<u>US TAX REFORM: PROPAGANDA AND PROSPECTS</u>
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Genevieve Larkin exclaims in the film "Gold Diggers of 1937": "It's so hard to be good under the capitalist system!" (Lloyd Bacon, director)

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CONCLUSION AND OVERVIEW

The most recent American corporate and individual tax "reform" proposal sketched by the President and Republican Congressional leadership is merely a "framework". These ringleaders and their acolytes proclaim that genuine legislative planning and serious negotiations will create a robust document, a beneficial bill suitable for passage. However, the overall explicit and implicit policy substance (partisan aims) incorporated in the current outline probably will not become law. Even if a few elements of the "reform" scheme manage to pass the House and Senate and become law, at most this will represent modest tinkering with rather than major changes in the current tax code.

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Why will the corporate and individual tax reform program advocated by the President and others generally fail to be enacted? First, partisan political divisions in America in general and Congress in particular are too severe. Although the Republicans control both Houses of Congress, their Senate majority is slim. Whereas Congressional Democrats for the most part have held ranks since the 2016 election, Republican unity, particularly within the Senate, has been fragile. Not all Republicans adopt the same (or Trump's policies).

The corporate and individual tax code reflects a diversity of political (cultural) viewpoints. Consequently, perspectives regarding as well as campaigns to transform, modify, or preserve critical aspects of it reflect opinions. Thus competing cultural camps with assorted outlooks and aims engage in heated rhetorical battles to advance their interests. Moreover, these proposed so-called tax reforms represent significant ideological approaches, not merely cosmetic fixes and updates.

In recent years, compromise in Congress in various critical policy matters has appeared with less frequency and generally only grudgingly. If the Senate cannot repeal (or repeal and replace) Obamacare (Affordable Care Act), how will they manage to make substantial alterations in an extremely complex document such as the United States tax code? Donald Trump's remarkable and shocking Presidential triumph in America's 11/8/16 election has not been followed by Congressional passage of his legislative agenda (Inauguration Day was 1/20/17). Why will Democrats help President Trump and Republicans win a notable legislative victory on taxation with election 2018 coming into view?

In the United States, even though labels are not definitive and groups can overlap, look further at and beyond the "political" sphere. America of course has never been entirely homogeneous or unified. The widely-shared American Dream has been expressed and implemented in various ways. Yet America's disagreements and debates currently are wide-ranging. The lines between and within camps are not always clear; moreover, individuals may be loyal (belong) to various (and often competing) categories.

In any case, the long list of America's noteworthy splits and fractures makes it especially changing to enact wide-ranging changes in the core taxation (and spending, including entitlements) policy arena. There are liberals (progressives), conservatives (traditionalists), centrists (moderates), and independents. Populists (both left and right wing) confront the establishment (elites). Globalists contend with nationalists.

America, as a house divided, has rich versus poor, haves versus have-nots. Highlight the nation's substantial economic inequality. Is America nowadays a Gilded Age era? Are economic and social mobility increasing?

Consider divisions relating to race (ethnicity), gender/sexuality, religion, age, geographic region, and urban/rural. Fierce quarrels rage not only over tax and spending policies, but also over health care. Heated fights occur on trade and tariff issues, economic regulation (how much is appropriate), abortion rights, immigration, gun ownership, and environmental fields such as climate change.

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Moreover, President Trump probably will be unable to lead the contending camps inside and outside Congress toward a realization of his tax "reform" plan. Some circles fervently admire Trump. His "Make America Great Again!" and "America First" slogans and many of his policy pronouncements obviously appeal to large numbers of Americans. Yet he nowadays lacks sufficient influence over Congress as a whole, including parts of the Republican caucus. And among the nation in general, his popularity is quite low. Many observers see him as erratic in his outlook and imprudent and insensitive in his opinions and actions.

Moreover, Donald Trump lacks government insider experience. Rhetoric and behavior (and talents) suitable for running a successful family-owned business, a reality television show, or even a successful Presidential campaign are not necessarily appropriate (adequate; likely to succeed) in regard to leading a country well or inspiring Congress to adopt his policy agenda.

