



# Cross-Atlantic implications of the New US policy mix

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# Outline

- 1. TrumpEconomics one year later: what is left? what is new?**
- 2. Trump's economic policy agenda and global imbalances: a *quantification of spillovers using QUEST***
- 3. Are Trump policies sowing discord? Implications for global policy coordination**
- 4. Conclusions: making effective use of the benign outlook to address global challenges**



## The policies (then/now)

Fiscal  
policy

- ↓PIT ↓CIT Border Adjustment Tax
- ↑Infrastructure investment, ↑ Military expenditure
- Repeal and replace Obamacare

'America  
-first'

- Trade (withdrawal from TPP, renegotiation of NAFTA)
- Migration
- Distrust of international policy fora

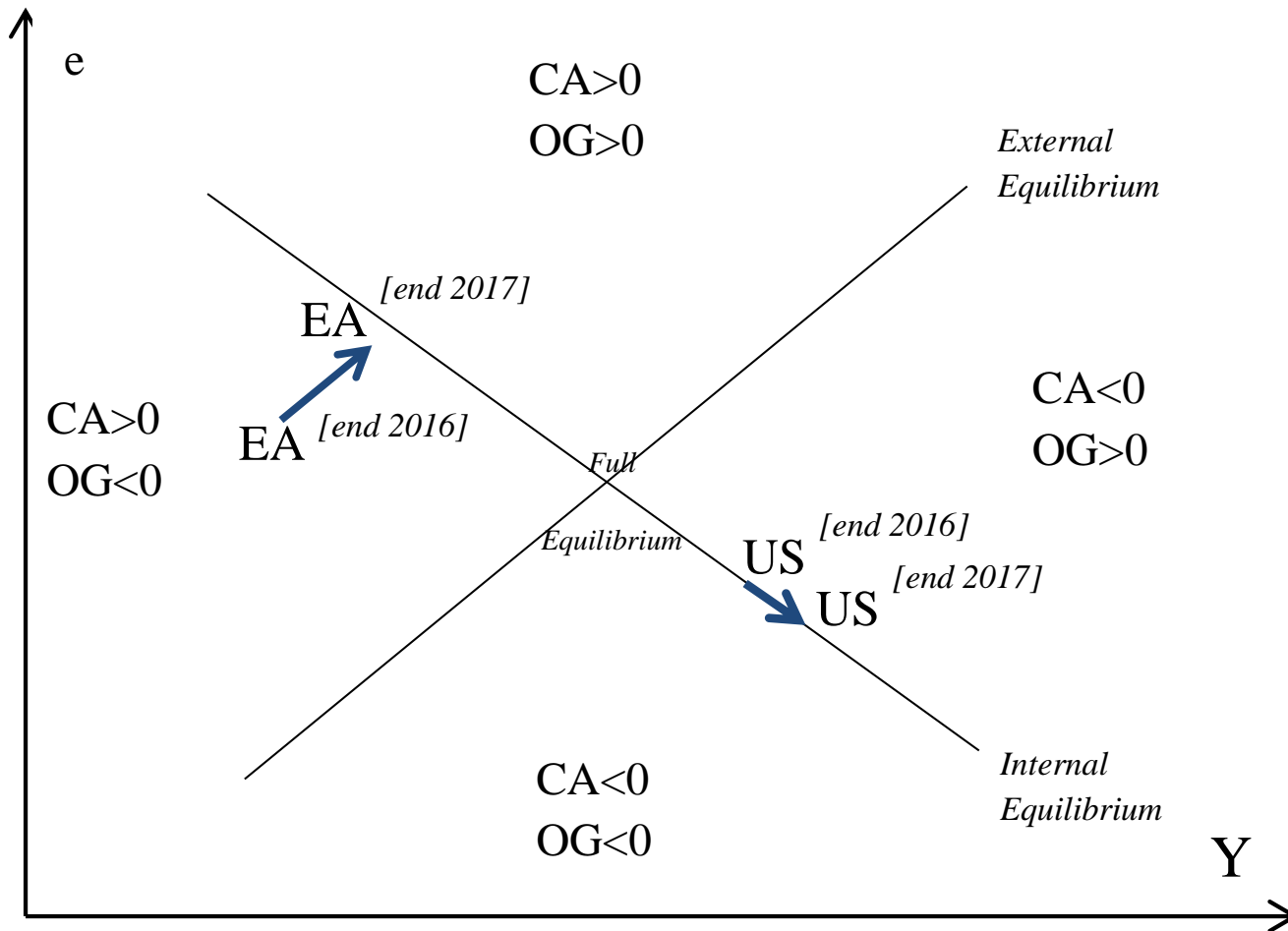
De-  
regulation

- Energy and Environmental (Paris Accord)
- Financial (Dodd-Frank Act)

