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What’s a president to do?

Barry Eichengreen | University of California, Berkeley | 20 March 2017

Donald Trump took office promising a raft of sweeping economic-policy changes for the United States. He has quickly discovered, like previous US presidents, that America's political system is designed to *prevent* rapid, large-scale change, by interposing formidable institutional obstacles from the Congress and career civil servants to state governments and the courts.

Start with reform of personal income tax. This should be a slam-dunk, because the president and congressional Republican leaders are on the same page. Trump's goal of removing the government's groping hand from Americans' pockets, by cutting the top marginal tax rate on ordinary income from 39.5% to 33%, is entirely consistent with mainstream Republican ideology, according to which high tax rates penalise success and stifle innovation.

But, to be politically viable, significant tax cuts for the wealthy would have to be accompanied by at least token tax cuts for the middle class. And broad-based tax cuts would blow a hole in the budget and excite congressional deficit hawks, of whom there are still a few.

One can imagine closing loopholes to render rate cuts revenue neutral. But one person's loophole is another's entitlement. Even if there are economic arguments for eliminating, say, the deductibility of mortgage interest payments, imagine the howls of protest from homeowners – including many Trump voters – who borrowed to purchase their houses. Imagine the reaction of Trump's friends in real estate.

Cuts on the spending side would assuage the deficit hawks. And big cuts to the Environmental Protection Agency, the US Agency for International Development, and National Public Radio are high on the Republican hit list. But the vast majority of federal spending is on entitlements, the military, and other proverbial "third rail" items that elected officials touch at their peril. Simply put, broad-based spending cuts to match broad-based income-tax reductions are not politically feasible.

Eliminating federal subsidies for health-insurance coverage under the Affordable Care Act ("Obamacare") would save the government a little over $100 billion a year, about 3% of federal spending. But those subsidies are largely paid for by their own dedicated taxes. Moreover, Trump and congressional Republicans are learning that replacing Obamacare is easier said than done. Health-care reform, as Hillary Clinton could have told them, is fearsomely complex. It is increasingly clear that the name will change ("Trumpcare" anyone?), and it can be expected that the Republican plan will cover fewer people, but much of the substance will remain the same.

Because corporate taxes are less significant in terms of overall federal revenue, rate cutting doesn't pose a comparable threat to the budget balance. But there is no agreement between Congress and the Trump administration on the form such cuts should take.

House Speaker Paul Ryan and others favor moving to a border adjustment tax that would tax corporate cash flows regardless of where the goods sold by US companies are produced, while exempting exports. Others, such as Treasury Secretary Steven Mnuchin, are evidently skeptical. And an important part of Trump's business constituency - import-dependent retailers like Target and Walmart - are actively hostile. Agreement on a plan won't come easily.

Trump's other flagship proposal is a $1 trillion infrastructure program. But this initiative will run headlong into deficit concerns, and it is fundamentally at odds with Republican skepticism about big government and specifically about the public sector's capacity to carry out investment plans efficiently. Trump will want to be able to point to a few signature projects. He will want his border wall with Mexico. But any new federal infrastructure spending is likely to be more symbolic than real.

So what will an impatient president, frustrated and hemmed in on all sides, do?

First, Trump will focus on the one set of economic policies a president can pursue without close congressional cooperation, namely those affecting trade. He can invoke the Trade Expansion Act of 1962, restricting imports on the grounds that they threaten US "material interests". He can invoke the International Emergency Economic Powers Act of 1977 on the grounds that the loss of jobs to Mexico and China constitutes an economic emergency. He can even invoke the Trading with the Enemy Act of 1917 on the grounds that the US has Special Forces active in the Middle East.

Second, Trump will respond - as populists do - by attempting to distract attention from his failure to deliver the economic goods. This means directing his ire and that of his supporters toward others, whether internal enemies like the press, the intelligence community, and Barack Obama, or external adversaries like the Islamic State and China. It wouldn't be the first time a politician used a domestic political crusade or a foreign policy adventure to divert attention from his economic failures.

We have already seen Trump's tendency to lash out at perceived enemies, foreign and domestic. And we know that this confrontational style is the *modus operandi* of senior White House advisers like Stephen Bannon and Stephen Miller. We can hope that cooler heads prevail. But, given the constraints on implementing Trump's economic agenda, it's hard to be optimistic.

Barry Eichengreen is a professor at the University of California, Berkeley, and the University of Cambridge. His latest book is Hall of Mirrors: The Great Depression, the Great Recession, and the Uses – and Misuses – of History.