Although Trump won in the Electoral College, he decisively lost the popular vote tally. The popular vote outcome obviously reflects America's sharp political divisions. Also, the Russian President "directed a vast cyberattack aimed at denying Hillary Clinton the presidency and installing Donald J. Trump in the Oval Office, the nation's top intelligence agencies said in an extraordinary report" (NYTimes, 1/7/17, ppA1, 11). Trump's popular vote defeat and reports on Russian political interference undermine Trump's political "legitimacy" (faith in it) and thus his ability to lead effectively.

The President's continued unwillingness to release his own tax returns makes it challenging for some to agree with his reform package. Might he or his family benefit from the proposed framework?

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Over three decades have passed since the last notable US tax reform (Tax Reform Act of 1986). Even though many gurus complain about parts of the current personal and corporate tax system, there does not appear to be a widespread consensus as to how to dramatically overhaul it.

Keep in mind that the individual and corporate tax codes are not merely long and complicated. It is a rhetorical structure reflecting a large and complicated society. Its lengthy enshrined provisions and interpretations of them therefore frequently represent competing visions and values. America's current tax laws took a long time to reach their current structure. The US from the vantage points of both individuals and corporations of course is a diverse and complex country; this parallels the complexity of the global economy, with which the nation is enmeshed. Some "special interests" will fight vigorously for the proposed "reform" (or parts of it), but other crews will lobby heatedly against all or many of its provisions. These considerations also make it very difficult, and particularly unlikely in the current domestic American political environment, for substantial tax changes ("reform" of whatever fashion) to occur.

DECODING THE TAX "REFORM" PACKAGE

The rap music group "Wu-Tang Clan" sings in "C.R.E.A.M.": "Cash, Rules, Everything, Around Me C.R.E.A.M. Get the money Dollar, dollar bill, y'all."

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In the context of proposed tax "reform" and "fixing our broken tax code", survey the documents promoted by the White House and its friends. These include "Highlights of the Unified Tax Reform Framework" and related material. The outline launched by the "Big Six" includes the Republican leadership in the House, Senate, and White House.
https://www.whitehouse.gov/the-press-office/2017/09/27/unified-framework-fixing-our-broken-tax-code
https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework_1pager.pdf
https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf

The White House declares there has been "Widespread Praise for President Trump's Unified Framework for Tax Reform" (9/27/17).
https://www.whitehouse.gov/the-press-office/2017/09/27/wtas-widespread-praise-president-trumps-unified-framework-tax-reform

Whether such "widespread praise" equals a majority of legislators or of the general public is not terribly clear. However, a recent Pew Research Survey (9/27/17) hints to the contrary on at least some of the tax reform agenda as far as the public as a whole is concerned: "More Americans favor raising than lowering tax rates on corporations, high household incomes".
http://www.pewresearch.org/fact-tank/2017/09/27/more-americans-favor-raising-than-lowering-tax-rates-on-corporations-high-household-incomes/

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Let's investigate the language of the Presidential/Republican leadership regarding and a few of the probable general consequences of the proposed tax "framework". This wordplay is permeated with values of good and bad.

A "unified" framework presumably is better than one representing disunity or disorganization. And in the current political context, unified suggests the authors spent sufficient time and effort together to design and produce a coherent (and arguably praiseworthy) program.

The notion of reform, whether in politics, economics, or elsewhere in culture, generally reflects an ideological standpoint. And reform generally is designated as "good". Thus the President and his comrades in this taxation scheme maneuver to persuade others to adopt their principles (or at least enact some or all of their beloved legislation). So since change is a relatively more neutral term in the political context, analysts should abandon the word "reform" and replace it with "change".

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Americans of course should put "America First", and good tax (and spending) measures undoubtedly will help to "Make America Great Again!" The term "reform" sounds like something pretty good, yes? Citizens should embrace a "framework" capable of "fixing our broken tax code" and support "pro-American tax reform"! Isn't fixing something broken usually good (at least if it was good before), and who wants anti-American tax reform (laws)? Even if tax simplification (such as tax structures with fewer brackets) is not necessarily better, the Administration and its cohorts claims their plan represents an improvement.