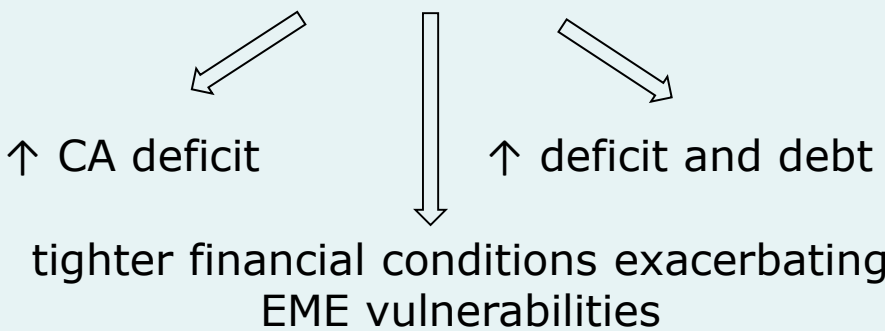
# The economic situation and outlook

- US in late 2016 – a Goldilocks economy?
  - Robust growth [BUT growth potential dented by the crisis]
  - Tight labour market [BUT low participation]
  - Still accommodative monetary policy [BUT weak inflation]
- Strong underlying momentum (high equities, sentiment)
- Indicators related to monetary policy fell from early-2017 peaks (T-bill yields, exchange rate)

# Global imbalances in 2017: where are we?



# Trump's economic agenda - spillovers and global imbalances

Fiscal stimulus (tax cuts)	Protectionist policies (tariff hikes)
<ul style="list-style-type: none"> <li>• Low multipliers at this stage of the cycle</li> <li>• Overheating → Faster rate hikes → → Stronger dollar</li> </ul>  <p>↑ CA deficit</p> <p>↑ deficit and debt</p> <p>tighter financial conditions exacerbating EME vulnerabilities</p>	<ul style="list-style-type: none"> <li>• Modest improvement in the trade deficit</li> <li>• Higher import prices → negative effect on domestic demand and employment</li> <li>• Stronger dollar</li> <li>• Risk of retaliation and trade war</li> </ul>

