**How Will Trump’s Policies Affect the U.S. Economy?**

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In a political environment skewed by fake news and “alternative facts,” the real impact of President Donald Trump’s policies is easily obscured. At the recent Tarnopol Dean’s Lecture Series on the Trump administration and the economy, Wharton experts offered their unvarnished take on the impact of these policies on the capital markets, the dollar, economic growth and job creation — and backed them with analysis based on data.

After closing above 20,000 for the first time, the Dow Jones Industrial Average has been giving back some of its gains of late amid a flurry of Trump mandates: escalation of a trade war with Mexico, anchored by a 20% tariff on its goods; making good on a promise to exit the Trans-Pacific Partnership trade deal in Asia; and instituting a temporary immigration ban on seven mainly Muslim countries that could hurt the quality of the U.S. workforce — especially in Silicon Valley — among others. Initially, the Dow was buoyed by Trump’s proposal to substantially cut corporate taxes, roll back many regulations and spend on infrastructure.

“Investors and businesses very much like the Republican agenda. Notice I didn’t say the Trump agenda,” says Wharton finance professor [Jeremy Siegel](http://knowledge.wharton.upenn.edu/faculty/siegel/). “Why do they like the Republican agenda? Lower corporate taxes, less regulation, lower taxes on interest and dividend income. All that is very, very good for investors.”

Siegel lays out the bull case: “If there’s a significant corporate tax cut, and most people expect there to be one, that could add 10% to earnings in and of itself. So that alone, you could say, could give 10% to the stock market. In addition, you have a cut back in regulations, which is something again that both investors and businesses want, that could be another boost that some people say could be worth 10%.” He notes that those projections do not even include potential gains from infrastructure spending.

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However, U.S. stocks have been whipsawed lately by Trump’s other orders. “What the market doesn’t like is most of the Trump agenda that is not part of the Republican agenda — clearly, big tariffs on imports, such moves as restricting immigration in a significant way, currency wars — anything like that is very anti-Republican,” Siegel says. The market has moved up “cautiously” because it is yet unsure whether Trump will follow the Republican path all the way. “I’m not going to put all my marbles there yet because anything can happen under Trump.”

The bear case is that the economy will take a big drubbing if trade wars break out. Siegel says that many Republicans believe the high Smoot-Hawley tariffs in the 1930s that taxed thousands of imported goods led to the Great Depression. While Siegel himself — along with most macroeconomists — does not agree with that premise (believing the cause was monetary collapse and the Federal Reserve’s inaction), if protectionism does break out globally, it would be disastrous depending on its magnitude. “If there is a trade war, the market would react extremely negatively,” he says. “We’d be down 10% to 15%.”

**Coming Trade War?**

Wharton international management professor [Mauro Guillen](http://knowledge.wharton.upenn.edu/faculty/guillen/) says protectionism is a “terrible idea.” Trade barriers have been enacted in the recent past, such as President Nixon levying a 10% tariff across the board in the early 1970s. “Every time you’re introducing protectionism, you’re hurting the consumer.”

There’s also the issue of substitution. If a 20% tariff on Mexican goods was put in place, it is not certain that people would automatically buy more products that are made in America. “Some consumers and companies will say, instead of buying from Mexico, I’m going to buy from an American-based producer, or they could go to China or Indonesia, or Costa Rica,” Guillen adds. “It’s not clear how the issue is going to play out.”

Moreover, many U.S. companies will have to scramble to adapt quickly to a major shift in rules. “Many other companies that source components from China will be caught off guard,” Guillen says. “They’ve been doing business, they’ve been making investments, they’ve been making decisions for a long time assuming a certain set of rules. Now, if those rules change overnight, they’re going to find themselves in a very difficult situation.”

