of families in the population. Source: Appendix Table B1.

Source: Emmanuel Saez and Gabriel Zucman, *Wealth Inequality in the United States Since 2013: Evidence From Capitalized Income Tax Data*, October 2014.

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Current State of the U.S. Economy? (8)



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Next, when looking at the distribution of income across the United States, there is a lot of anger among working middle-class families. There is some empirical data underlying that discontent. Right before The Great Depression in the 1920s, the top 1% had 25% of the income, and we are now about the same level. When the US had policies that were attacking inequality and poverty with introduction of Medicare or Medicaid, low-income housing vouchers, and so on, this number went down to less than 10%. Another issue is who is gaining from income growth. Till 2012, the economy grew about 7%, but 91% of the gains went to 1% of the population. In 2015, the top 1% now gets half of the gains from growth. The bottom 99% have a little bit now, but this is still very inequitable. Looking at inequality of wealth, the numbers are worse. The top 0.1% has the same share of the wealth as the bottom 90%. This is very worrisome in terms of inclusive and long-term sustainable growth perspective.

What is the Current State of the U.S. Politics?

- Executive Branch: Republicans (Trump)
- Legislative Branch: Republicans (both houses of Congress)
 - Senate: 52-48 (Democrats +2, need 3 more)
 - House of Reps: 241-194 (Democrats +6, need 24 more)
- Judicial Branch: Appointments by Republicans
 - 1 Supreme Court vacancy: swing vote
 - Maybe additional Supreme Court vacancies
- Election results
 - Popular vote (136.6 m total): Clinton 65.8 m (48.2%); Trump 63.0 m (46.1%) → Clinton +2.8 m (2.1%)
 - Electoral vote (270/538 to win): Clinton 232 (43.1%); Trump 306 (56.9%) → Trump +74 (13.8%)
 - Voter Turnout: VEP 60.0% → Trump 27.2% of VEP (1.5)
 - FBI investigations, Russia hacking/disinformation

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Next, let's look at the results of the most recent presidential and congressional election. The executive branch has gone from the Democrats to Republicans with the election of Trump, and both houses of Congress are now Republican. The Senate; the Democrats did gain two seats, but they would need three more to take over the Senate with the Republican in the White House. If this is 50-50, the tiebreaker is Vice President Pence who is a Republican. So, in the next midterm elections in 2018, the Democrats would need to gain three net seats to take over the Senate. In the House of Representatives, the

Democrats picked up 6 net seats, but they would need 24 more to take over the House of Representatives.

In the judicial branch, there is one Supreme Court vacancy. That will be a Trump appointment. It has to be approved by Congress, but he does have the majority of Congress. There are a couple of other vacant seats that might occur in the next 4 years. The Supreme Court is an appointment for life. The court right now ideologically is split four and four.

The election result was also contentious. Hillary Clinton won the popular vote by almost 3 million or about 2%. Only in the US can you win the popular vote and not win the election. If you look at the Electoral College, the win is convincing for Trump. You need 270, he has 306 and that's about 14% victory. Several swing states went to Trump. If you win a state by one vote, you get all the electoral votes. However, you can't take surplus votes from one state, combine with another state.

Then, we have Voter Eligible Population (VEP) who is everybody of voting age. Registered voters are basically everybody of voting age except those not eligible to vote because of immigration status, convicted felony charges, or certain other categories. This time the voters' turnout was 60%. This was 58.6% during Obama's reelection in 2012 and 62.2% in his first election in 2008. This means that of the voter eligible population, 27% voted for Trump, and the other three quarters either voted for somebody else or didn't vote at all.

Then, we have the FBI investigations of Clinton during the race. It violated FBI protocol of never commenting on an ongoing investigation. In the Russian hacking/disinformation, all 17 US intelligent agencies agreed that this was deliberate, can be traced to Russia, and was ordered by Putin. They, however, could not comment on its impact on elections.