# Impact on growth of tax reform: two views

**negligible**

effect on real GDP in the next decade

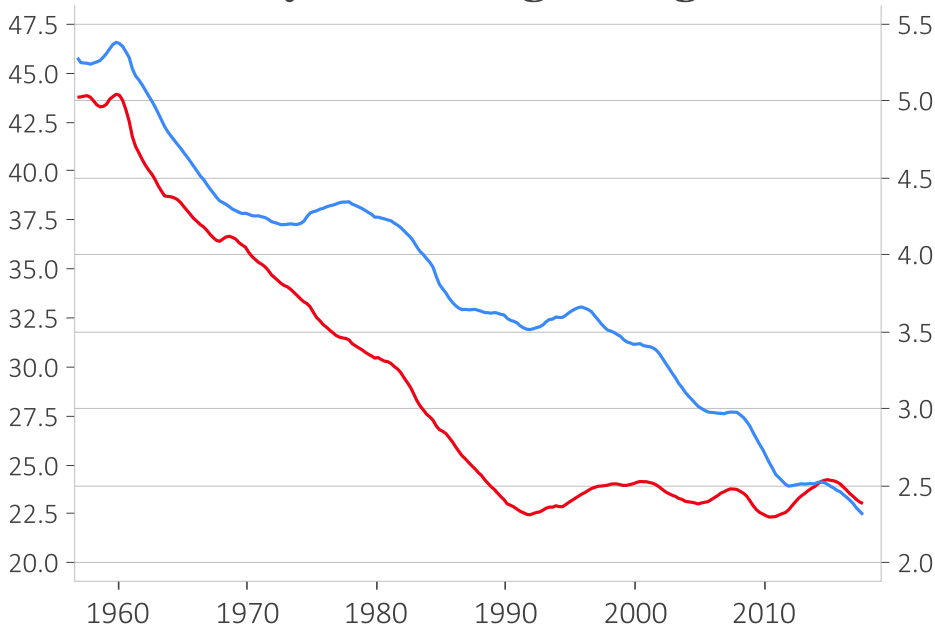
**Significant  
(e.g. +5%)**

- **Mature cycle** → more decisive response of monetary policy
- **Effective US CIT** rate in line with G7 peers and falling
- **Companies already awash with cash**, but not investing
- Moving to a territorial system may **encourage outsourcing**
- Past efforts to incentivise **profit repatriation not successful** in boosting investment

- Economic models suggest lower taxes spur **investment and growth**
- **Capital expensing and falling user cost of capital** to boost investment
- Elimination of profit-shifting incentives **attracting activity back to the US**
- **Repatriated profits** supporting higher employment and wages

# But, can the tax reform *really* boost investment?

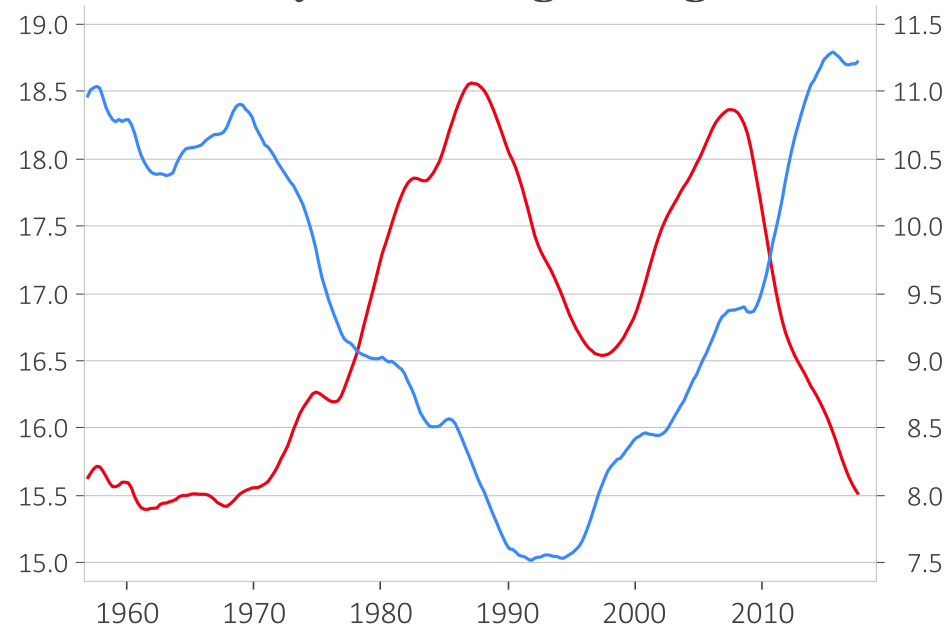
**United States: Corporate taxes as a share of GDP and pre-tax profits (10-year moving average)**



— Corporate Taxes as % of pre-tax Profits (with IVA&CCAdj), lhs  
 — Taxes On Corporate Income as % of GDP, rhs

Source: U.S. Bureau of Economic Analysis (BEA)

**United States: Investment and corporate profits as % of GDP (10-year moving average)**



— Corporate profits (with IVA and CCAdj), rhs  
 — Gross Private Domestic Fixed Investment as % of GDP, lhs

Source: U.S. Bureau of Economic Analysis (BEA)

