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Is This Tax Reform, or Just Confusion?

Joel Slemrod

Based on the experience of recent decades, the United States apparently musters the political will to change its tax system comprehensively about every 30 years, so it seems especially important to get it right when the chance arises. But at the annual meeting of the National Tax Association in November 2017, one of the keynote speakers began his remarks by asserting that if one set a monkey in front of a typewriter and, after some period, saved only those parts of what had been typed having to do with tax reform, the resulting tax law would be better than what the Republicans were poised to legislate. Ouch. The keynote speaker was Harvard economist and former Secretary of the Treasury Lawrence Summers. Fareed Zakaria (2017), the author and journalist, called the Tax Cuts and Jobs Act just passed "possibly the worst piece of major legislation in a generation . . ." and said, "Those who vote for this tax bill … will live in infamy . . ." Not just the worst tax legislation, but the worst legislation of any kind! The headline of a *Wall Street Journal* op-ed written by Alan Blinder (2017) was "Almost Everything Is Wrong with the New Tax Law."

Defenders of the tax legislation were, naturally, more positive. One supporting petition that was signed by 137 economists, including many academics, asserted that "[e]conomic growth will accelerate if the Tax Cuts and Jobs Act passes, leading to more jobs, higher wages, and a better standard of living for the American people" (as reported by CNBC 2017). The hyperbole of champions was often quantitative.

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A report released by the Council of Economic Advisers (2017) asserted that a tax law like the one eventually passed—featuring a big cut in the corporate income tax rate—could lead to as much as a $9,000 increase in average wages. President Donald Trump remarked that he saw no reason why the tax bill could not deliver a growth rate as high as 6 percent (as reported in Bach 2017).

All in all, a casual observer of the public discussion of tax reform in 2017 could reasonably conclude that economists agree about almost nothing, including whether a specific tax law should even be categorized as tax reform or as mere confusion.[1] In this paper, I address that question and, more importantly, offer an assessment of the Tax Cuts and Jobs Act.[2] The law is clearly not "tax reform" as economists usually use that term: that is, it does not seek to broaden the tax base and reduce marginal rates in a roughly revenue-neutral manner. However, the law is not just a muddle. It seeks to address some widely acknowledged issues with corporate taxation, and takes some steps toward broadening the tax base, in part by reducing the incentive to itemize deductions.

The Last Big Tax Reform, in 1986

I begin by revisiting the Tax Reform Act of 1986, which is the last time the US income tax was substantially overhauled. In the lead-up to that legislation, dissatisfaction with the income tax law had been simmering. President Jimmy Carter (1976) had called the tax code "a disgrace to the human race." Serious political debate can be traced to a bill introduced by Senator Bill Bradley (D-NJ) and Representative Richard Gephardt (D-MO) in the summer of 1983 called "The Fair Tax Act," which featured dramatically lower top individual and corporate tax rates, a broadening of the tax base at both the corporate and individual levels, and a structure designed to preserve both the existing distribution of the tax burden and the level of revenue collected. The Bradley–Gephardt bill was followed by a very similar proposal co-sponsored by two Republican senators, Jack Kemp of New York and Bob Kasten of Wisconsin.

President Reagan fueled the process in early 1984 by calling for a tax reform study. The US Department of the Treasury (1984) study—a multivolume report and set of proposals—was formulated essentially without political interference. It contained recommendations for a quite radical base-broadening, rate-reducing tax reform, including repealing the deduction of state and local taxes, introducing a deduction for 50 percent of dividends paid, as well as inflation indexing of depreciation, inventories, capital gains, and interest. Simplification was stressed, and the

[1] The title for this article is inspired by a line in the 1967 song "Love and Confusion" by Jimi Hendrix: "My heart burns with feeling, but my mind, it's cold and reeling/Is this love, baby, or is it just confusion?"
[2] Although the tax bill is commonly referred to as the Tax Cuts and Jobs Act, that is not its official name. The short name violated a Senate rule, so it was renamed: "To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." A thoughtful preliminary analysis of the bill is offered in Gale, Gelfond, Krupkin, Mazur, and Toder (2018).

report spoke positively of a tax system in which two-thirds of individual taxpayers could opt for "return-free" filing in which the IRS would calculate tax liability based on information reports from third parties, with taxpayers needing only to verify or correct the "pre-filled" return. Politics subsequently intervened, and all of the just-mentioned aspects were abandoned when a reformulated proposal was released in May 1985. But the comprehensive Tax Reform Act of 1986 did survive the political process, and was signed by President Reagan on October 22, 1986.[3] It had wide bipartisan support: among Democrats, only 12 senators and 74 House members voted against the bill; among Republicans, only 11 senators and 62 House members voted against the bill—almost the same level of opposition as from the Democrats.

At least at first glance, the Tax Reform Act of 1986 and the Tax Cuts and Jobs Act of 2017 may appear to have much in common. Both bills substantially lowered the headline corporate rate, from 46 to 34 percent in 1986 and from 35 to 21 percent in 2017. Both substantially raised the standard deduction. Both reduced individual tax rates, although the 1986 law reduced them much more dramatically at the top, as the statutory rate on the highest incomes fell from 50 to 28 percent over a two-year period, capping a stunning fall from 70 percent to 28 percent between 1981 and 1986. Both bills featured some broadening of the tax base. The Tax Reform Act of 1986 introduced full taxation of realized capital gains, eliminated the sales tax deduction, and put severe limits on passive losses. One key difference is that the 1986 corporate tax rate cut was accompanied by the elimination of the investment tax credit and a slight slowing of depreciation allowances, such that most observers concluded that the cost of capital would increase, rather than fall (for example, Jorgenson and Yun 1990). Another key difference is that the Tax Cuts and Jobs Act was neither revenue neutral nor distributionally neutral, while the Tax Reform Act of 1986 was designed to be both, with a projected increase in corporate tax revenue offsetting projected declines in individual tax revenue.

How Has the Environment for Tax Law Changed since 1986?

Tax law in the United States and in the world did not stay put between 1986 and 2017. The top US personal income tax rate crept up from 28 percent, reaching 39.6 percent by 1993, then falling to 35 percent for 2003 until 2012, and then returning to 39.6 percent. A preferential tax rate for long-term capital gains was reintroduced in the 1990 budget act (by raising the tax rate on other income while leaving unchanged that on capital gains), and a lower preferential rate was enacted

[3] Jeffrey Birnbaum and Alan Murray, the two Boswells of the Tax Reform Act of 1986, brilliantly recounted the political ups and downs in their 1987 book *Showdown at Gucci Gulch*, managing to make tax policy formulation *exciting*. Steuerle (2008) offers a valuable history of postwar US tax policy, focusing on developments after 1980. Two papers, McLure and Zodrow (1987) and Auerbach and Slemrod (1997), address the economics and politics of the Treasury proposals and the 1986 tax act.

in 1997; subsequently, an even lower rate was adopted and extended to dividends in 2003. To increase incentives for investment, "bonus" depreciation rules (allowing a fraction of capital expenditure to be written off immediately) were introduced in 2002 initially at a rate of 30 percent; they lapsed for a few years, were then revived by the Economic Stimulus Act of 2008, eventually increased to 100 percent for assets acquired after September 8, 2010, and then fell back to 50 percent.

