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Here's the big problem with the Trump-GOP tax cuts

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In the coming days, many American workers will receive their first paychecks adjusted for the new federal income tax cuts. And Democratic Party politicians will have a problem.

Up to now many Democrats have pushed the line that the Republican-led cuts are a giveaway to the rich at the expense of the poor and middle class.[1] The paychecks--with lower withholdings and higher take-home pay for most households in the middle and lower classes, including a larger tax credit for the poorest workers--will disprove that claim.

Workers, happy to pocket an extra $25 or so a week, will likely conclude that the Democrats have been lying about the tax cuts all along.

There are legitimate reasons to criticize the cuts; this column offers one below. So why didn't the Democrats make those arguments instead of pushing a false claim that will soon be disproven?

Regardless, they'll now likely acknowledge that, yes, workers are getting a little more money. But, they'll stress, the biggest beneficiaries are the rich and--worse--corporations. Problem is, the corporate tax cut is probably the most socially beneficial part of the new tax law.

For years, U.S. firms have shouldered one of the highest corporate income tax rates in the world, at just under 39 percent (state and federal combined). In 2017 that was the third-highest rate among the world's 173 nations.

In contrast, the average corporate rate across Europe (national and subnational taxes combined) was less than 23 percent.

And even though U.S. firms can take advantage of deductions and loopholes (as do firms in other countries), they ultimately pay some of the highest taxes among the world's major industrialized nations.

High corporate taxes affect business decisions in socially harmful ways. Taxes discourage deals that would have produced more goods for consumers, more employment, better wages and better payouts to shareholders. These missed opportunities are known as "deadweight losses."

By cutting the corporate rate to 21 percent, Congress has reduced those losses, which may be why several firms have announced wage increases, employee bonuses and business expansions following the passage of the new tax law.

But even with this economic boost, the tax cut is expected to result in less government revenue. How to make up for the lost money? One way would be to raise taxes on rich individuals, which shouldn't produce as many deadweight losses. The new tax law does this to some extent by limiting tax breaks used by the rich. For instance, the new tax law caps the mortgage interest deduction so the rich can't use million-dollar homes as tax shelters, and also caps the federal deduction for state and local taxes so it won't be as beneficial to the rich.

But the new tax law also reduces all personal income tax rates, including on the highest earners. So instead of offsetting the loss of some corporate taxes, the new individual rates mean even less money for government.

Right now, lawmakers plan to make up for that lost money by increasing government borrowing. There's nothing necessarily wrong with borrowing; it is an appropriate way to finance long-lived goods like roads and military hardware.

But the new borrowing would go mainly to covering government operating expenses. That means the new tax law isn't really a tax cut at all, but simply a delayed payment--much like a household using credit cards to pay its monthly bills. Taxpayers will ultimately make that payment with interest in the future when the bonds come due.

Some Republicans say they will reduce this borrowing by cutting government spending. Government certainly spends a lot of money that it shouldn't, so spending cuts would be welcome. But it's easy for government to continue borrowing instead of making serious spending cuts.

Indeed, President Trump has promised to maintain or expand spending on Social Security, Medicare and Medicaid, national defense (including the Veterans Administration) and homeland security, which together comprise 70 percent of all federal spending.

If anything, we should worry that government spending will increase as a result of the tax cuts.

Most people know the Law of Demand, the idea that if the price of some good decreases, people will consume more of it.

The tax cuts, in essence, reduce the price of government, leading to demand for more, bigger government--perhaps in the form of a new infrastructure bill and the return of congressional earmarks, as well as the end of the budget sequestration that has restrained federal spending since 2013.

But perhaps this is too pessimistic. President Trump and Republican lawmakers have repeatedly vowed to cut spending, shrink government and balance the budget.

Surely they'll do that.

Otherwise taxpayers will likely conclude that Trump and the Republicans have been lying all along.

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