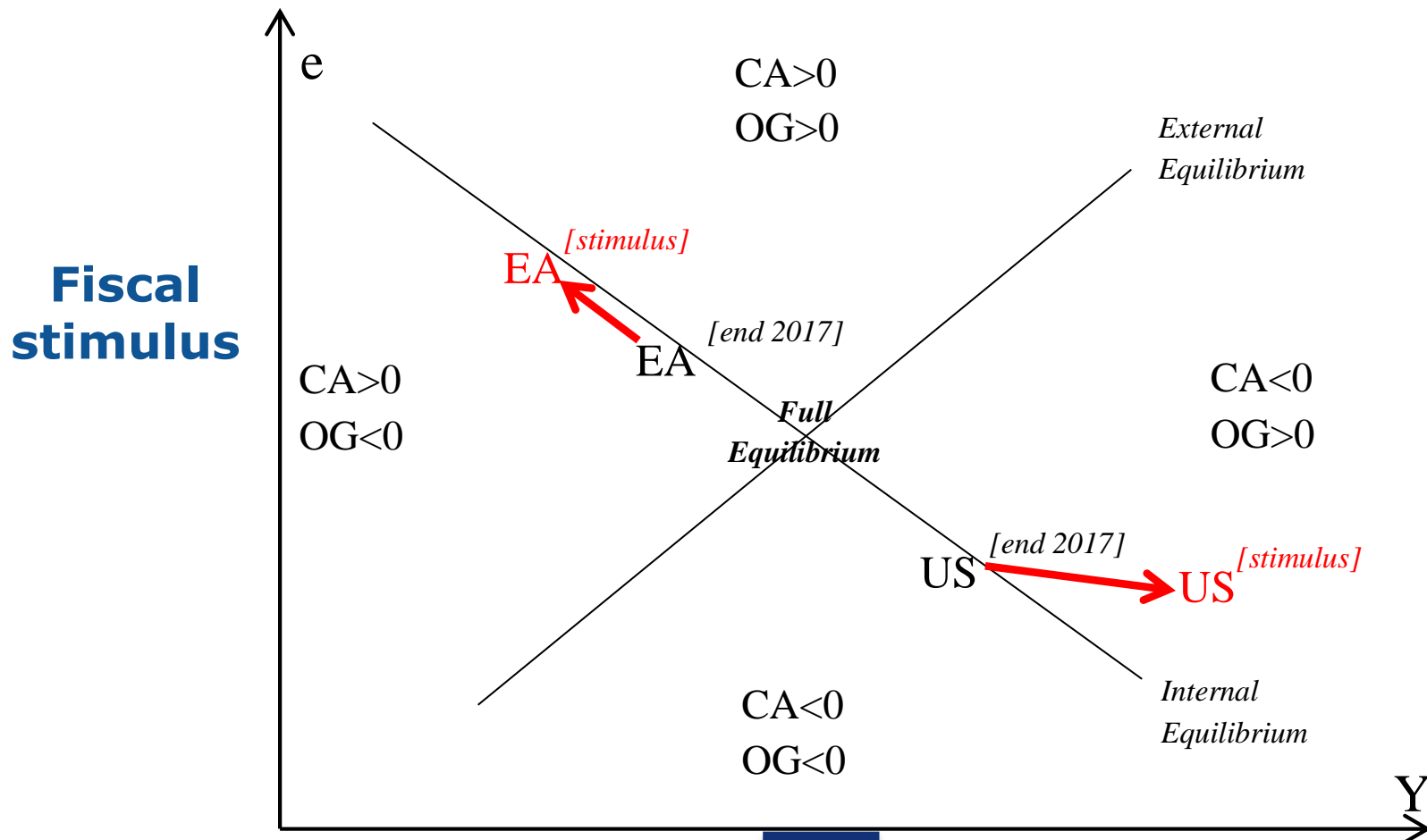


# Fiscal stimulus spillover effects to EA (QUEST)

## Fiscal stimulus (effective corporate profit tax cut of 1% of GDP)

- **US:** higher investment and GDP → rising inflation and wages  
→ faster normalisation of interest rates → appreciation of the USD  
→ offsetting some of the benign growth effects
- Lower exports and higher imports → widening of the CA deficit
- **EA:** GDP effect small as two effects offset each other:
  - Positive demand spillover to EA and
  - Negative investment spillover due to capital fleeing to the US
- Depreciation of the euro leads to a slight improvement in the trade balance
- **Effect on global imbalances – US and EA pushed further into disequilibrium**