Because the world has changed, we wouldn't expect that the best tax system in 1986 would also be ideal in 2018. (Nor, of course, did the Tax Reform Act of 1986 attain the ideal at the time.) Several aspects of change in the economic environment especially matter for thinking about tax policy. First, the US economy has become more integrated into the world economy. The sum of US imports and exports as a percentage of GDP nearly doubled from 1986, when this ratio was 16.9 percent, to 30.9 percent in 2013, only to decline slightly to 26.5 percent in 2016 (based on data from the World Development Indicators of the World Bank at https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?locations=US). As discussed further below, US corporations held $2.6 trillion abroad by 2017. As a result, the effect of taxes on cross-border stocks and flows has become even more important than in 1986.

Second, corporate tax rates in other countries around the world have declined steadily, largely driven by the pressure of global competition for investment and revenue, so that by 2017 the statutory US corporate income tax rate stood near the top of the league table. Between 1986 and 2017, the average statutory corporate income tax rate of OECD countries fell from 47.2 percent to 24.5 percent.[4] Of course, having an economic policy out of step with the rest of the world is hardly a sufficient argument for change; indeed, I imagine most supporters of the Tax Cuts and Jobs Act would not want to use this line of reasoning to justify, for example, US adoption of a national health insurance system or of a 15 percent value-added tax.

Third, US income inequality has increased steadily in the past three decades. By one calculation, the share of income received by the top 0.1 percent of earners has more than doubled from about 5 percent in the mid-1980s to over 10 percent by 2015 (Alvaredo, Atkinson, Piketty, Saez, and Zucman, No date).

Fourth, intangible capital such as research and development has gained in importance. While investment in intangible capital was about 80 percent of investment in tangible capital in the mid-1980s, by the early 2010s it was about 140 percent (Branstetter and Sichel 2017, figure 2). The income generated by intangible capital is easier to shift across countries, and spending on intangible capital was generally immediately deductible even before the Tax Cuts and Jobs Act.

Finally, the US fiscal picture looks very different. In 1986, federal debt held by the public amounted to 38.4 percent of GDP. In 2017, it stood at 76.5 percent,

[4] These figures are author's calculations, based on data in Historical Table II.1 in http://www.oecd.org/tax/tax-policy/tax-database.htm#C_CorporateCaptial and Table II.1 in http://stats.oecd.org/index.aspx?DataSetCode=TABLE_II1. The tax rates are unweighted averages and include both federal and subfederal rates.

in part because of the stimulus programs undertaken during the Great Recession, and partly because of the inexorable demographic changes that have been pushing promised entitlements for the elderly above the taxes in place to fund them.

The Tax Cuts and Jobs Act

Tax reform was not a major preoccupation of the Obama administration, although some notable changes did occur. For example, tax increases accompanied the Patient Protection and Affordable Care Act of 2010, including a 3.8 percent surtax on investment income of households with over $250,000 ($200,000 for single filers) of income and a 0.9 percent Medicare payroll surtax on households with over $250,000 of wages and self-employment earnings ($200,000 for single filers). The American Taxpayer Relief Act of 2012 made many of the Bush-era tax cuts permanent, and created an additional tax bracket at the top with a marginal tax rate of 39.6 percent.

The Obama administration did issue reports in 2012 and then again in 2016 about business taxation (White House and US Department of the Treasury 2012, 2016). The 2016 report called for broadening the corporate tax base by eliminating dozens of tax expenditures, reducing the maximum corporate tax rate from 35 percent to 28 percent, eliminating the corporate alternative minimum tax, limiting interest paid deductions, and eliminating oil and gas tax preferences. All but the last-mentioned aspect of this Obama-era report were echoed in the Tax Cuts and Jobs Act of 2017. Also, the Obama-era report rejected the move to a pure territorial system, under which the income earned abroad by foreign subsidiaries of US multinational corporations is exempt from US tax,[5] and instead proposed a 19 percent minimum tax on foreign earnings when they are earned rather than—as was current law—upon repatriation, and a one-time tax on unrepatriated earnings.

Even before gaining control of Congress and the presidency in 2016, Republicans were formulating changes in the tax system. The "Path to Prosperity" plan issued by the House Budget Committee in March 2012 (and renewed in 2013) called for reducing the corporate tax rate to 25 percent, repealing the alternative minimum tax, and moving to a territorial system. In 2014, the then-chairman of the House Ways and Means Committee, Dave Camp (R-MI), released a revenue-neutral tax reform plan that would reduce the maximum corporate income tax rate to 25 percent and levy a top rate of 25 percent on the income of "pass-through" business entities (whose income is not subject to the corporate income tax but "passes through" to the owners who are taxed), but require slower methods and longer periods for depreciation and introduce a 95 percent exclusion of dividends

[5] In contrast, a pure worldwide system would subject the foreign earnings of US corporations to US tax. Before the Tax Cuts and Jobs Act of 2017, the US corporate system was a hybrid system under which, in principle, foreign earnings were subject to tax but were offset by a limited foreign tax credit and taxed only upon repatriation of the earnings.

from foreign subsidiaries plus a tax on their accumulated earnings; on the individual side, it would lower rates and reduce the number of brackets, fold the personal exemption into a higher standard deduction and child tax credit, and put a floor on deductible charitable contributions of 2 percent of adjusted gross income. In June 2016, a Tax Reform Task Force (2016) set up by the House Republicans issued a report that offered a "blueprint" for a new tax code that cut the top individual tax rates from 39.6 percent to 33 percent, abolished the individual alternative minimum tax, exempted half of interest receipts, and repealed the estate tax. On the business side, it provided full expensing (that is, immediate write-off of the costs of investment rather than depreciating over time) for tangible assets, capped the tax rate on pass-through entities at 25 percent, eliminated deductions for net interest expense, cut the corporate rate to a flat 20 percent and, notably, adopted a destination-based business tax system under which exports are exempted from the tax base and imports are taxed.

