

ECONOMIC NEWS



United States: Will Tax Cuts Accelerate Growth?

The White House and the Republican leaders in Congress published the most recent version of their tax reform plan last week. While the plan expands somewhat on what was briefly announced in April, a lot of details are still missing, and ultimately it will be up to Congress to fill in these gaps.

For households, the key measures submitted are a reduction in the number of marginal tax rates from seven to three, an increase in the standard tax deduction, and the elimination of the alternative minimum tax and the estate tax. Some credits and deductions would be eliminated. For businesses, a notable change is a corporate tax cut from 35% to 20%, the introduction of a 25% tax rate for sole proprietorships, and the option for businesses to immediately write off their equipment investments, for at least five years.

Will these measures boost economic growth? Generally speaking, any measure that increases disposable income for households should have a positive effect on consumption. However, many factors can affect the extent of the impact. A few examples are the general state of the economy, the inclination of households to save and who are the tax changes primarily aimed at. There are many elements in the proposed plan that cast doubt on its effectiveness. Firstly, the economy has less and less unused production capacity. This is why the Federal Reserve (Fed) has begun normalizing its monetary policy. Secondly, most of the analyses performed to date show that the wealthiest households are primarily the ones that will benefit from significant tax cuts (be it in dollars or in proportion of income). More affluent households typically have a higher savings rate, which reduces the effects on consumption and growth.

As for businesses, the suggested tax cuts are impressive. However, businesses already pay an effective tax rate between 20% and 25% according to estimates, owing, in particular, to numerous tax credits. The effect is therefore likely to be subdued. In addition, profit margins and levels are currently high in the United States, and it is questionable whether a further increase in such margins will greatly benefit growth. More encouraging

are the investment incentives, especially if they accelerate productivity and, ultimately, foster stronger potential GDP.

IMPLICATIONS

At best, the tax cuts proposed by the White House and the Republicans might have a modest positive impact on growth. However, considering the budgetary cost of more than US\$2,000B over 10 years according to estimates by non-partisan organizations, is it worth it? Especially since the current economic situation requires less of a temporary boost and more of a long-term effect on growth potential that could be better supported by other types of policy. Having said that, there is also little certainty that the Trump administration and congressional leaders will be able to deliver, given what transpired on the healthcare front. In closing, the more prudent course is to wait before incorporating this tax reform into our U.S. economic growth scenario; the Fed would do well to do the same.

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