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Cut Taxes or Build Bridges? Partisan Debate in U.S. Rolls On

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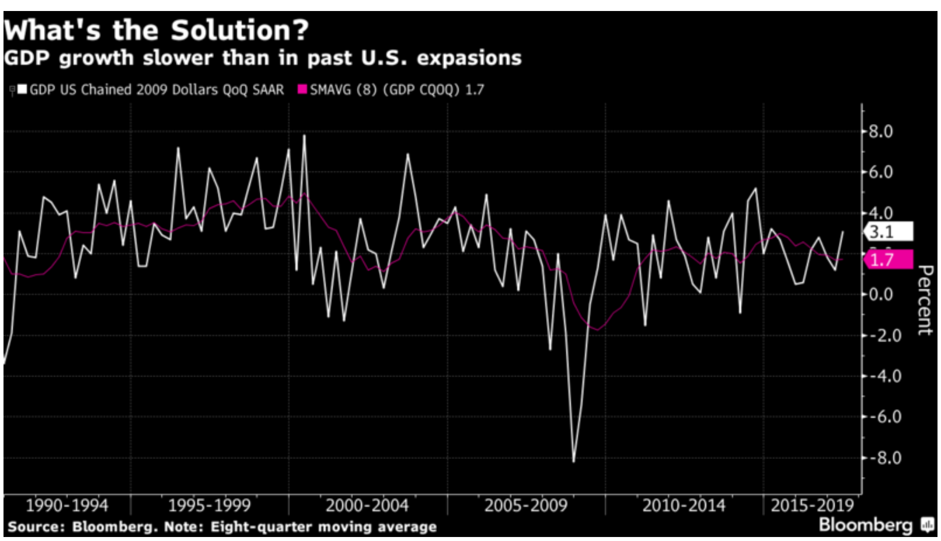
When it comes to deciding which has the biggest bang for the buck -- a tax revamp or infrastructure spending -- it all comes down to the details, and to a certain extent the political affiliation of the economist making the call.

Economists generally agree that both can boost growth if they're designed and timed well. They disagree, though, over which can have the most and longest-lasting economic impact, with Republicans generally favoring lower taxes and Democrats backing higher outlays on roads and infrastructure.

For now, President Donald Trump is siding with his fellow Republicans and is pushing for an overhaul of the tax code, at least temporarily shelving his campaign call for increased infrastructure expenditure. Although many of details still need to be filled in by Congress, the Trump proposal would slash taxes for companies and simplify the tax code for households.

"We can breathe new life into struggling industries and forgotten towns," Trump said on Wednesday, touting his tax proposal in a speech in Harrisburg, Pennsylvania, to a group of truck drivers.



Economic history is replete with examples of tax and spending changes that didn't accomplish what was intended. Japan has spent trillions of yen building roads, bridges and airports in recent decades but has little to show for it except a massive increase in government debt. Many of the projects were in less-populated parts of the country and were designed more to curry favor with key political constituencies than to boost growth.

Jobless Recovery

Tax cuts also have not always proved to be the elixir that its most ardent advocates maintain. President George W. Bush's tax reductions in 2001 and 2003 resulted in a jobless recovery and the disappearance of budget surpluses built up by his Democratic predecessor, Bill Clinton, who presided over an economic boom despite having raised taxes.

Democratic President Barack Obama combined higher infrastructure spending with lower taxes in his big stimulus package in 2009 and economists are still arguing about how effective it was, again largely along party lines.

From a cyclical perspective, the best time for tax cuts or higher government spending is when the economy is depressed and in need of a short-term boost to lift corporate and consumer confidence.

That's not the case today. "I don't think that either is really necessary right now," said Neil Dutta, head of U.S. economics at Renaissance Macro Research LLC in New York, referring to tax cuts and infrastructure spending. "There's no sort of crisis that's befallen the U.S. economy."

In fact, the economy has been expanding for more than eight years and if anything, is showing signs of pressing against some of its capacity constraints. That's perhaps most evident in the labor market, where the unemployment rate of 4.2 percent -- a 16-year low -- is below the level that many economists consider sustainable in the long run.

Soft Landing

Indeed, Federal Reserve Chair Janet Yellen and her colleagues are trying to engineer a soft landing of an economy they think may be growing a tad too fast by raising interest rates and reducing the central bank's balance sheet. A looser fiscal policy -- be it through lower taxes or higher government outlays -- would work against that.

The big debate among economists is not so much about the short-term demand side impacts of particular budget changes but rather about their longer-lasting supply-side effects.

Proponents of increased infrastructure spending argue it will make the economy more productive by speeding up everything from the delivery of goods over the nation's roads to the transmission of data over the Internet.

Some have advocated pairing increased public outlays with private money in an effort to prevent wasteful political logrolling. Think failed Democratic presidential candidate Hillary Clinton's proposal for a national infrastructure bank that would have combined funds from investors and the government.

Republican economists maintain that business tax cuts can lift productivity by promoting private -- not public -- investment. Trump's proposal to provide corporations with a temporary tax break on their purchase of equipment and other capital improvements is specifically aimed at doing just that.

Tax Debate

Tax overhaul advocates also contend that reductions in marginal tax rates for individuals, including the wealthy, encourages them to work a lot harder, in the process lifting growth. Harvard University professor Lawrence Summers, who served under Democratic presidents Clinton and Barack Obama, called such claims “absurd” in a newspaper column this week.

There’s also a dispute among economists about how important it is to offset the effects of reduced taxes or increased spending with other changes in the budget to prevent the deficit from increasing. This debate though doesn’t always break down along political lines.

Summers has argued that bigger deficits stemming from increased deficit spending won’t lead to economically damaging increases in interest rates because of a global oversupply of savings -- his secular stagnation thesis. That doesn’t sound all that different from former Vice President and tax cut proponent Dick Cheney’s purported remark that “deficits don’t matter.”

And while Republican lawmakers spent years criticizing Obama for allowing the nation’s debt to roughly double on his watch, many of them now seem willing to go along with tax reductions even at the expense of bigger deficits.

Economists William Gale of the Brookings Institution and Andrew Samwick of Dartmouth College found that deficits do matter in a paper first published in 2014. They concluded that individual income-tax cuts financed via higher deficits lifted interest rates and reduced national savings in the long run.

“The net impact on growth is uncertain, but many estimates suggest it is either small or negative,” they wrote.

President’s Plan

Economists, though, do mostly agree that some of the claims made by administration officials for the president’s tax plan don’t add up.

Treasury Secretary Steven Mnuchin has maintained that the program will slash budget deficits by spurring faster economic growth and thus more federal revenue. Twenty-one of 26 economists surveyed by Bloomberg News in late September disagreed and predicted the plan would lead to more government red ink.

Deficit-neutral tax reform “is almost certainly a good idea,” said Jeffrey Miron, an economist at Harvard University and the libertarian Cato Institute in Washington. “These ones being proposed, again, subject to the details, but as best we can tell, are not even remotely budget-neutral.”

The administration has also argued that its policies will lift annual economic growth to a sustainable 3 percent, from the 2.2 percent rate it’s averaged since the recession ended in June 2009. Only two of 31 respondents to an Oct. 6-11 poll of economists saw that happening.

University of Michigan professor Joel Slemrod said that economists are generally good at ruling out some of the more extreme claims made for particular policy changes. But when it comes to being more specific, their political affiliations at times show through.

“It’s troubling,” he said. “Economics will be treated more like a science once the correlation between economists’ political views and their forecasts of a given policy goes away.”