The tax legislative process started to take shape in July 2017, when key congressional and administration officials issued a one-page statement stressing tax "relief" but backing away from the controversial destination-based business tax plan. In September, a nine-page plan with more details was released. These documents provided a starting point for the Congressional debate. Eventually, a bill containing related but generally different provisions was passed in Congress on December 20 and signed into law by President Trump on December 22, 2017.

Changes in the Corporate Income Tax

Changes in the corporate income tax are the focal point of the Tax Cuts and Jobs Act. The issues here are discussed more fully in Auerbach's article in this symposium so I will not concentrate on corporate income tax changes; but they are too important to any discussion of the new tax law to ignore entirely.

Many nonrate aspects of the Tax Cuts and Jobs Act will affect decisions for certain firms: for example, the new law disallows the carryback of net operating losses (to reduce taxes paid in previous years), but allows for their indefinite carryforward (potentially to reduce taxes paid in future years). But I will focus on the central change, the cut in the corporate tax rate from 35 percent to 21 percent.[6] Two issues with reducing the corporate income tax rate are of primary importance: the effects on investment and on income-shifting.

The new tax law affects investment incentives in a variety of ways, but two avenues are especially relevant. The first is how it affects the cost of capital. Although normally a corporate income tax cut reduces the cost of capital, the effects of the Tax Cuts and Jobs Act rate cut are less clear. Lowering the corporate income tax rate always provides a lump-sum benefit to *past* investments, so some of the revenue loss does not map into improved incentives for future investment. In this case, with the enactment of expensing of most tangible capital expenditures (until the end of

[6] Prior to 2017, the corporate tax rate schedule was graduated, but the great majority of income was taxed at a 35 percent rate.

2022) and the continued expensing of intangible investments,[7] the rate cut does not as substantially reduce the cost of capital; with expensing, the government is in effect a silent partner to private investment, bearing the same fraction of costs that it takes in revenue, and the extent of its partnership (that is, the tax rate) doesn't matter for the cost of capital.[8] One attempt to quantify the impact of the Tax Cuts and Jobs Act on the cost of capital concluded that the 2017 law would reduce the cost of capital for equity-financed corporate (and noncorporate) investment, increase it for debt-financed investment, and decrease it overall; the estimated decrease was negligible for intellectual property (DeBacker and Kasher 2018).

Business tax cuts could also affect investment by increasing cash flow. This controversial notion has been around since Fazzari, Hubbard, and Petersen (1988) found empirical evidence suggesting that the investment of financially constrained firms appears to be more sensitive to cash flow, which is consistent with the notion that more cash flow relaxes financing constraints on investment. But this finding has not been consistently replicated. For example, Chen and Chen (2012, p. 394) conclude that "investment-cash flow sensitivity has completely disappeared in recent years," while other papers argue that cash flow is still a significant determinant of investment even when there is an exogenous shock to cash flow without a corresponding change in firm growth opportunities, as is arguably the case for the Tax Cuts and Jobs Act.

The statutory rate of corporate income tax also influences the direction and volume of taxable income shifting across national borders. With a 21 percent corporate tax rate, the incentive for outward shifting will decline, although 0 percent tax rate havens will still be attractive destinations for taxable income, and I expect to see some nonhaven countries react to the Tax Cuts and Jobs Act by lowering their corporate tax rate.

A shift from a worldwide toward a territorial corporate tax system by itself *increases* the reward to shifting taxable income abroad because no residual tax is due upon repatriation. However, the Tax Cuts and Jobs Act does not enact a pure territorial system (some have even called it a hybrid worldwide system), because it contains provisions designed to restrain income shifting. In addition, it contains a significant expansion of the base of cross-border income to which *current* US taxation would apply via the GILTI provision, which stands for "global intangible low-taxed income," that imposes a 10.5 percent minimum tax without deferral on profits earned abroad that exceed a firm's "normal" return.

The Tax Cuts and Jobs Act did eliminate US tax due upon the act of repatriating the future earnings of foreign subsidiaries of US multinational companies.

[7] Under the Tax Cuts and Jobs Act, after 2021 companies will not be able to write off research and development expenses immediately, but rather will be able to deduct them over a five-year period. Whether this provision will survive expected intense lobbying to overturn it is unclear.

[8] With a tax rate of τ, expensing of all costs and full deductibility of losses, the present value of equity-financed investments is $\Sigma((1-\tau)R_t-(1-\tau)C_t)/(1+r)^t=(1-\tau)\Sigma(R_t-C_t)/(1+r)^t$. Those projects that have a positive present value (and thus are value enhancing) will still have it regardless of the value of τ; those that do not, still do not regardless of τ.

But what about the as-yet-unrepatriated past earnings of foreign subsidiaries, which by 2017 had grown to $2.6 trillion (ITEP 2017), in part because some companies were waiting for the next tax holiday—which has now arrived? The Tax Cuts and Jobs Act taxed them retroactively, at a rate of 15.5 percent rate on cash and 8 percent on noncash, payable in installments over eight years, whether they were repatriated or not. Some claimed that, by eliminating the tax cost to the repatriation of these funds, this would stimulate investment in the United States due to the parent companies' newly "available" funds, but this outcome is unlikely. The fact that companies had significant resources in the form of cash held by their foreign subsidiaries presumably had already made it much easier to obtain domestic loans when funds were needed, as lenders knew that, if necessary, the foreign profits could be used to repay the loans. Furthermore, on average, US companies are hardly cash-constrained, holding $1.84 trillion at the end of 2016 (Moody's Investor Service 2017). For empirical evidence, we can look back to the American Jobs Creation Act of 2004, which offered a temporary tax holiday for repatriations in 2004 and 2005, allowing funds to be brought back subject to a 5.25 percent tax rate. One careful study found that those companies that repatriated were ones with limited investment opportunities, and that much of the money went to share repurchases; there was no evidence of a stimulus to business investment, employment, or research and development expenditure (Blouin and Krull 2009; for a dissenting view, see Faulkender and Petersen 2012).

After the Tax Reform Act of 1986, as the top personal income tax rate fell below the corporate rate, there was a massive surge in businesses classifying themselves as pass-through entities—like partnerships or S corporations—whose income is not subject to the corporate income tax but instead becomes part of the individual taxable income for the owners. One might expect the reverse to occur starting in 2018, when the corporate income tax rate fell to well below the top personal tax rate (even considering the 20 percent deduction of income allowed to certain types of pass-through business income). In fact, the financial management firms KKR and Ares Management are two examples of companies that have already announced that they will convert from a partnership to a corporation.