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Guillen further questions the rationale behind choosing to launch a trade war with Mexico, whose exports make up about 10% to 12% of the U.S. trade deficit. “Why pick a fight with Mexico? … The problem is broader than that.” He also points out that the 18% devaluation in the Mexican peso — since Trump won the election — could offset the 20% proposed tariff. Overall, Guillen says the larger question for Trump and his policies is this: “What are you trying to accomplish?”

When it comes to trade, Siegel explains that Trump’s point is to level the playing field. “We let their goods in, but they don’t let our goods in. Or they put much more restrictions on our exports than we do on their exports. It is true if we get those countries to accept more of our exports, actually both of us would be better off. … We didn’t push hard enough” to get into their markets. However, Guillen points out these trade imbalances might be true for China, but not Mexico. “There is free trade both ways.”

There is talk of instituting a “border adjustment” to further boost U.S. trade, says Siegel. The rule exempts exports of U.S. companies from taxes, but also reduces the deductions they can take on imports to lower taxable income. “This is a huge subsidy to exports, a huge tax on imports and every economist says that will cause the dollar to be stronger.”

Siegel says some models see the dollar appreciating by as much as the actual corporate tax rate if the full terms of the border adjustment is adopted and the impact would be “mammoth.” Since the U.S. still imports more than it exports, he believes the net impact of this move will be to boost revenue. U.S. companies that make goods domestically and sell them abroad will be winners while big importers like Walmart are the losers.

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The dollar could appreciate by about 25% if the corporate tax rate fell to 20%, and the real value of imports and exports will be unaffected as exchange rates fluctuate, adds [Kent Smetters](http://knowledge.wharton.upenn.edu/faculty/smetters/), Wharton professor of business economics and public policy who was deputy assistant secretary for economic policy under President George W. Bush. (Siegel disagrees because he says it does not take into account global capital flows.)

“But here’s the issue. Even though this creates a level playing field with France and other European countries that have a territorial VAT [value added tax], getting that through the WTO [World Trade Organization] — that will be the fight,” Smetters says. Some European companies get a VAT refund.

Smetters says that back then, the Clinton administration instituted its own form of border adjustment, which the Bush administration inherited. However, the lawyer-stocked WTO ruled that it was illegal, he adds. “The lawyers understand statutory incidents” and have less insight into economic policies.

**European Tensions**

Europe is facing some deep divisions over economic and immigration policies as well. “Differences in opinion are getting bigger and bigger,” Guillen says. “On top of that comes Brexit [British exit from the European Union] but the most worrying is you do have populist parties, and their [support] is growing” in the upcoming European elections. These parties tend to be anti-immigrant and favor leaving the EU. Add to the conflagration the Italian banking crisis, a worsening situation in Greece and a youth jobless rate in some European nations of 45%.

At least, the people who voted for Brexit got one thing right. “There’s this dogma in Brussels [EU headquarters] that more integration in Europe is the solution to every problem. I personally believe that’s not the case,” Guillen says. “The EU did not figure out exactly when to stop [centralizing decisions] and where to let in enough [national] decision-making.” Sharing one currency — over half of EU members use the euro — complicates the matter.

However, Siegel believes no country will be leaving the Eurozone – the group that shares the currency. “If Greece didn’t leave the euro, no one’s leaving the euro. The idea is ludicrous that these [populist] parties in Italy are going to lead them out of the euro. The Italians remember the Italian lira [which at one point was trading at 2,500 to the U.S. dollar].” He notes that “if it weren’t for the immigration issue, there wouldn’t be Brexit.”

**Immigration Reform**

In the U.S., illegal immigration was a key issue for the Trump campaign. Trump has pledged to build a wall between the U.S. and Mexico to stem the flow of undocumented workers and somehow make Mexico also pay for it. But an analysis by Smetters actually shows that deporting these workers — estimated between 11 million and 12 million overall — would hurt the U.S. economy.

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Trump’s plan assumes that if these workers were deported, native-born workers would take over these jobs. “That’s just simply not empirically true,” Smetters says. “When you export undocumented workers, those [typically low-skilled] jobs really aren’t replaced by native born workers” but by automation.

