Counterfactual Trump's Fiscal Policies
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Macroeconomic theory gives a glance at the potential outcomes of the Trump administration's fiscal policies on the economy. It posits that the nation's gross domestic product (GDP) or income, Y, is equal to consumption, C, plus investment, I, plus government spending, G, plus net exports, NX, or Y = C + I + G + NX (Adolfatto, 2005).

Consumption, C, is household expenditures (Teigen, 1978). It is a linear function of disposable income, Y_d. Economists represent consumption as: $C = C_a + cY_d$, where c is the propensity to consume out of disposable income and is between 0 and 1.

Thus, consumers consume primarily out of after-tax earned income and out of autonomous consumption, C_a (consumption that does not depend on income), as well as out of government transfer payments, which is a component of disposable income.

When government policies reduce disposable income by implementing random mass federal government workforce layoffs, as well as reducing transfer payments (redistribution of income without the exchange of goods or services, i.e., Medicaid; women, infant, and children (WIC) program, and so on), it reduces the level of consumption of the laid off employees and of transfer payment recipients.

The planned imposition of tariffs on imported goods will raise domestic prices of consumer goods and also cause domestic consumption to fall. Say that a United States (US) merchant imports avocados from Mexico and pays the Mexican producer one US dollar per avocado. With the proposed 25 percent tariff on imported goods from Mexico, the US importer must pay the US government a tax of 25 cents per avocado, raising the importer's cost per avocado to $1.25, plus shipment and other overhead costs, which will be paid by US consumers.

Given the normal downward-sloping demand curve, as the prices for imported goods rise, the quantity purchased will fall, and merchants' inventories will accumulate. As a result, merchants will purchase fewer goods from wholesalers and producers, which will adversely affect the rate of foreign and domestic production, as well as labor.

As consumption, production, and government spending decrease, more layoffs will occur leading to a reduction in overall consumption and since consumption is 70 percent of the GDP, a likely recession. Additionally, rising prices will lead to inflation and increases in interest rates by the Federal Reserve, which will curtail investments, (I) and job creation.

Economist Malcolm Sawyer (2003) argued that the government is the employer of the last resort. The idea that the government must use a fiscal stance to support a high level of demand emanated from Abba Lerner (1943) under the heading of functional finance.

According to Sawyer (2003), "The basic justification for using the budget deficit to support a high level of employment is that private sector demand is inadequate to generate such levels of employment" (p. 882). Likewise, Davanzati, Pacella, and Realfonzo (2009) also believed that expansionary fiscal policies increase employment in the public and private sectors.

Therefore, the Trump administration's policies of layoffs and the taxation of imported goods are counterfactual to macroeconomic theory.

References

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