

»» The USA has no economic policy



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The economic policy agenda so far communicated by the new US administration can be summed up under three main points: infrastructure programme, tax cuts, and increased protectionism. A closer look reveals that these ideas are fuzzy and inconsistent.

Still no infrastructure plan

There are still no signs of an infrastructure initiative. Yet the need for infrastructure investment is immense. The American Society of Civil Engineers (ASCE) has identified a need for infrastructure investment to the tune of USD 4.5 trillion for the next ten years and a funding gap of some USD 2 trillion. But no one has an idea how this should be implemented.

Use taxes to guide investment?

This is where Trump's new tax plans come into play. In late April, Treasury Secretary Mnuchin provided the basic outline for a tax reform. Its implementation is intended to boost private-sector demand in a bid to trigger additional infrastructure investment. To achieve this, however, targeted direct increases in public expenditure would be a more effective method. Tax cuts initially increase only disposable incomes, and how these are then used depends on the individual marginal propensities to consume and to invest. Tax cuts are thus hardly suitable for influencing the realisation of desired infrastructure projects.

But the biggest question mark surrounding the tax cut plan is whether it can even be realised. The expected long-term budget revenue shortfalls (estimated at around USD 7 trillion within the next 10 years) can be expected to generate enormous parliamentary

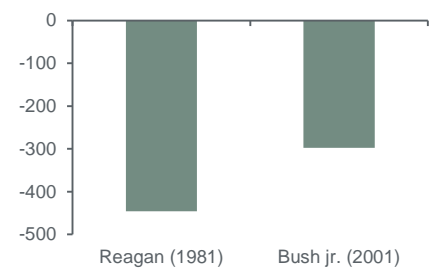
resistance, even among the Republicans. The Trump administration is hoping that the tax cuts will not cause such high deficits in the long term but will essentially 'fund themselves' through higher growth (and thus higher tax revenues) – an old dream of supply-side economics. But reality tells a different story: major tax relief packages adopted under presidents Ronald Reagan or George W Bush resulted in massive revenue losses for the state (Figure 1).

More demand would drive imports

Particularly in the current situation, given the current cyclical phase and potential growth of around 1½ %, this should be similar because the cyclical effect of fiscal stimulus will likely be limited. Rather, with the economy nearing full capacity utilisation levels, inflationary effects would be the most probable consequence.¹ But should it actually be possible to stimulate aggregate demand even further, growing demand for imports would lead to a higher external deficit. After all, the USA is a prime example of an economy in which domestic demand correlates very positively with imports and, thus, with a higher current account deficit (Figure 2).² In other words, the tax plans are at odds with the protectionist stance on external trade. The Treasury Department did state in its 'Semiannual Report on International Economic and Exchange Rate Policies' as recently as in April that none of the twelve trading partners reviewed met all criteria to be able to refer to them as trade or currency manipulators. But that did nothing to keep the president from stepping up his protectionist rhetoric again recently, especially towards Germany.

Figure 1: Effect of tax cuts on budget revenue in the USA

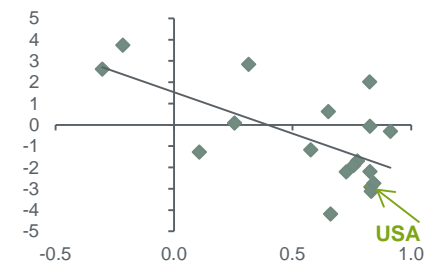
Effect of tax cuts on (federal) revenue within the first four years after entry into force, cumulative (in USD billions)



Source: US Treasury (Office of Tax Analysis, 2013)

Figure 2: Correlation between consumption and imports, and current account balance

G 20 countries (without Saudi Arabia and Russia) plus Spain, 1990 to 2016



Note: In the USA the positive correlation between investment and imports is on a similar level as between consumption and imports

Sources: IMF, Feri, own calculations

Conclusion

The new US administration has not yet been able to present a coherent economic policy. What is needed are an infrastructure programme that is viable in the long term and boosts productivity, and measures to strengthen export potential. ■

¹ Cf. Dohmen, C. and T. Rehbock (2017), Can an expansive fiscal policy deliver an economic miracle in the USA?, KfW Research, Frankfurt am Main <https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-2017/Fokus-Nr.-169-April-2017-US-Produktionspotenzial.pdf>

² We also pointed this out in: Rehbock, T. (2016), U.S. trade - no turning point yet, KfW Research, Frankfurt am Main <https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-Nr.-131-Juli-2016-US-Außenhandel.pdf>.