# Trump's economic agenda - spillovers and global imbalances



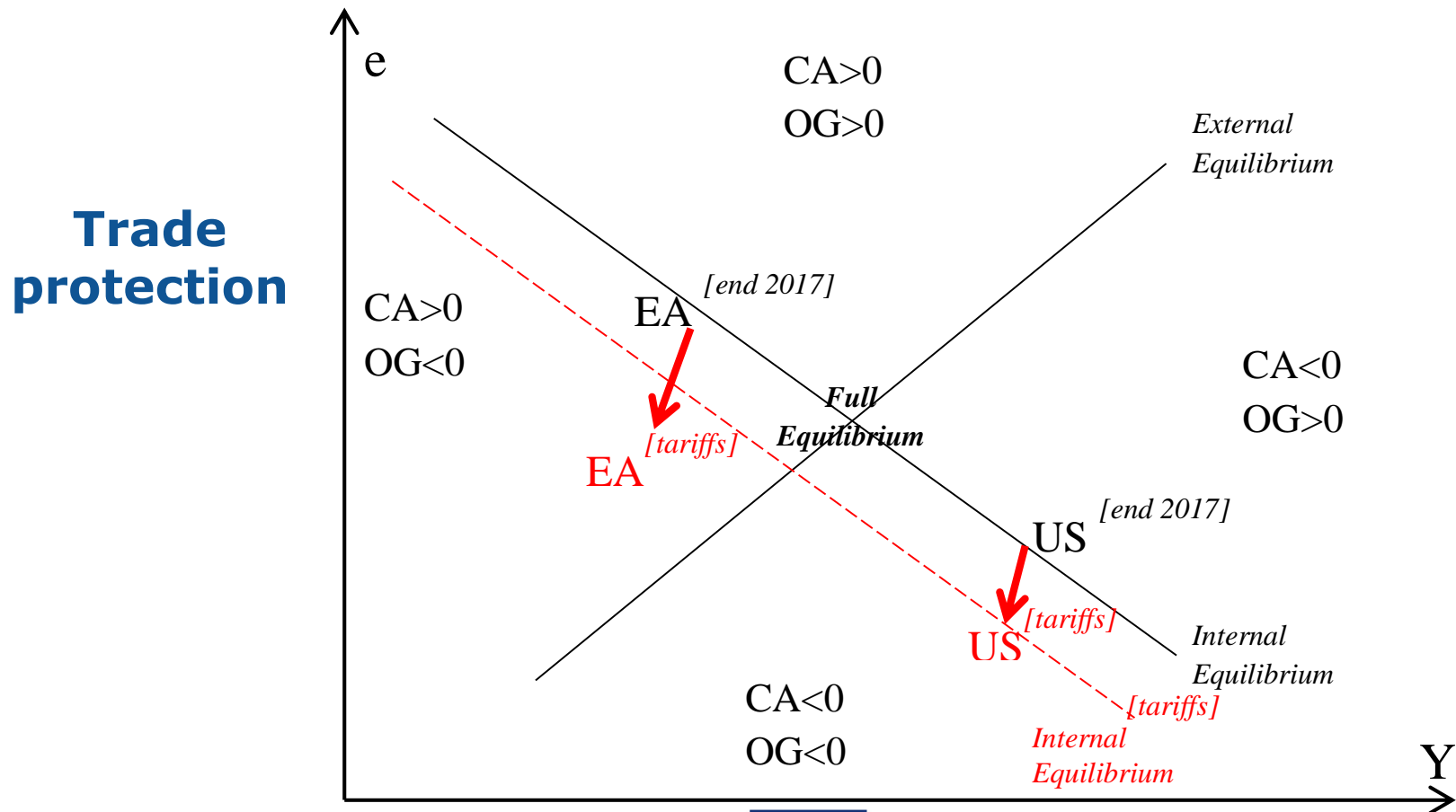
# Tariff increase spillover effects to EA (QUEST model)

## Protectionist policies

(+4% tariff hike vis-à-vis the EA, +6% non-tariff barriers no retaliation)