Such business reclassifications have implications not only for the actual distribution of income, but also for how it is measured using tax return data. The reported taxable income of pass-through business entities appears on personal tax returns, but the income generated by businesses subject to the corporate income tax appears on personal returns only if and when it is paid out as dividends or shows up as capital gains. Thus, when, as after the 1986 tax reform, business income shifts to pass-through entities, inequality based on personal tax returns will seem to have risen when it has not really done so (Slemrod 1996). Now that the corporate rate has fallen substantially below the top personal rate, students of income distribution need to be on the lookout for the reverse phenomenon: some business income that pre-2018 was showing up on personal tax returns might "disappear," with only traces seen as dividends and capital gains. The more general issue here is that, whenever the definition of taxable income changes, there will be a mechanical change

in measured income and its distribution. This can matter a lot for some important issues. Auten and Splinter (2017) revisit the trends in US income inequality since 1960 adjusting for tax base changes, including the shifting of business income between C corporations and pass-through entities, and find that these adjustments reduce the increase in the top 1 percent's share of income since 1960 by as much as two-thirds.

Changes in the Individual Income Tax

The Tax Cuts and Jobs Act included cuts in individual tax rates (and changes in the bracket breakpoints), but the cuts were not nearly as big as in 1986. In 2017, the highest individual income tax rate fell from 39.6 percent to 37 percent; in 1986, the rate for the highest income earners fell from 50 percent to 28 percent over two years. In principle, the individual rate cuts in the Tax Cuts and Jobs Act expire after 2025, although almost no one thinks that will really happen. In spring 2018, there was already talk of a second tax bill that would extend those rate cuts past their scheduled expiration in 2025 (as reported in York 2018).

Just as the Tax Cuts and Jobs Act lowered individual rates a bit, it broadened the individual tax base a bit, although not as extensively as did the Tax Reform Act of 1986. Much of this happened indirectly, via the near doubling of the standard deduction, which reduces the value of claiming itemized deductions relative to claiming the standard deduction. One substantive and controversial base-broadener was a $10,000 cap on the itemized deduction of state and local taxes. This was one of the most progressive changes in the 2017 tax act; the Joint Committee on Taxation (2018, p. 8) estimated that over 45 percent of the lost tax benefit would have gone to taxpayers with more than $500,000 of annual income. To be sure, there are principled arguments for cutting back on this deduction—for example, that it bluntly subsidizes subfederal spending regardless of any externality involved—but one suspects that red-state, blue-state politics were also involved. After all, among states, the median of the deduction for state and local taxes taken as a percentage of adjusted gross income in 2014 was 4.5 percent, but it was 9.1 percent in New York, 8.7 percent in New Jersey, 8.3 percent in Connecticut, and 7.9 percent in California (Tax Foundation 2017).[9]

As in 1986, several end-of-year tax planning strategies became attractive in 2017 as the shape of the tax bill became clear. For example, those who likely will not itemize in 2018 had an incentive to move their deductible expenses such as charitable contributions up to 2017; similarly, some itemizers should have tried to accelerate payments of state and local taxes. Conversely, pass-through enterprises

[9] The states of Connecticut, New Jersey, and New York have filed a lawsuit challenging the cap. The state of New York has also enacted a "workaround" to the cap, creating a new optional payroll tax that shifts the state and local tax deduction from individuals who can no longer fully take it to businesses that can; the state will count these remittances toward state income taxes owed by the workers (for discussion, see Rubin and Vilensky 2018). Some states have also enacted laws to designate funds to solicit private contributions, not subject to the $10,000 cap, to support public services. Whether any of this will fly with the IRS is not yet known.

had an incentive to postpone income into 2018 when the new 20 percent deduction kicked in. In 1986, the anticipatory effects were in some cases stunning, especially in the case of capital gains, whose tax rate was scheduled to increase beginning on January 1, 1987. Burman, Clausing, and O'Hare (1994) determined that long-term capital gains on corporate stock realized and reported to tax authorities in December 1986 were seven times their level in 1985. The possibility of anticipatory behavior is important to bear in mind when the historical record for 2017 and 2018 is analyzed, because comparing behavior in 2017 to behavior in 2018 might reveal more about a short-term timing elasticity than a long-run elasticity, which will generally be smaller.

Implications for Growth

To the extent that economics played a role in the debate leading up to the Tax Cuts and Jobs Act, what mattered most were projections about its impact on the aggregate economy, in large part because this affected the estimate of the revenue loss from the legislation—the bigger the stimulus to economic activity, the smaller the revenue loss.

The Congressional Budget Office (2018, Box B-2, p. 117) summarizes and provides sources for ten different estimates of the impact of the Tax Cuts and Jobs Act. The official arbiter of the revenue cost, the Joint Committee on Taxation, put the "static"[10] ten-year revenue loss at $1.456 trillion from 2018 to 2027. It also estimated that the Tax Cuts and Jobs Act would increase the level of GDP by 0.8 percent on average over the ten-year budget window due to increases in labor supply and investment. These effects were estimated to reduce the revenue loss by $458 billion, or about one-third of the static revenue loss; the projected increase in interest rates would add another $51 billion to deficits. As the basis for these estimates, the Joint Committee on Taxation used a weighted average of the results of three models: the "macroeconomic equilibrium growth model" of its own staff, plus an overlapping generations and a dynamic stochastic general equilibrium model. As a comparison, the Congressional Budget Office put the offset due to macroeconomic effects on total deficits from 2018–2028 at 20 percent, reducing the sum of the deficits from $2.314 trillion to $1.854 trillion.

Other prominent groups came out with growth estimates on either side of those offered by the Joint Committee on Taxation. For example, the Penn Wharton model estimated that GDP by 2027 would be between 0.6 percent and 1.1 percent larger than otherwise, offsetting the static revenue estimate by between just 8 and 19 percent. On the high side, a model developed by the Tax Foundation forecast GDP rising by an average of 0.29 percent per year over the next decade, enough that the plan would decrease federal revenues by $1.47 trillion without considering any induced growth but by just $448 billion with estimated growth effects, so that the growth effect offset about 70 percent of the static revenue loss. (The much bigger estimated effect is apparently largely due to its assumption of an infinitely

[10] The descriptor "static" does not mean that these estimates ignore likely behavioral responses—they do not—just that they do not account for revenue feedback due to any induced change in aggregate growth.

elastic supply of capital to the US economy.) A letter to the Treasury Secretary Steven Mnuchin signed by nine prominent economists suggested a similarly large response, a gain in the long-run level of GDP of just over 3 percent, or 0.3 percent per year for a decade.[11]

It is important to keep in mind some limitations of these models. These estimates are not about welfare effects, because they do not allow for the value of the decreased amount of leisure or the value of the reduced consumption to finance saving. Moreover, they do not account for that part of the income that is owed to foreigners who lend funds to finance the excess of induced domestic investment over induced domestic saving. The significance of this factor is reflected in the Congressional Budget Office (2018) projection that real GDP (income generated in the United States) would be 0.7 percent higher over 2018–2027, but that real GNP (income of Americans) would rise by only 0.4 percent, implying that nearly half of the increased income generated within the United States would accrue to foreigners.