Indeed, this propaganda promises "more jobs, fairer taxes, and bigger paychecks". Moreover, there will be "lower rates for individuals and families" and "tax relief and simplification for American families". Not only is it "time for Congress to provide a level playing field for our workers" and to "put more money into the pockets of everyday hardworking people". In addition, the glorious "framework repeals the unfair Death Tax" [incidentally, the wealthy are the only ones who pay this]. Why not legislate "Moves to an American Model for Competitiveness"? Permitting immediate expensing of new business investments will generate "a much-needed lift to the economy". Language emphasizes the benefits that will accrue to "American workers, small businesses, and middle-income families"

As part of its mission to achieve "fairness", this program will assist corporations via slashing their tax rates (giving them a "level playing field"). But contrast the Reform Framework's stress on benefits to individuals, everyday hardworking people, families, the middle-class, and small businesses with the relative silence (lesser emphasis) regarding other beneficiaries. Despite the substantial (and some critics would say disproportionate or unfair) benefits of the tax "reform" to big business/large corporations and wealthy/very high income individuals/families, the cunning drafters of the outlined framework do not underscore the consequences of its provisions to these recipients.

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In the 1987 movie "Wall Street", the corporate raider Gordon Gekko preaches: "Greed… is good".

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The "reform framework" of course is not a finished creation (it arguably resembles a skeleton missing several bones); further effort and perhaps Congressional negotiations will add flesh to it.

The Tax Policy Center's (Urban Institute and Brookings Institution) "A Preliminary Analysis of the Unified Framework" (9/29/17) offers an overview of the reform framework's likely fiscal and other consequences.

http://www.taxpolicycenter.org/publications/preliminary-analysis-unified-framework
http://www.taxpolicycenter.org/sites/default/files/publication/144971/a_preliminary_analysis_of_the_unified_framework_0.pdf

The Tax Policy Center's ("TPC") analysis predicts the Unified Framework "would reduce federal revenues by $2.4 trillion over the first ten years [fiscal 2018-2027] and $3.2 trillion over the subsequent decade [2028-2037]." See Table 1. Over the first decade, business tax provisions (including those affecting corporations and pass-through businesses) will cut revenues by $2.6 trillion. Individual income tax provisions (excluding those related to business income) will increase revenues by about $470 billion. Elimination of estate and gift taxes cuts roughly $240 billion in revenues. Given this rise in revenues from the individual provisions, it seems likely that a significant portion of the overall income tax reduction to the top quintile (in particular) derives from the substantial diminution of business taxes.

The Committee for a Responsible Federal Budget estimates a $2.2 trillion net revenue loss through 2027 via the Big Six "reform" strategy, close to the TPC's forecast. http://www.crfb.org/blogs/big-6-tax-framework-could-cost-22-trillion

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See the TPC's "Share of total federal tax change" percentages for the quintiles in Tables 2 and 3 for the 2018 and 2027 "Distribution of Federal Tax Change From Proposals in the Unified Framework" (see also Appendix B, Table B1). Not everyone ("tax unit") in each of the five quintiles receives a tax cut. However, the Tables show that a majority within each quintile does, with the exception of the top quintile in 2027. However, in 2027, the top quintile as a whole on average still wins a large tax cut.

In any case, most of the benefits of the federal tax changes accrue to the top quintile, especially the top one percent. In 2018, the top quintile receives 74.5 percent of the "total federal tax change", with the top one percent gobbling up 53.3pc of the total. Although the TPC's presentation is not altogether clear, it seems that many of the net benefits to the upper income group derive from changes to the corporate tax structure.

In any case, suppose the Tax Policy Center's Tables are fairly accurate. They suggest that the Presidential/Republican leadership "reform" plan is a primarily an effort to benefit the high-earners/big money (wealthy) groups with tax breaks. Most of the affluent people benefiting from the proposed framework probably belong to some sector of "the establishment" (although many of these are Republican, many are Democrats or independents), even if some of those well-to-do beneficiaries occasionally don "populist" clothing and spout anti-establishment rhetoric.