- Higher tariffs and NTBs raise costs of imports and domestic prices → overall loss of wealth weighing on domestic demand and GDP both in US and EA
- The effect on trade balance is modestly negative in the US, and also negative in the euro area
- Retaliation amplifies negative economic impacts
- **Effect on global imbalances: GDP loss across the board, marginal widening of the US deficit and narrowing of the EA surplus**

# Trump's economic agenda - spillovers and global imbalances



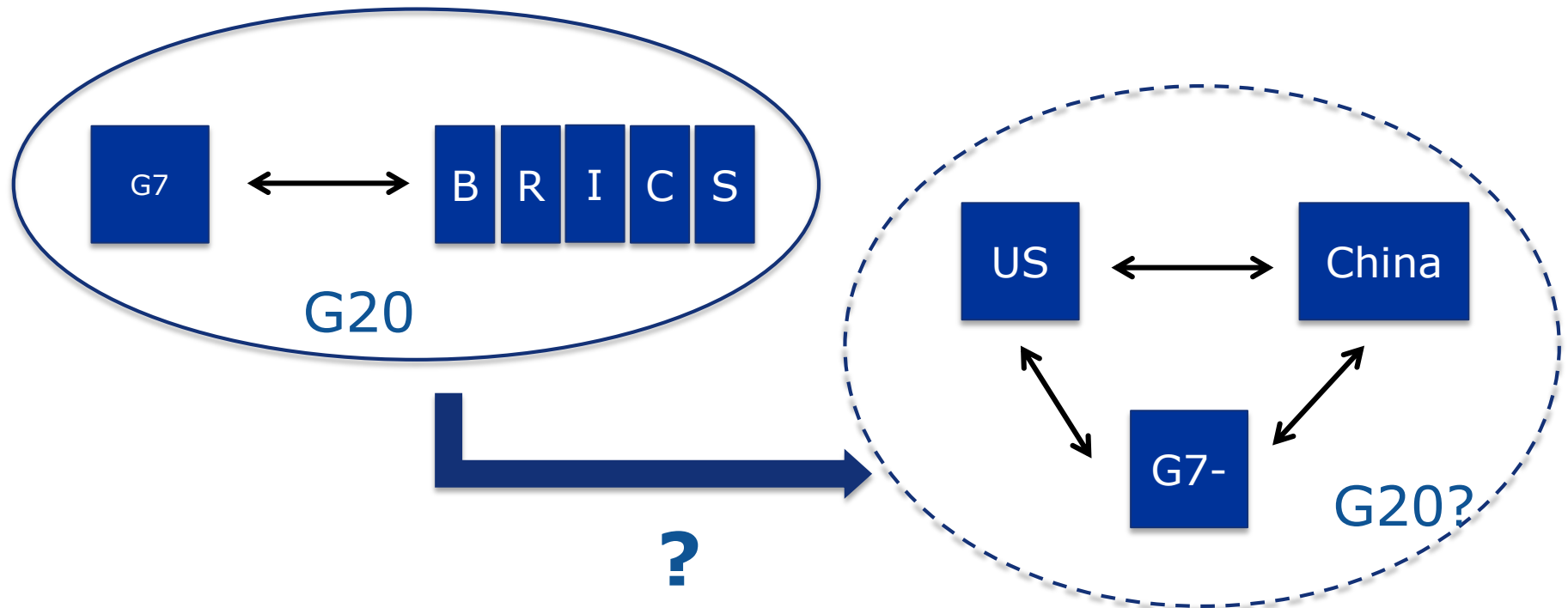


## Challenges to multilateralism

- Trade  shift to bilateralism
- International Monetary System (Crisis Management, IMF)  US disengagement
- Tax  competitive tax shifts
- Financial Regulation  risk of partial roll-back
- Migration  lacking cooperative solutions
- Climate change  US reneging

# Challenges to multilateralism: role of the G20 and G7

A new dynamic game?



# Conclusions

- At the end of 2017 the US economy seems to be in good shape...
- ...but long-standing challenges remain largely unaddressed [*e.g. fiscal sustainability, slow growth potential, etc.*]
- The economic policy agenda of the current Administration is not likely to solve these...
- ...but rather risks aggravating the problems
- Important to make use of the benign outlook to address these problems
- Case for international cooperation stronger than ever