Finally, the growth effects of these models do not always take into account the effects of larger budget deficits. In their careful review of the empirical literature, Gale and Samwick (2017) conclude that the weight of the evidence suggests that deficit-financed tax cuts *reduce* national income in the long run, although if coupled with appropriate reforms, the overall mixture could expand the size of the economy.

Implications for Simplicity

On November 2, 2017, chairman of the House Ways and Means Committee Kevin Brady (R-TX) and Speaker of the House Paul Ryan (R-WI) said that, under the new tax system being contemplated, nine of ten taxpayers could file on a postcard. That same day, stock in the tax preparation company H&R Block dropped 2.8 percent to its lowest point in over half a year. The share price soon bounced back, but in June 2018, the company announced it was closing 400 locations. The rhetorical emphasis on a postcard-sized tax form has become quaint, now that more than 90 percent of tax returns are filed using software. In any event, a draft version of a new postcard-sized Form 1040 was unveiled in June 2018. The two-sided form is too large to qualify for the standard postcard rate and would reveal the filer's Social Security number unless enclosed in an envelope. It does eliminate more than half of the 78 line items on the previous form, but may require as many as six new worksheets not on the postcard (as reported in Tankersley 2018).

As with the Tax Reform Act of 1986,[12] a substantial simplification was achieved in the 2017 legislation by the near-doubling of the standard deduction, which is

[11] The letter is available at https://www.treasury.gov/press-center/press-releases/Documents/Economist_Letter_STM_11252017.pdf. A subsequent article coauthored by one of the nine signatories of this letter, Robert J. Barro, and a critic of the Tax Cuts and Jobs Act, Jason Furman, suggested that the growth rate stimulus would be between 0 and 0.2 percent per year (Barro and Furman 2018).

[12] The net simplification in the Tax Reform Act of 1986 was unclear. In this journal, in Slemrod (1992), I concluded that, despite a few scattered signs that tax-related financial planning declined, the compliance cost of the income tax system was probably higher circa 1992 than it was in the early 1980s, which suggests that the 1986 reform achieved little, if any, simplification in the income tax system.

predicted to reduce the fraction of itemizing returns from about 30 percent to about 12 percent (Tax Foundation 2017).[13] Undoubtedly, this change will reduce both administrative and compliance costs. To the extent that the itemized deductions should be subtracted from income to obtain a better measure of well-being, as is probably true for most medical expenses (as a counterexample, elective cosmetic surgery expenses are not deductible), this provision will also erode horizontal equity. Expanding the standard deduction also means that less than half as many people will receive the implicit subsidy to charitable giving, state and local government spending, mortgage borrowing, and the other expenses that deductibility provides. However, the big spenders among the itemizers will still itemize, so the weighted average increase in the cost of these activities will not be nearly as large as the drop in the fraction of itemizing households suggests. Eliminating the corporate alternative minimum tax is certainly a simplification, as is substantially limiting the scope of the individual alternative minimum tax so that it affects many fewer taxpayers. The Joint Committee on Taxation (2018, p. 11) estimated that the number of taxpayers subject to the individual alternative minimum tax will fall from over four million to approximately 600,000.

The Tax Cuts and Jobs Act also adds some nontrivial complications, especially in certain provisions affecting choice of corporate form and the attempts to block income shifting of corporate taxes. Enforcing the new rules that allow a deduction of up to 20 percent of the income of pass-through entities subject to myriad limits and restrictions will be very tough.[14] One newspaper article described the "crack and pack" strategies that businesses are exploring to get around the provision excluding high-income lawyers, doctors, and other professionals from this deduction (reported in Simon and Rubin 2018). "Crack and pack" refers to splitting operations apart, reclassifying, and re-categorizing their operations. One lawyer quoted in the article spoke of splitting his law firm into one entity holding four lawyers and the other holding the 26-person administrative staff, presumably in the hope that the latter could be exempt from the statutory limitation. Some business owners are considering giving shares of the business to family members, each of whom files a tax return that falls below the income threshold. The cat-and-mouse game between the IRS issuing regulations and new ways around them has just begun (for further discussion of the gaming opportunities opened up by the Tax Cuts and Jobs Act, see Kamin et al. forthcoming). An even bigger problem might be monitoring the larger incentives now built in to reclassify labor income as

[13] As with the Camp proposal mentioned above, the doubling of the standard deduction was coupled with the repeal of personal and dependent exemptions, which are contingent on family size. The pro-family nature of the income tax system was largely retained by an expansion of the existing child credit and the introduction of a new credit for any dependent, including children who are too old to be eligible for the child tax credit.

[14] The effectiveness of limiting the pass-through deduction has implications for distribution, as well; the Joint Committee on Taxation (2018, p. 4) estimates that more than half of the benefit of this provision will go to taxpayers with income in excess of $500,000 per year.

business income subject to lower tax rates.[15] In addition, the new rules designed to limit income shifting in the new world of a modified territorial system, like the "base erosion and anti-abuse tax" (BEAT), a sort of limited scope alternative minimum tax, and the GILTI mentioned earlier, are reputed to be labyrinthine.

What the Tax Cuts and Jobs Act Didn't Do

Given that comprehensive tax reform comes along rarely in the United States, it behooves us to consider what the Tax Cuts and Jobs Act might have accomplished but did not.

I begin with base broadening. Although the mantra of tax reformers has long been "broaden the base, lower the rates" on the grounds that deviations will cause inefficient distortions of resources, this argument is not airtight: the broadest base is not necessarily the best. Optimal commodity tax models show that a uniform tax on all goods and services (equivalent in a one-period model to an income tax with no deductions for particular expenditures) minimizes efficiency cost only in very special circumstances—implicit separability between leisure and goods.[16] Otherwise, the optimal tax pattern should take advantage of commodities' relative substitutability or complementarity with leisure: a complement to leisure such as skis should be taxed relatively heavily and a substitute for leisure such as work uniforms should be taxed relatively lightly or even subsidized. It might also be optimal to single out particular activities for special tax treatment if they generate externalities. However, allowing an income tax deduction for an expenditure provides a subsidy equal to the taxpayer's marginal income tax rate, which is only by chance equal to the marginal social benefit, especially given that the implicit rate of subsidy is higher for those with higher marginal tax rates. Finally, income net of, for example, medical expenses almost certainly provides a better measure of well-being than income not subtracting them, and so *not* allowing this deduction would violate horizontal equity.

