Trump and the Economy

How to Jump-Start Growth

John Paulson

The central economic goal of Donald Trump's administration will be to boost U.S. economic growth. Steven Mnuchin, Trump's nominee for treasury secretary, has said that the administration's objective is to raise the rate of GDP growth to three to four percent, doubling the rate achieved over the last decade. This will be accomplished by establishing a globally competitive corporate tax rate, adopting a territorial corporate tax system, reducing excessive regulation, boosting domestic energy production, and introducing better trade policies.

The United States has the highest corporate tax rate of any country in the Organization for Economic Cooperation and Development. At 35 percent, the U.S. rate far exceeds the rates of the United Kingdom (20 percent), Germany (16 percent), Canada (15 percent), Ireland (13 percent), and many other countries. This high rate discourages investment, and reducing it will encourage it. The Trump administration plans to lower the corporate rate to 15 percent, eliminating the disadvantage for U.S. companies, making the United States a more attractive destination for investment, and creating jobs for American workers.

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In addition to a high domestic corporate tax rate, the United States also imposes a 35 percent tax on repatriated foreign earnings (with a credit for any foreign taxes paid). This has led U.S. companies to locate their manufacturing operations abroad and to keep their foreign earnings abroad, as well, rather than bring them back to the United States. Few other countries have such a policy, and it is one reason why U.S. companies have parked an estimated $2.5 trillion overseas.

This unfavorable tax structure, moreover, has caused many U.S. companies to behave oddly. Apple, for instance, borrows money in the United States, even though it has over $200 billion in cash reserves abroad (kept there in order to avoid paying the taxes that repatriation would generate). The chip maker Qualcomm recently announced a $39 billion acquisition of the Dutch company NXP Semiconductors—a move that will help it avoid paying billions in U.S. taxes, according to Americans for Tax Fairness. And scores of U.S. companies have actually "inverted," turning themselves into nominally foreign companies so as to take advantage of such firms' ability to bring cash earned abroad into the United States tax free.

To reverse this trend and encourage U.S. companies to bring their foreign cash home for investment, Trump has proposed reducing the tax on repatriated earnings from 35 percent to ten percent. The move has broad support among Republicans in Congress, and some combination of a lower corporate tax rate and a lower tax on repatriated funds will likely be passed into law.

Another factor holding the U.S. economy back has been excessive

Man with a plan: Trump at a Carrier plant in Indianapolis, December 2016

CHRIS BERGIN / REUTERS

regulation. Unnecessary regulation makes it harder for companies to succeed and results in increased costs, lower investment, and restricted growth. This has been especially true of the financial sector in recent years, as reactions to the financial crisis overshot the mark. Not all regulation is pernicious, of course. Higher capital requirements and the elimination of off-balance-sheet financing, for example, have helped strengthen the domestic and global financial systems. But many of the financial regulations in the 2010 Dodd-Frank Act have placed heavy burdens of compliance on companies and impeded lending.

The cost of complying with cumbersome new regulations has been staggering. For example, from 2011 to 2015 alone, the ten largest U.S. banks collectively paid $52.5 billion in consulting and advisory fees on compliance-related issues. In 2014, Citibank had 30,000 employees working on compliance and regulatory issues, up by 33 percent from three years earlier. In the same year, J.P. Morgan increased its risk-control staff by 33 percent, in addition to using thousands of outside consultants.

The obstacles to growth caused by excessive and poorly conceived regulation are part of the reason the current economic recovery has been so slow compared with its predecessors. Limitations on credit have put a damper on new home construction, consumer spending, and business investment.

The mortgage sector offers an example of the complexity, redundancies, and wastefulness of ill-considered government intervention. Regulators have been fighting one another about who

has authority over the area, with each regulator imposing its own layer of often conflicting regulations. The result has been an almost total halt in private mortgage securitizations, which have fallen by 99 percent from their 2005 peak of over $1 trillion in annual issuance. This near freeze has deprived a huge segment of Americans of mortgage financing. Overregulation and the collapse of the private mortgage securitization market have restrained the recovery in new home construction—which helps explain why, although new home construction has risen from its recent lows, it is still far below its previous peak and below the average level of housing required.