Moreover, the presence of undocumented workers raises the wages of those who can legally work in the U.S. “Undocumented workers tend to take on lower wage jobs that don’t require English and that don’t require as much social skills. That forces native-born workers to, in fact, trade up in terms of their education, in terms of their skillset.”

Smetters adds that while undocumented workers tend to have lower skill levels, a third of legal immigrants have college degrees. Guillen says immigration overall drives innovation, with immigrants launching 24% of all tech ventures in the U.S. over the past two decades. “That speaks volumes about the dynamism of immigrants at the high end and low end.”

Smetters does see Trump softening his stance on immigration once he builds his long-promised Mexican wall. “If he gets that political win … everything will be more negotiable.”

Ironically, the Trump proposal that could get plenty of political headwinds might be the issue of infrastructure spending. Wharton Dean [Geoffrey Garrett](http://knowledge.wharton.upenn.edu/faculty/ggarrett/), who moderated the talk, surmised that hardline Republicans wouldn’t want to run up the deficit while Democrats wouldn’t want to help a major Trump initiative.

Smetters says one answer is to focus on repairing existing infrastructure instead of building new ones. “Repairs have the highest ROI [return on investment],” he says, noting that more than 400 Pennsylvania bridges need inspection in the next two years. If they fall into disrepair, “the disruption to transportation there could be very large.”

**How Much Can Cutting Federal Regulation Boost the U.S. Economy?**

**It's far from clear a regulatory rollback will significantly boost growth**

The New York Times - By Josh Zumbrun - January 30, 2017

Financial markets and the White House are betting that a [rollback of federal regulations](http://www.wsj.com/articles/trump-signs-executive-order-to-cut-restrict-regulations-1485790245) can provide a significant boost to the U.S. economy. Research suggests that’s no sure thing. The volume of federal regulation has grown dramatically over recent decades and **Donald Trump** says that’s holding back growth. But estimates of the costs and benefits of the expanding regulatory state are so disparate, it’s nearly impossible to pin down the payoff for Mr. Trump’s plan to cut back red tape.

Conclusions vary so much not only because of the differing political instincts of researchers, but because studying regulations piece by piece produces different estimates than trying to gauge the impact of all regulations at once. Mr. Trump signed an executive order to cut the number of federal regulations, requiring that two old regulations be eliminated for every new one created. Here’s a primer on the regulatory state and its effect on the economy.

**Regulatory Growth**

In 1887, Congress passed the Interstate Commerce Act, which sought to regulate the burgeoning railroad industry, and prevent monopolies from developing. It is generally considered the first major foray into federal regulation. Despite periodic bouts of deregulation in certain industries, federal regulations in the U.S. have continued to expand.

One crude measure comes from simply tallying pages in the [Code of Federal Regulations](http://www.ecfr.gov/cgi-bin/ECFR?page=browse), which has climbed fairly relentlessly over the past half century under Republican and Democratic presidents and Congresses alike.

Some growth may be expected as new industries develop and the population expands. And the burden of meeting existing regulations is arguably lighter than figuring out new ones. Thus, another important measure could be each year’s new regulatory activity.

For that, a rough gauge is the number of pages each year in the [Federal Register](https://www.federalregister.gov/), where the government publishes proposed rules and public notices. This data is compiled by the **Competitive Enterprise Institute** in its annual [“Ten Thousand Commandments”](https://cei.org/10KC) report (not supportive of the heavy regulatory flow) but the report acknowledges the limitations of these measures. “A short rule could be costly and a lengthy one relatively cheap,” said **Clyde Wayne Crews**, the report’s author.

**Bottom Up**

Broadly speaking, there are [two approaches](https://fas.org/sgp/crs/misc/R44348.pdf) to estimating costs and benefits. A “bottom up” approach aggregates estimates for each individual regulation. A “top down” approach relies on economic modeling to show the overall effect of regulations on growth.