These arguments imply that base broadening proposals must be considered on a case-by-case basis. For example, a deduction for state and local taxes, which was scaled back by the Tax Cuts and Jobs Act, could arguably be justified on the grounds that some state and local spending provides externalities beyond the taxing jurisdiction's borders. However, because much state and local spending provides no such externality, an untargeted deduction seems like a blunt instrument for this purpose.

The 2017 tax act did not make a big dent in some of the biggest tax expenditures—spending programs that operate through the tax system—with the tax preference to employer-provided health insurance being the biggest. In fact, the Tax Cuts and Jobs Act postponed from 2020 to 2022 the "Cadillac Tax" of the Affordable Care Act that would levy a 40 percent tax on the costs of health plans

[15] This issue is faced by the dual income tax systems used in Nordic countries, under which labor income is generally taxed at a higher rate than capital and business income (Sørensen 2010).
[16] An early and elegant introduction to this argument is provided in Sandmo (1976), and Kaplow (2008) provides a comprehensive treatment.

that exceed $10,200 per individual or $27,500 for family coverage. Similarly, it did not directly address, other than via the less-widespread itemization that limits both property tax and mortgage interest deductions, the substantial income tax preference for owner-occupied housing arising from the complete exemption of the return (implicit rent) the asset provides. The cap on the home value eligible for the mortgage interest deduction was tightened up a bit, from $1 million to $750,000 (for first and second homes), which reduces the subsidy for some high-value debt-financed properties, especially those more likely to be located in blue states. In addition, the Tax Cuts and Jobs Act suspends until 2026 the deduction for interest paid on home equity loans and lines of credit unless they are used to buy, build, or substantially improve the taxpayer's home that secures the loan.

It did not increase the federal gasoline tax, stuck at 18.4 cents per gallon since 1993, or implement some form of carbon tax. Such changes have been favored even by many generally tax-phobic conservative economists and groups, such as the Chamber of Commerce, as a way to fund road repair and to address climate damage (as discussed in Mankiw 2006). A gas tax hike could be a potent source of revenue; every one-cent per gallon increase would raise more than $1.3 billion of revenue per year (Congressional Budget Office 2016, p. 198).

It did not abolish the estate tax, as many Republicans favored and most of their precursor proposals featured. However, it did (through 2025) approximately double the exemption to $11.2 million per individual and $22.4 million per married couple, reducing the number of estates that will be subject to the tax by about two-thirds, from about 5,500 to 1,700 (Tax Policy Center 2017a).

It did not eliminate the tax treatment of carried interest, so that investment fund managers will continue to be subject to the lower capital gains tax rate on their share of the fund's qualified dividends and long-term capital gains. The Obama administration favored this change, and Trump expressed support for it during the presidential campaign, but it did not make it into the Tax Cuts and Jobs Act. However, the Tax Cuts and Jobs Act did increase from one to three years the minimum holding period for carried interest profits to qualify for the capital gains tax rate.

Overall, the Tax Cuts and Jobs Act did not move to a radically different tax system. Some of those economists who gave the Tax Reform Act of 1986 a low grade did so because they would have preferred moving to a consumption tax (for example, Shoven 1990). The US Department of the Treasury (1984) report had included a separate volume on the value-added tax, and concluded that its advantages did not justify its incremental administrative cost. In 2017, this idea didn't get very far, although two Republican presidential candidates (Ted Cruz and Rand Paul) supported a value-added tax, albeit by other names; Cruz called it a "business flat tax," and Paul called it a "business activity tax." Of special interest to tax cognoscenti was the proposal made by Republican presidential candidate Marco Rubio, who favored a version of David Bradford's X Tax, a modification of the Hall–Rabushka flat tax that levies graduated rates of 15 percent, 25 percent, and 35 percent on labor income, while maintaining a flat (25 percent) rate on business receipts minus expensed costs of doing business (as reported in Pomerleau 2016).

For a few months, there was discussion of replacing the corporate income tax with a destination-based cash flow tax, the base of which is revenues minus costs and payments to labor. In essence, it is a value-added tax plus a subsidy to labor income at the same rate; as with most value-added taxes, imports are subject to tax while exports are not, providing the destination basis. (Alas, the DBCFT has neither a mellifluous acronym like VAT nor a super-heroic moniker like the X Tax.) For more detail and arguments in favor of the destination-based cash-flow tax, see Auerbach, Devereux, Keen, and Vella (2017). It did not become part of the Tax Cuts and Jobs Act.

What the Tax Cuts and Jobs Act Got Wrong

I've argued that the Tax Cuts and Jobs Act featured a few of the same kinds of base broadeners and simplification features that tax reform advocates supported in the Tax Reform Act of 1986 and moved the corporate tax system in some directions that are widely supported, and were in fact advocated by the Obama administration. But in two fundamental aspects it pushed the tax system in what I believe is the wrong direction.

Deficit

Although the Tax Reform Act of 1986 was designed to be revenue neutral,[17] the Tax Cuts and Jobs act was not—not even close. The Joint Committee on Taxation (2017) estimated that it will reduce revenue by $1.456 trillion over the 10 years 2018 through 2027, not including debt service costs or macroeconomic feedback. The Congressional Budget Office (2018, pp. 128–129) estimated the reduction in federal revenue over 2018–2028 at $1.854 trillion, including both macroeconomic effects and the effect on debt-service costs. This is clearly the wrong direction. Deficit spending is not needed at present for short-term stimulus purposes. The increased debt reduces budget flexibility for the next recession and worsens the massive long-term fiscal imbalance already faced by the United States.

There were political concerns over the deficit in 1984–86, too: a big tax cut in 1981 followed by smaller tax increases in 1982 and 1984 had deficit hawks concerned. After all, the ratio of publicly held debt-to-GDP ratio had grown from 25.2 percent in 1981 to what seemed at the time to be a scary 38.4 percent in 1986. This ratio is now twice as high. In the mid-1980s, the leading alternative to maintaining revenue neutrality in the gestation of the Tax Reform Act of 1986 was to *increase* revenue.

Of course, the reductions in tax revenue from the Tax Cuts and Jobs Act adds to people's paychecks and businesses' cash flows. However, borrowing is not a way to raise resources for the government; instead, it puts off assigning the tax burden and shifts it to future generations. The political benefit of cutting taxes is obvious, as the

[17] Whether it succeeded is another question; for discussion, see Wallace, Wasylenko, and Weiner (1991).

burden passed on to future generations is abstract and uncertain. The Tax Reform Act of 1986 leveraged a similar feature to a much lesser degree, because it reduced individual income taxes overall, and most popular accounts of winners and losers ignored that the increases in corporation tax would be borne by *some* people, even if it was difficult to say exactly which ones.

