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The US Presidential Candidates and the Economy

The two candidates for president of the United States present starkly different views on economic policy. Donald Trump proposes historically large tax cuts while Hillary Clinton proposes a modest tax increase. Both candidates have made proposals that would increase public investment in infrastructure. Trump claims that he would balance the budget by cutting spending. However, he rules the biggest categories of spending – Social Security, Medicare and national defense – off-limits. Taken together, this means decimating the rest of the budget.

Trump has argued that he would massively increase economic growth by cutting government regulation, imposing protectionist trade measures and cutting taxes. Secretary Clinton argues that her proposals would be good for the economy by investing in people, although in a nod to the populist sentiment Trump has unleashed, Clinton is sounding much more protectionist than recent presidents, including both her husband and Barack Obama.

It is hard to find economists who believe that protectionist trade measures boost economic growth. The Peterson Institute of International Economics estimates that Trump's trade proposals would precipitate a trade war with our biggest trading partners, costing as much as 4.8 million US jobs, and possibly even more if the proposed measures were to expand beyond China and Mexico.¹ Given the resulting economic damage, the report questions whether Trump's policies could be sustained, although Trump would argue that his tariff proposals will give him the leverage to negotiate better deals with our trading partners. Campaign rhetoric notwithstanding, the report asserts that Clinton likely represents a continuation of the status quo on trade – an assertion that Trump agrees with.

Clinton's plan would raise taxes, almost exclusively on the rich, and would attempt to strengthen the taxation of multinational corporations. Tax rates on households with more than \$5 million in income would increase from 43.4% under current law to 47.4%. The plan would also limit the value of certain tax subsidies for high-income households and impose a new "Buffett Rule" tax – named after the liberal billionaire who complained that he pays a lower tax rate than his secretary.

Clinton would increase the estate tax, although it would still only apply to very wealthy decedents. Her proposal would end tax subsidies for fossil fuel production and would subsidize certain activities, such as long-term care giving. The plan would tax capital gains at gradually lower rates for assets held between two and six years in an effort to encourage investors to be more patient. Overall, it would raise about \$1 trillion in new revenues over the next decade, although nearly all of those revenues would be earmarked to finance new spending initiatives.

Her plan includes some simplifications of the tax code for small businesses, but taxation for high-income households would become much more complex, thus raising the costs – both monetary and non-monetary – of compliance. These additional costs could be avoided through a more thoughtful design. Clinton's plan would reduce incentives to work, save and invest for those with high incomes, and thus it could be expected to slow the economy somewhat. However, to the extent that the additional revenues reduce budget deficits, the reduced competition with the private sector for capital could eventually push down interest rates, which would boost private sector investment.

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¹ M. Noland, G.C. Hufbauer, S. Robinson, T. Moran: Assessing Trade Agendas in the US Presidential Campaign, PIEE Briefing 16-6, Peterson Institute for International Economics, 2016.

Trump's plan is harder to assess because it keeps changing. In the primary season, he proposed massive tax cuts that would have added more than \$10 trillion to the national debt over the next decade. During the summer, the plan changed, and a few weeks ago, another entirely new incarnation appeared – although even that plan's details seemed to change moment by moment while the campaign staff hammered out details, some of which are still up in the air. Overall, the plan looks similar to a proposal by the Republican leadership of the US House of Representatives, which we estimated would reduce federal revenues by about \$3 trillion over the next decade.²

The overall effect of the Trump plan on the economy is also a mixed bag. On the one hand, it will reduce top marginal individual income tax rates by about ten percentage points and would slash corporate income tax rates from 35% to 15%. The 15% rate would also apply to some unincorporated businesses (although the exact scope of this provision has been hard to pin down). In addition, businesses would be allowed to immediately deduct (expense) new investments, moving business taxation towards a cash-flow consumption tax (a variant of the European-style VAT). His plan would also eliminate the estate tax.

These features would tend to boost incentives to work, save and invest. The conservative Tax Foundation reckons that the Trump plan could boost the economy by as much as eight percent in the long run, assuming that interest rates do not react to the run-up in debt.³ However, our analysis in collaboration with economists at the University of Pennsylvania of the somewhat more pro-growth House tax plan concluded that the positive economic effects in the short run would eventually be offset by the drag created by steadily rising national debt. Eventually, higher interest rates would negate the short-term supply-side boost from lower marginal tax rates.

One wildcard in the Trump plan is his treatment of business income. The 15% tax rate on small businesses will provide a large incentive for high-income workers to label themselves as independent consultants or contractors rather than employees. On a million dollar salary, that would save them \$180,000 in taxes. Presumably there would be rules aimed at discouraging such gaming. However, experience in Scandinavia, where labor income is generally taxed at a higher rate than capital income, suggests that it is hard to police the boundary between labor and capital.

One area where the candidates agree is infrastructure. Clinton has proposed \$300 billion in new infrastructure investment. Trump says he would invest double that amount. US infrastructure is deteriorating and inadequate, and with interest rates currently at historical lows, now seems like an ideal time to make such investments. Carefully designed investments boost the economy in the short run by injecting cash into the economy and in the long run by raising productivity and lowering commuting and transit costs. However, the US Congressional Budget Office warns that the public infrastructure investments that are funded are often not the ones that would produce the highest payoff.

There are certainly many other factors beyond the candidates' tax proposals that will affect the economy. For example, Clinton would dramatically increase the federal minimum wage, boost public research expenditures and increase federal funding for higher education. Trump promises to stamp down on illegal immigration and deport many or most of the undocumented immigrants currently living in the country, which could cost the federal government \$400 to \$600 billion and reduce GDP by over \$1 trillion. Overall, Clinton's proposals would make the tax system much more progressive, while Trump's would disproportionately benefit the wealthy. This reflects a longstanding debate about whether explicit redistribution or supply-side tax incentives represent the best approach to help struggling workers.

² We are scoring the new Trump plan now and plan to post updated estimates and analysis by mid-October at www.taxpolicycenter.org.

³ A. Cole: Details and Analysis of the Donald Trump Tax Reform Plan, September 2016, Fiscal Fact No. 528, Tax Foundation, 19 September 2016.