What Good and What Bad May Lie Ahead in 2017?

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Since yesterday's column was a look back on the good and bad things of 2016, let's now look forward and speculate about the good and bad things that may happen in 2017.

I'm not pretending any of this is a forecast, particularly since economists have a miserable track record in that regard. Instead, the following lists are simply things I hope may happen or fear may happen.

We'll start with the things I want.

- **Reform of healthcare entitlements** – Republicans in 2017 will control Congress and the White House, so they'll have the power to fix our broken entitlement system and dramatically improve America's long-run outlook. And since the House and Senate GOPers have voted for budgets that presume much-need structural changes to Medicare and Medicaid, that bodes well for reform. The wild card is Donald Trump. He said some rather irresponsible things about entitlements during the campaign, which suggests he will leave policy on autopilot (which is not a good idea when we're heading for a fiscal iceberg). On the other hand, politicians oftentimes disregard their campaign commitments (remember Obama and "you can keep your doctor"?), especially when they get in power and finally take a hard look at budget numbers. Perhaps the most optimistic sign is that Trump has appointed Budget Committee Chairman Congressman Tom Price to be Secretary of the Department of Health and Human Services and Congressman Mick Mulvaney to be Director of the Office of Management and Budget. I very much hope Trump seriously addresses the health entitlements.
- **A lower corporate tax rate, "expensing," and repeal of the death tax** – During the campaign, Trump proposed a very large tax cut. With Republicans controlling both ends of Pennsylvania Avenue, some sort of significant tax cut should be feasible. It's highly unlikely that Trump will get everything he wants, but the three items at the top of my wish list are lowering the corporate tax rate, ending the tax code's bias against new investment by replacing punitive "depreciation" rules with "expensing," and repeal of the death tax. Those reforms would have the strongest impact on long-run growth. And the icing on the cake would be a repeal of the state and local tax deduction, which subsidizes high-tax states such as California, Illinois, New York, and New Jersey (I'd also like to see repeal of the healthcare exclusion, but I'm focusing on things that might actually happen in 2017 rather than what's on my fantasy list).

- **Regulatory reform** – The tentacles of the regulatory octopus are stifling the American economy. There's no single fix for this problem. The overall system for approving regulations should be changed (I will write on the "REINS Act" in a few days), but that's a partial solution for future red tape. To deal with the existing burden of red tape, a different set of answers will be necessary, including sensible political appointees so that bureaucrats will have a harder time pushing for regulations that are needlessly expensive and misguided and instead will be charged with undoing existing red tape. In some cases (Dodd-Frank, Obamacare, etc), it will be necessary to change current law in order to roll back regulatory excess.

- **Italian default** – I'm not hoping for Italy to face a fiscal crisis, but it almost certainly will happen in the near future. The nation's demographic decline, combined with its bloated welfare state, are a horrible recipe. And while it's theoretically possible to avert a mess by capping spending and fixing programs (just as it is still possible to fix the mess in Greece), I don't think good policy is very likely. So Italy will soon face a fiscal crisis and the real question is whether there's a good response. Ideally, if this happens in 2017, Italy will be allowed to default (presumably because Trump's representative at the International Monetary Fund vetoes any sort of bailout). This will mean, a) the people and institutions who were silly enough to lend money to a profligate government will suffer losses, making them more prudent in the future, b) Italy will lose the ability to borrow more money, putting an end to additional red ink, c) Italian politicians will be forced to immediately balance the government's budget, which hopefully means genuine budget cuts, and d) the Italian people will (hopefully) realize that a system based on looting and mooching can no longer be maintained.

Now here's a list of things I'm afraid may happen.

- **Punting on entitlement Reform** – As noted above, the wild card for any sort of genuine entitlement reform is Donald Trump. If he decides to be President Santa Claus by appeasing various interest groups (like the previous GOPer in the White House), then reform will be dead. Simply stated, House and Senate Republicans will not push good changes without support from the White House. But that's only a partial worst-case scenario. Trump may choose to be like the previous Republican President and actually expand entitlements (perhaps by borrowing a page from Elizabeth Warren's playbook and expanding Social Security). If Trump decides to punt (or, gulp, make things worse), that has very grim implications. Reform will be dead for at least eight years (either because Trump gets reelected or because he's replaced by a Democrat who also opposes reform) and the longer we wait to address the problem, the harder it will be to save America from a Greek fiscal future.

- **A "Poison Pill" in tax reform** – While there is a great opportunity to fix some of the biggest warts in the internal revenue code, I worry that lawmakers will include some bad revenue raisers to help "pay for" the good provisions. I don't think there's any danger (at least for 2017) of a value-added tax, but the plan from House Republicans includes a "border adjustable"/"destination based" tax on imports (known as a DBCFT) that is not only protectionist, but could eventually morph into a VAT. A smaller tax cut without a DBCFT would be better than a bigger tax cut with a DBCFT.

- **An infrastructure boondoggle** – It appears that some sort of infrastructure plan will be approved in 2017. I wrote last year to suggest three guidelines for the incoming Trump Administration on this issue, but I fear that this initiative will become a typical DC feeding frenzy. Lots of spending with no accountability.

- **Italian bailout** – If the inevitable Italian fiscal crisis occurs in 2017, the worst possible outcome would be a Greek-style bailout. That approach has several undesirable implications. It will a) exacerbate moral hazard by rewarding the investors who bought Italian bonds, b) it will enable Italian politicians to incur more debt, and c) it will enable the Italian people to continue thinking that big government is good because someone else is paying for it. To be sure, because there's so much more debt involved, bailing out Italy will be much harder than bailing out Greece. But so long as the corrupt and venal IMF plays a role, it's always prudent to assume the worst policy will be imposed.

I hope all readers have a happy new year, and I hope, for the sake of America and the rest of the world, that the first half of today's column is more accurate than the second half.

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