Higher deficits will tend to increase interest rates and crowd out private investment to an extent that depends on how much the higher interest rates induce greater private saving and inflows of foreign capital. Reviewing the empirical evidence, the Congressional Budget Office's central estimate is that each dollar of increase in the budget deficit reduces domestic investment by 33 cents (Huntley 2014).

This issue was noted, after the passage of the Tax Cuts and Jobs Act, by some prominent economists, including some who lauded the growth-enhancing properties of the Tax Cuts and Jobs Act. Martin Feldstein (2018) took to the op-ed pages of the *Wall Street Journal* to call the exploding debt and deficit the federal government's most urgent domestic challenge, and recommended slowing the growth of Social Security and Medicare. Feldstein's argument raises the "starve-the-beast" theory of deficit-financed tax cuts: that they are a tactic to force down government spending. However, the historical record suggests that this tactic does not work (Romer and Romer 2009). Laurence Kotlikoff (2017), who had argued that the Tax Cuts and Jobs Act would ultimately raise GDP by 5 percent and be approximately revenue neutral, also argued that the United States didn't need a tax bill that was revenue neutral at best, but rather needed a tax bill that raised federal revenues dramatically—by 60 percent.

Distribution

While the Tax Reform Act of 1986 was designed from the start to be distributionally neutral, no such constraint was put on the Tax Cuts and Jobs Act of 2017. Given that the 2017 tax act was not revenue neutral, what distributional neutrality even means is not clear. Here is some relevant information. Using conventional incidence assumptions, the Tax Policy Center (2017b) calculated that the top 1 percent of income earners on average gets a tax cut in 2018 of $51,140, the average member of the middle quintile receives $930, and the lowest quintile gets just $60 on average; these dollar figures amount to a 3.4, 1.6, and 0.4 percent increase in after-tax income, respectively. Overall, more than half of the benefits go to the top 10 percent of earners, so the tax cuts accrue disproportionately to high-income households. But high-income households are liable for a disproportionate fraction of tax liability, so how the current federal tax burden is allocated across income groups does not change much, at least in the short run before various provisions begin to sunset.[18] Nevertheless, put in the context of the sustained increase in inequality in the last few decades, this massive tax cut for the richest members of society strikes me as the wrong direction for policy. Moreover, the distributional consequences over the long

[18] This can be inferred from the calendar year 2019 table in Joint Committee on Taxation (2017, p. 1); note that this starts to change as early as calendar year 2021 (p. 2).

run depend on how the deficits are financed; if, for example, they are financed by cuts in entitlement programs such as Medicare and Medicaid, the balanced-budget consequences are massively regressive (Gale, Gelfond, Krupkin, Mazur, and Toder 2018, pp. 23–26).

The distributional impact of the new tax legislation depends crucially on what one believes about the incidence of the corporate tax rate cut. The Tax Policy Center (2017b) incidence calculations assume that 60 percent of the benefit of a corporation income tax rate cut ends up benefiting owners of corporate shares, and only 20 percent goes to workers (with the other 20 percent going to capital owners generally). Both the Congressional Budget Office and Treasury's Office of Tax Analysis come to similar conclusions. Of course, just because these highly respected government offices assert something doesn't make it correct; the more the corporate tax rate cut would ultimately benefit workers rather than share owners or capital owners, the more progressive will be the ultimate distributional impact of the Tax Cuts and Jobs Act. Among academic tax economists, this issue is *very* controversial.

More than a half century ago, Harberger (1962) developed and parameterized a general equilibrium, closed-economy model of this question and concluded that over a horizon he called the long run (although the capital stock was assumed to be fixed), the burden of the tax would be borne by capital owners in general, and not passed along to people in their role as workers or consumers. The more open an economy, the greater the share of burden from a source-based tax on capital that will fall on immobile domestic factors such as land and labor; in the extreme case of a small, open economy facing an elastic supply of capital, none of the burden of such a tax will be borne by capital owners. If profits are partly due to location-specific rents, the tax burden may fall in part on the claimants to these rents, although if the rents are location-specific and firms are mobile, the burden can be shifted to the immobile factors (early models are described in Kotlikoff and Summers 1987; see also Auerbach 2006). Over the very long run, to the extent that a corporate tax cut induces capital accumulation, which in turn raises the productivity of workers, a competitive labor market will generate real wage increases. The distributional impact will depend on which groups of workers, skilled versus unskilled, see their wages rise, which in turn depends on their relative complementarity with the accumulated capital.

A more recent literature revisits the question of who bears, or benefits from, changes in the corporate tax rate in static models without capital accumulation where wage-setting institutions and labor market frictions matter (for a skeptical review of this literature, see Gravelle 2017). For example, in wage bargaining models, firm owners and workers share any surplus generated by the firm and, if corporate tax cuts increase that surplus, the models predict that some of that increase will be shared with employees through higher compensation. A similar result obtains in some efficiency wage models. Recent empirical analyses with this kind of model in mind have found substantial pass-through to workers, as much as one-half in the Arulampalam, Devereux, and Maffini (2012) study of federal corporate taxation in nine European countries and in the Fuest, Peichl, and Siegloch (2018) study of

German municipal business taxes. These effects are certainly context-dependent, however, and their application to US federal corporate taxation has not been demonstrated. For example, Azémar and Hubbard (2015), who conclude based on an analysis of 13 OECD countries that on average 60 percent of corporate taxes are passed to labor, find that the pass-through is more than ten times as high in countries with the highest union density compared to the average union density; the pass-through would presumably be even lower, and perhaps negligible, for the largely nonunion United States.

The unsettled question of the incidence of the corporation income tax means that the overall distributional impact of the Tax Cuts and Jobs Act is also uncertain. But to assert that it will largely benefit workers is, in my opinion, a stretch that the empirical literature does not substantiate.

How the tax burden *should* be assigned to people of different levels of well-being is a delicate problem because it inescapably involves interpersonal comparisons of utility. In the seminal modern paper of optimal taxation theory in this area, Mirrlees (1971) investigated how a government seeking to maximize a utilitarian social welfare function in a society of people with heterogeneous ability to earn income should choose the rate structure, and therefore the progressivity, of an income tax that must raise some given amount of total revenue. In this class of models (an early example is Helpman and Sadka 1978), increased dispersion in the distribution of earning power increases optimal progressivity; thus, the large increase in pre-tax income inequality in the past three or four decades would have, ceteris paribus, increased optimal progressivity. However, these models cannot prescribe the level of optimal progressivity without additional value-laden assumptions about society's willingness to trade off equity and efficiency.