The advocates of the Unified Tax Reform Framework seek to convince the middle class (and "everyday hardworking people") to support their "reform" strategy by offering them a bit of money and a lot of inspiring yet cunning wordplay. Isn't "lowering the tax burden on the middle class" (and hard workers, especially of the "everyday" variety) good and marvelous policy? "Strengthening and growing the middle class, and keeping more money in their pockets, is how we build a stronger America"; that's wonderful too, right?

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See the current Administration's earlier (April 2017) tax and spending plan as well as candidate Trump's 2016 ones. These seem broadly consistent with the tax philosophy (benefiting the affluent) of the current "reform" plan. Their federal deficit consequences may be greater than those of the current proposal, but that does not make those of the current plan insubstantial. Note the analyses from the Tax Policy Center and the Committee for a Responsible Federal Budget. http://www.taxpolicycenter.org/taxvox/new-dynamic-analysis-confirms-estimates-trump-tax-plan-would-add-trillions-deficit

http://www.taxpolicycenter.org/sites/default/files/publication/142616/2001405-the-implications-of-what-we-know-and-dont-know-about-president-trumps-plan_1.pdf

http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000924-an-analysis-of-donald-trumps-revised-tax-plan.pdf

http://www.crfb.org/blogs/how-much-will-trumps-tax-plan-cost

MIRACLE GROWTH AND MAGIC TRICKS

Examine other eloquence surrounding the "Highlights of the Unified Tax Reform Framework". Crucial to the persuasive strategy of the President ("America First"; "Make America Great Again!") and other so-called tax reformers are remarkable claims that economic growth somehow will pay for the individual and corporate tax cuts. Supposedly there will be no need to reduce expenditures (including entitlements) substantially to finance the tax cuts. Thus the federal budget deficit will not explode. Isn't this extraordinary reform essentially risk-free? Is this promised land within reach?

The great majority of analysts strongly dispute the vision that economic growth derived from tax cuts will entirely (or at least substantially) eliminate the larger deficit resulting from those reductions. The faith of alleged reformers such as President Trump, his Treasury Secretary, and their allies is unsupported, or at least generally discredited.

According to the Committee for a Responsible Budget, "Tax Cuts Don't Pay for Themselves" (10/4/17), "There is no theoretical basis to suggest tax cuts could be self-financing. To do that, the economy would need to grow by $5 to $6 for every $1 of tax cuts. There is broad consensus among economic models that future tax cuts won't pay for themselves…Past tax cuts in 1981 and the early 2000s have led to widening budget deficits and lower revenues, not the reverse as some claim." And: "No Reasonable Economic Model Shows Tax Cuts Paying for Themselves". http://www.crfb.org/sites/default/files/tax_cuts_dont_pay_for_themselves_final.pdf

Treasury Secretary Mnuchin's views that the tax cuts will reduce the deficit because of the economic growth they will generate (expressed in a 10/1/17 interview on the NBC News show, "Meet the Press") "break with conventional economic thinking" (see the NYTimes article, "Republican Tax Plan May Not Be Built to Last"; 10/1/17 website). https://www.nbcnews.com/meet-the-press/meet-press-october-1-2017-n806371

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What, if any, spending cuts in discretionary (or other) programs will pay for these tax changes? Will battles over spending priorities in general and entitlements in particular block passage of the current reform plan, or at least substantially reduce the amount of any tax cut?

Apparently the Big Six reform agenda, at least for now, will not involve tax cuts paid for by spending cuts, including safety-net programs such as Medicaid. House Speaker Ryan claimed in his CBS News "Face the Nation" interview (10/1/17) that the tax plan will be "deficit neutral" (not increase the debt). But he also suggested the failure of Republicans to repeal Obamacare (the Affordable Care Act) shows that it is politically toxic to dismantle entitlement programs. The NYTimes quoted him: "I think we'd kill tax reform if we did." (See NYTimes, "Republican Tax Plan May Not Be Built to Last".) https://www.cbsnews.com/news/transcript-paul-ryan-on-face-the-nation-october-1-2017/

It will be very challenging for the reform all-stars to find compromises with their determined opponents on spending (especially entitlement) issues.