To lead the effort to break up the regulatory clog, Trump has appointed two highly capable executives. Mnuchin is the former CEO of OneWest Bank, and Gary Cohn, Trump's choice to head the National Economic Council, is the former president of Goldman Sachs. Both have extensive knowledge of the negative effects that excessive regulation has on the availability of credit and on growth. And beyond finance, other sectors ripe for regulatory reform include health care, labor, and energy.

A competitive corporate tax structure and reduced regulation will lead to higher economic growth. There are scores of real-life examples that show the impact of tax and regulatory policies on growth, and some patterns are clear. Generally, countries with high tax rates and high regulation (such as France and Italy) achieve lower growth, while those with low tax rates and low regulation (such as Ireland) achieve higher growth.

With the second-lowest corporate tax rate in Europe and light regulation, Ireland has the highest growth rate in the region and offers a model to follow. When asked why businesses invest there, executives point to the business-friendly environment. And even my own firm, after reviewing many other locations in Europe, chose to locate its offshore services operations in Dublin for the same reason.

BEYOND TAXES AND REGULATION

The United States has abundant energy resources and the technology to exploit them in previously unimaginable ways. A barrage of regulations, however, have made it difficult to reap the full benefits of this situation. The Trump administration plans to lift restrictions and streamline the permitting process in order to facilitate growth in energy production and infrastructure.

A good example of such barriers to growth can be found in the slow rate of approval for export terminals for liquefied natural gas. American firms have developed technology that allows them to extract gas from previously unattainable sources at extremely low prices. Unless the gas is liquefied, however, it cannot be exported and remains trapped in the United States. The construction of liquefied natural gas export terminals would allow it to be sold abroad. This would encourage still more development at home, creating more jobs, reducing the trade deficit, and spurring growth. Unfortunately, such construction has been delayed and restricted because of the vast number of approvals required from agencies that include the Environmental Protection Agency, the Federal Energy Regulatory Commission, the Department of Energy, and many others.

A final component of the Trump administration's economic plan will be

the renegotiation of trade deals so as to protect and expand U.S. exports. Trump has said that he is not opposed to trade in general—in fact, he strongly favors it—but he does oppose unfair trade. And dealings with China are a good example of where improvements can be made.

In 2015, the United States imported $482 billion worth of goods from China while exporting only $116 billion, leading to a trade deficit of $366 billion. Chinese firms have almost unrestricted access to U.S. markets, yet U.S. firms face severe restrictions and roadblocks when trying to do business in China. Putting the commercial relationship on more equal terms, as well as tightening up the enforcement of intellectual property laws, would help raise U.S. exports and significantly reduce the bilateral trade deficit.

Making the United States an attractive place for investment, supporting export industries, and improving terms of trade with foreign counterparts will go a long way toward improving the U.S. trade balance, boosting U.S. growth in the process.

Disregarding the media's gloom and doom, U.S. investors and businesses have responded more favorably to the incoming administration's economic plans than most expected, with the S&P 500 rising by more than seven percent between the election and the end of the year and financial services rallying 19 percent. In December, Ray Dalio, chair of the hedge fund Bridgewater Associates, said that Trump's pro-business outlook could help boost growth. And in January, Mark Fields, the CEO of the Ford Motor Company, announced that Ford would cancel a $1.6 billion project in Mexico and instead expand its operations in Michigan, citing "the more positive U.S. business environment" that he expected under Trump.

Competitive corporate taxes, easier repatriation of foreign earnings, a less burdensome regulatory environment, expanded domestic energy production, and trade deals that give U.S. companies a fair chance to compete—together these will create jobs, accelerate growth, and lead to a new era of American prosperity.

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