The **Office of Management and Budget** already estimates the cumulative cost-benefits via an annual report to Congress.

In its [most recent report](https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/legislative_reports/draft_2016_cost_benefit_report_12_14_2016_2.pdf), OMB estimated regulatory costs of between $74 billion and $110 billion. The benefits of the regulations, however, were significantly higher: $269 billion to $872 billion. The OMB is part of the executive office of the president, and thus inherently political. But even under the most recent Republican, President George W. Bush, the OMB [estimated the cost](https://georgewbush-whitehouse.archives.gov/omb/inforeg/costs_benefits/2008_draft_cb_report.pdf) of regulations ($45 billion to $54 billion in his final 2008 report) to be significantly lower than the benefits (pegged at $122 billion to $655 billion.)

Republicans in Congress have sought to increase requirements to perform cost-benefit analysis on each regulation. Many times, however, the costs are so different from the benefits they can be nearly impossible to compare. Consider, say, requirements of labeling gluten-free food, a major health issue for some but a fad diet for others.

Also, regulations with an impact of less than $100 million are not required to be analyzed. Such rules could be individually small, yet cumulatively burdensome.

**Top Down**

The hand-to-hand combat of analyzing individual regulations gets complicated. The top-down approach instead uses complex economic models to determine relationships between regulations and their effect on growth.

The most aggressive of these studies find that regulation reduces the annual growth rate every year, and that therefore, compounded over time, the effects become enormous. [One study](https://poseidon01.ssrn.com/delivery.php?ID=823120105064102073015107104066017109052085065093048051024027069074116101066098003028020016099038123036046075001084077090065094025090034086038107121093093005089015054089003003099106121024067086124105012116069124119102126072070076008115065120122085064&EXT=pdf) from **George Mason University**‘s **Mercatus Center**, known for its anti-regulation stance, estimated regulations across 22 industries reduced the growth rate by about 0.8% per year.

“Had regulation been held constant at levels observed in 1980, our model predicts that the economy would have been nearly 25% larger by 2012,” conclude the authors, **Patrick McLaughlin** of George Mason and **Pietro Peretto** and **Bentley Coffey** of **Duke University**. That amounts to a $4 trillion reduction in GDP, nearly $13,000 per capita.

The authors of the Mercatus study concede they may miss some regulatory benefits: “Some regulations may lead to benefits, such as improvements in environmental quality, which are well known to be mainly missing from GDP measurements,” they write.

The results of such analyses are also highly sensitive to modeling assumptions. A [2012 study](https://regulatorystudies.columbian.gwu.edu/files/downloads/032212_sinclair_vesey_reg_jobs_growth.pdf) from **George Washington University’s Regulatory Studies Center** slightly tweaked a few assumptions of previous estimates and determined that, “statistically speaking, our results reveal no impact.”

**International Experience**

There’s little doubt that regulatory improvements can boost an economy. The **World Bank** produces an annual [“Doing Business”](http://www.doingbusiness.org/) report that gauges the difficulty of navigating regulations in different countries. Moving up the rankings has a clear association with improved economic performance. For example, one [2006 analysis](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=893321) by a trio of researchers at the **London School of Economics** and World Bank found that moving from having more burdensome regulations—in the bottom 25% of all countries—to more business-friendly ones—in the top 25%—could boost annual economic growth by as much as 2.3 percentage points.

That supports the notion that regulatory improvement could lead to much faster growth. But it’s unclear if such gains are available for the U.S., because it’s already ranked as having the [eighth-best regulatory environment](http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf).

The report suggests the U.S. has room for meaningful improvement on a few dimensions. The World Bank ranks the U.S. 51st  (out of 190) for starting a business, 39th for ease of obtaining construction permits, and 36th for ease of paying taxes.

But that raises yet another complication. Many of those regulations are at the state and local, not federal, level.