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Will proponents of the Unified Tax Reform Framework be satisfied with passage of a substantially smaller net tax cut than one over two trillion dollars for the next ten years (2018-2027; Tax Policy Center estimate $2.4tr) and more than three trillion over the subsequent decade

(2028-2037: TPC prediction $3.2tr)? Probably. The enthusiastic team of "reformers" surely believes that some (overall) noteworthy tax cut (especially for the high-earners/wealthy and corporations) is better than none. Half of over five trillion dollars (for 2018 through 2037) still is a mountain of money; even 20 percent of five trillion is substantial cash.

And a Republican victory on tax reform legislation will enable its eloquent orators to claim that their party accomplished something notable (and good) for the middle class and hardworking Americans; such legislative success likely would help Republicans in the 2018 House and Senate races. Besides, advocates of the current proposed framework can return to the table and seek to accomplish further "reform" if they enhance their bargaining position as a result of gains via these elections.

THE PROPOSED TAX REFORM AND THE US FEDERAL BUDGET

Many intertwined variables influence the size and trend of America's federal budget deficits. The Congressional Budget Office offers guidance regarding the American budget situation. Based on these, audiences can make conjectures regarding potential deficits resulting from the net tax cuts (overall spending increases) of the President/Republican leadership tax reform framework.

See "An Update to the Budget and Economic Outlook: 2017 to 2027" (6/29/17; federal fiscal years October 1 to September 30, designated by calendar year in which they end), especially Table 1 (p13; see also Table 5).
https://www.cbo.gov/publication/52801

Under the current "Baseline Budget Projections" (which assumes current laws remain generally unchanged and thus do not include the Trump's reform scheme. The Baseline also does not include several billion dollars in likely additional expenditures inspired by the damaging 2017 hurricane season), debt held by the public rises from about $14.7 trillion in 2017 (76.7 percent of nominal Gross Domestic Product) to about $25.5 trillion in 2027 (91.2pc of GDP). The 2017 budget deficit stands at 3.6pc of 2017's $19.1 trillion GDP. Though the shortfall dips to 2.8pc in 2018, it ascends to 4.0pc of GDP in 2021 and 5.2pc in 2027 (GDP about $28.0tr in 2027). The CBO notes this budget deficit pattern will propel debt held by the public as a percentage of GDP from 2017's already high level (76.7 percent) to 91.2pc in 2027, which would be the its highest debt percentage of GDP since shortly after World War Two.

Suppose that as a result of the current "Highlights of the Unified Tax Reform Framework", the debt held by the public increased by around $2.0 trillion by 2027. That will make debt held by the public rise to about $27.5tr.

The amount of real (and nominal) US economic growth that will occur due to tax reform of course is a highly contentious issue. Assuming no increase in US nominal GDP over the 2018-2027 span from the CBO's current forecast, debt held by the public as a percentage of GDP rises fairly significantly, reaching 98.3 percent in 2027. If 2027's nominal GDP as a result of tax reform climbs five percent relative to the current CBO estimate, GDP that fiscal year will be about $29.4 trillion ($28.0*1.05). If debt held by the public is $27.5tr, 2027's debt as a percentage of GDP climbs modestly from the current Baseline prediction to (a still very lofty) 93.5pc.

In any event, even without the enactment of any of the Tax Reform Framework, America's long run federal debt outlook remains dangerous. See the CBO "The 2017 Long-Term Budget Outlook" (particularly the Cover Page chart and Table 1's "Key Projections in CBO's Extended

Baseline"; 3/30/17). Debt held by the public as a percentage of GDP jumps to 113.0 percent in 2037 and leaps to about 150.0pc in 2047.
https://www.cbo.gov/publication/52480

LANGUAGE GAMES AND US TREASURY NOTE YIELDS

Opinions differ regarding whether all, many, or some of the proposed tax changes described by, implicit in, or likely to result from the President/Republican Big Six "Unified Tax Reform Framework" are good, bad, or indifferent. Views clash regarding the degree to which such "reforms" (or their alternatives) are fair or unfair, just or unjust. Political (economic) perspectives diverge regarding the extent to which that overall tax program or one of more of its components are reasonable/rational/intelligent/prudent/wise/appropriate or not.