Current State of the U.S. Politics? (2)

- **Trump transition**
 - Historically low approval at 44% vs. Obama (83%), George W. Bush (61%), Clinton (68%)
 - Polarizing cabinet nominees
 - Steven Mnuchin/Treasury, Wilbur Ross/Commerce, Mick Mulvaney/OMB, Gary Cohn/NEC
 - Rex Tillerson/State, James Mattis/Defense, Jeff Sessions/Justice
 - Rick Perry/Energy, Andy Puzder/Labor, Betsy DeVos/Education, Tom Price/HHS, Ben Carson/HUD, Scott Pruitt/EPA
 - Divisions within Republican Party

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How has Trump handled the transition? His approval rating on entering the White House is historically the lowest of somebody entering the White House. Normally, when you win, there's a honeymoon period for the first 100 days. For Trump, it looks like the divorce has started before the honeymoon. Part of it is because of his cabinet nominees. He has not reached out to the opposition. His nominees are basically white male billionaires or former military with a couple of exceptions.

Steven Mnuchin, an ex-Goldman Sachs, is nominated for treasury. He's controversial because he made lot money by investing in IndyMac bank that foreclosed on thousands of homeowners during The Great Recession. Wilbur Ross is a billionaire, international investments, less controversial. Mick Mulvaney is the head of the Office of Management Budget. He is a deficit hawk and doesn't believe in deficits. Gary Cohn is the head of the National Economic Council. He is a former president of Goldman Sachs. Rex Tillerson, the Secretary of State, is a former CEO of Exxon Mobil. James Mattis is a conservative but well respected former Marine Corps General. He needed a special wavier to take over his office. He might be a voice of reason in restraining some of the impulses of Trump. Jeff Sessions has a bad record in supporting voting rights and minority rights, and he would be the chief law enforcement official, Attorney General of Justice.

Rick Perry, former governor of Texas, is in-charge of energy. When he ran for presidential nomination against Trump, he said he would abolish the Department of Energy. Andy Puzder is nominated to protect workers, Department of Labor. He's against minimum wage. Betsy DeVos, Education, believes strongly in charter schools and vouchers, not so much in public education. Tom Price, orthopedic surgeon, was a leading critic of Obamacare and is now in charge of implementing Obamacare, Health and Human Services. Ben Carson is in charge of Housing and Urban Development. He does not believe in affordable housing vouchers. Scott Pruitt is head of the Environmental Protection Agency and doesn't believe in global warming and thinks science is a hoax.

There are two most likely scenarios that will take place. Scenario I is if Trumponomics is implemented, then the economy gets a short-term modest boost of inequitable and unsustainable growth, which primarily benefits the big businesses while hurting the middle class and low income households increasing inequality of income, wealth, and opportunity. The dollar will continue to appreciate, trade imbalances would grow, inflation would increase, Fed would raise interest rates, and the economy slows down. Scenario II is that he is not able to convince Congress, the courts, and the bureaucracy. Then, you could have political gridlock until the mid-term elections, which could lead to the status quo or the delusion becomes a nightmare.

Finally, which Trump will prevail? You have got Trump the businessman whose image is a transactional one that focuses on making deals with stakeholders. In the end, he will try to work out something that makes him look good. The Kennedy School believes on evidence-based policy and that facts do matter that would influence his pragmatism and that he leads with his economic proposals rather than his social and security agendas. Then, we have Trump the campaigner who never switches to a governing mode, but governs like he campaigns. Ideology becomes more important than pragmatics, and it's either faith-based policies or faith-based economics. He leads with things like repealing Obamacare and banning immigrants who are danger to the United States over the economic policies. There are areas of agreement, but if you lead with more of the social agenda, it's much more likely to split Congress and lead to nowhere.

In the end, it comes down to the governing style of the President. Spontaneity is good, but creating dangerous uncertainty is bad. Businesses cannot price risk and uncertainty. It is also difficult for countries to plan national defense when you have no idea which words to believe. Passion and leadership are good. Acting on impulse is dangerous as we don't know which will prevail. Strong leadership is good. People want him to be

disruptive. That's different than having an incredibly large and sensitive ego. Trump has displayed aspects of both of these, and it's unclear will he grow into the office and assume more of a prudent governing style or continue to be essentially a tweeter-in-chief.