A Teachable Moment

Whether or not the Tax Cuts and Jobs Act is good for the US economy and its population, it is clearly good for those of us who study taxation. Indeed, it is a wonderfully generous gift because it provides scores of natural experiments that could help provide credible estimates of the causal effects of tax policy. Indeed, the recent move away from studying natural experiments in taxation, toward other research designs such as bunching analysis and randomized controlled trials may have been partly caused by the dearth of recent comprehensive tax reform episodes.

It is, of course, far too early to assess the full economic impact of the Tax Cuts and Jobs Act, but even within the first few years one can learn quite a bit (for a set of studies a few years after the passage of the Tax Reform Act of 1986, see Slemrod 1990). Two aspects of the immediate aftermath of its enactment are of particular interest, however. One is its degree of popularity. Between its enactment in December 2017 and mid-April 2018, over 40 polls were taken by major polling organizations. In that period, the fraction approving of the Tax Cuts and Jobs Act never exceeded the fraction disapproving by more than a sliver. The excess of the

percent disapproving over approving peaked at the time of passage at just over 21 points, fell to be about even in mid-February as paychecks swelled due to reduced income tax withholding by employers, but then started to diverge, with disapprovers exceeding approvers by almost 8 percentage points by the end of April (as summarized at Real Clear Politics, "Trump, Republicans' Tax Reform Law," https://www.realclearpolitics.com/epolls/other/trump_republicans_tax_reform_law-6446.html). However, the Tax Reform Act of 1986 was also viewed less favorably over time: in 1990 compared to 1986, on average people were less inclined to think it had a positive effect on the economy, was fairer, less complicated, and provided tax reduction (Auerbach and Slemrod 1997, table 6, p. 618).

Second, because the Tax Cuts and Jobs Act was much more partisan than the Tax Reform Act of 1986—no Democrats in either House of Congress voted for the 2017 legislation—its perceived success is much more tied to partisan political bragging rights. This might partly explain why, in the immediate aftermath of its passage, and in some cases even before it had become law, hundreds of companies announced actions they say were induced by the new law—raising wages, providing bonuses, and announcing hiring and investment. Some have viewed these disclosures as attempts to curry favor with the Trump administration and Republican Party or as trying to boost the public image of tax reform so that, in the event Democrats regained control of the House or Senate, they would not try to dismantle key pieces of the tax legislation (as Republicans did with the Patient Protection and Affordable Care Act of 2010). Analyzing these announcements, in Hanlon, Hoopes, and Slemrod (forthcoming), we conclude they are systematically related both to economic factors such as the size of the tax cut a company received and also to political factors such as whether the company is in a politically sensitive sector.

Looking ahead to the future research agenda, several aspects of the process leading to the new law render it an especially promising laboratory. The potential endogeneity of timing that has so concerned macroeconomists studying fiscal policy (for example, see the discussion in Romer and Romer 2010) is not an obvious problem in this case, as there was nothing about the state of the business cycle that precipitated the passage of the Tax Cuts and Jobs Act—instead, it passed because a close election tipped in one direction. The macro economy being well-behaved in the few years leading up to the Tax Cuts and Jobs Act also helps, because plausibly the post-tax-reform counterfactual is also fairly placid (setting aside the disruptions caused by, for example, a trade war).

On the other side, the extensiveness of the Tax Cuts and Jobs Act is a mixed bag for research purpose. It changes scores of relative prices and rewards, as did the Tax Reform Act of 1986, making identification of the impact of any one aspect more difficult. For instance, how can the effect of moving to a territorial corporate tax system be separated from the corporate tax rate cut or the anti-income-shifting measures? The Tax Cuts and Jobs Act also does not provide a natural difference-in-differences design of the impact of individual marginal tax rates as did the Tax Reform Act of 1986, which cut the top rate substantially, from 50 percent to 28 percent, and other rates much less. Feldstein (1995), the seminal difference-in-differences estimate of

the elasticity of taxable income, was based on the much larger tax rate cut for the highest-income group compared to everyone else.

Reference to the elasticity of taxable income literature reminds us that it is not only the world and the tax system that have changed in the past 30 years—the economics of taxation has, too. The tax research agenda beginning now should absorb what we have learned in the past 30-plus years, both in theoretical perspective and empirical methods. In the past two decades, tax economists have focused on the concept of the elasticity of taxable income (ETI), the idea that, under some assumptions, all the behavioral responses to taxation—real decisions such as labor supply as well as avoidance and evasion—are symptoms of inefficiency, and the anatomy of the total response does not matter for that issue (although it might matter for evaluating further policy changes). This is not just a matter of estimating compensated ETIs instead of labor supply elasticities. Since Slemrod and Kopczuk (2002), we have also realized that the ETI is not a structural parameter, but rather depends on aspects of the tax system such as how broad the tax base is and how it is enforced. For example, the response of wealthy Americans to an increase in the tax rate on capital income arguably depends on the effectiveness of the IRS in monitoring evasive foreign accounts.

Is It Tax Reform, or Just Confusion?

Neither choice is accurate, in my opinion.

The Tax Cuts and Jobs Act is not tax reform, at least not in the traditional sense of broadening the tax base and using the revenue so obtained to lower the rates applied to the new base. Nor, based on its unofficial title, did it aspire to this approach as a main objective. It does, though, contain several base-broadening features long favored by tax reform advocates.

Nor is the Tax Cuts and Jobs Act just confusion. There are coherent arguments buttressing the centerpiece cut in the corporation tax rate. To the extent that the new legislation reduces the cost of capital (which is not obvious), business investment will be higher than otherwise.

Its serious downsides are the contribution to deficits and to inequality. The former is less of a concern to the extent that the Tax Cuts and Jobs Act turns out to stimulate growth; the latter is less of an issue the more its centerpiece cuts in business taxation will be shifted to the benefit of workers, especially low-income workers. In both cases, the Tax Cuts and Jobs Act represents a huge gamble on the magnitude of these effects, about which the evidence is not at all clear. My own view is that the stimulus to growth will be modest, far short of many supporters' claims, and so the Tax Cuts and Jobs Act will increase federal deficits by nearly $2 trillion over the next decade, a nontrivial stride in the wrong direction that promises to shift the tax burden to future generations. How it will affect the within-generation distribution of welfare is the most controversial question of all. Although according to conventional wisdom, the Tax Cuts and Jobs Act delivers the bulk of the tax cuts

to the richest Americans, whose relative well-being has been rising continuously in recent decades, other plausible models of the economy, supported by some new empirical evidence, raise the possibility that the gains will be more widely shared. This is the most important question about which we know too little.

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