Regardless of all such diversity of viewpoints regarding supposed tax reform, and all else equal, growing federal deficits tend to promote interest rate yield increases in US Treasury marketplaces. Of course an army of other variables entangle to affect American government interest rate heights and trends. For example, consider inflation indicators (prices, wages, assets), Federal Reserve and other leading central bank policies, and levels and patterns in other interest rate marketplaces (in the US and elsewhere), the S+P 500 and other stock playgrounds, the broad real-weighted US dollar (and dollar cross rates), commodities "in general", and real estate.

If the apparent policies and guidelines of the current Reform Framework ("as a whole") become law, most agree this will increase the federal budget deficit from present (CBO and other) estimates. The US fiscal shortfall probably will expand, though probably less, even if only a significant amount of the potential Framework legislation is enacted.

Finally, suppose the passage of at least some of President Trump's tax agenda looks fairly possible to a significant number of interest rate and other financial marketplace players. That hope (chance of enactment) will tend (even if only slightly) to boost interest rates. After all, some possibility of legislation is not the same as no possibility.

And all else equal, to the extent that an actual enacted tax reform framework (particularly corporate/business tax changes) boosts corporate earnings, that tends to propel corporate stock prices higher.

Moreover, even if net federal tax reductions (particularly in the corporate sector) probably are unlikely anytime soon (if at all), not everyone agrees with this view. So fairly widespread persistent faith that such "reform" eventually will occur probably encourages many financial pilgrims to keep buying (or at least holding on to) stocks, especially American ones (and even though some US stock valuation measures hint stocks are "high" or "overvalued"). Thus vigorous rhetoric promoting tax reform by several respected and powerful political and economic leaders (at least to some point) can assist the bull move in the S+P 500 and related stock domains. After all, many believe that the potential for tax reform (and possible boosts in infrastructure spending and reductions in regulatory burdens) under a Trump Administration encouraged the stock marketplace rally ("the Trump rally") following his November 2016 election.

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The Federal Reserve plans to gradually reduce the size of its gigantic balance sheet by reinvesting less of the proceeds of (principal payments from) its maturing Treasury and other debt securities. To some extent, this factor indicates a risk of higher government interest rate yields. Assuming over time a rather large federal deficit (perhaps widened by tax reform legislation), this Fed reinvestment policy pattern means that other UST buyers must step in and substitute for the decline in the Fed's UST demand. As the Fed remains determined to achieve its two percent inflation objective, how eager will they be to do so?

Foreigners hold a huge share of US Treasury securities. To what extent will foreigners finance future US budget deficits? Under what circumstances will they become net sellers? Keep in mind an ominous sign: foreign official institutions generally have been net sellers of US Treasury notes and bonds since October 2014 (net buyers in only three months; data through July 2017).

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The US Treasury 10 year note probably began a major bear move with 7/6/16's 1.32 percent low. Since its July 2016 bottom, the UST 10 year yield on balance has walked upward. Note that the UST yield since the 7/6/16 bottom has advanced above a critical trend line pointing down from 6/13/07's major peak at 5.32pc through the 1/2/14 (3.05pc), 6/11/15 (2.50pc), and 11/9/15 (2.38pc) interim tops.

Right after Trump's victory, the US 10 year government yield bounced higher. Its 11/8/16 high was around 1.87 percent; it closed on 11/9/16 at 2.06pc, thereby breaking above 3/16/16's 2.00pc minor top. It has continued to hover above two percent; the low yield following the March 2017 elevation was 9/8/17's 2.01pc.

For the UST 10 year note, twice the July 2016 bottom is 2.64 percent. Its 12/15/16 high was 2.64pc, with 3/14/17's 2.63pc. A sustained yield march above 2.65 percent would be significant, with one over 1/2/14's 3.05pc summit even more so. A move above 2.65pc probably would warn of (or confirm) a significant top in the S+P 500.

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