# Business implications of the Trump policy revolution

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*In this brief, Meridian Research Group and Longview Global Advisors map out the medium-term implications of President-elect Donald Trump's ambitious policy agenda.*

## Does the Trump agenda offer upside for all?

Since election day, the S&P 500 index has risen by more than 6%, reflecting investors' assumptions that President-elect Trump will focus on growing the economy and creating jobs through fiscal stimulus, tax cuts and simplification, and deregulation. Almost all of his first one hundred days' agenda is directed at this objective.

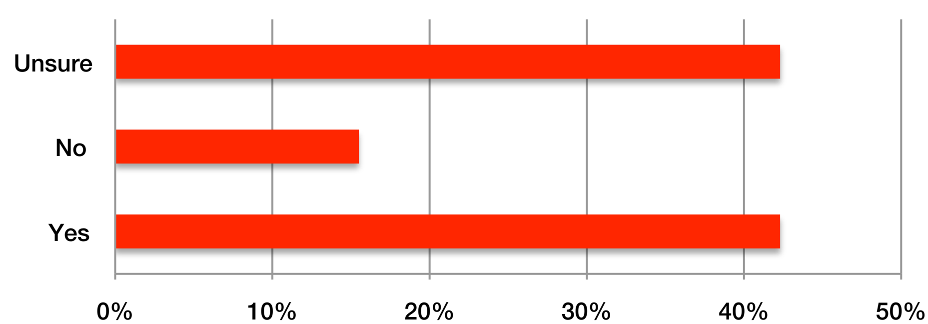
While the market's reaction may be warranted, significant policy uncertainties and political risks exist that should temper the outlook for individual businesses and investors. To this point, a National Association of Corporate Director's conference call and poll of over 100 of its members, revealed that 42% were unsure about the impact on their business of the Trump policy agenda—the same percentage that was positive about the outlook (see chart below).

- **Not all will be upside.** Headline GDP growth resulting from lower taxes, increased infrastructure spending, and less regulation will be tempered by rising inflation and interest rates and a strong dollar. Domestic opposition, trade dislocation and disputes, and geopolitical events could lessen the effects of Trump's growth and jobs agenda.

- **Some policy benefits will be slow to materialize.** The realities of the legislative process and the desire to ensure smooth implementation of policy changes means key initiatives will be phased in over time. For example, tax policy changes are unlikely to be enacted until the latter part of 2017, at the earliest, which means they won't take effect until 2018, or beyond. Deregulation often requires an administrative review process and many changes to regulations will be challenged in the courts.

- **Many industry-specific benefits are threatened.** Republicans' desire to re-balance the playing field, for example, by reducing marginal income tax rates, means that industry- and situation-specific benefits such as investment tax credits, the carried interest provision, and other incentives will need to be cut to maintain revenue neutrality. ▶

*Survey: Will President Trump be good for your business? (106 respondents)*




*Source:* National Association of Corporate Directors, December 15, 2016

- **Uncertainty will be ongoing.** The President-elect has indicated that unpredictability will be a key part of his negotiating strategy. This approach is reflected in instances such as Trump making positive comments about the U.S. relationship with China while also embracing Taiwan's president. Many of his senior appointees don't have policymaking or government experience which also adds a measure of uncertainty.

## Assessment of policy opportunities and risks

Trump has defied many key tenets of Republicanism that have been in place since the Reagan administration. He has shown willingness to challenge conventional Republican wisdom about free trade, the role of government spending in stimulating economic growth, and U.S. policy toward Russia.

He has defied predictions that he would tack towards the center. Trump is transactional: He appears to be less interested in party loyalty than in prevailing in whatever political challenge lies in front of him. His willingness to "name and shame" and "cut deals" with individual firms also suggests that that he is not averse to picking winners and losers in a way that is anathema to more typical market-oriented Republicans.

As a consequence, business leaders and investors require a new framework for understanding policy opportunities and risks in the Trump era. This framework should include several factors.

- **While one shouldn't necessarily take Trump's comments literally, one should take them seriously.** While he often backtracks on his provocative statements and pledges, Trump's assertions are important indicators of his policy intent. For example, his calls to "build a wall" along the Mexican border to stop illegal immigration communicate that he favors a robust approach to border enforcement, the details of which are quite clear from prior proposals from conservatives in Congress. His embrace of Taiwan is indicative of his intent to redefine the field of play and gain bargaining leverage with Beijing.

- **Personnel is policy.** Outside of a fairly small set of marquee issues, Trump does not have strong policy biases. His approach in business and comments about how he manages suggests that he will lean heavily on his team. Therefore, it's important to deeply understand the perspectives that members of his team bring to the table. So far, Trump's appointees suggest his administration intends to pursue dramatic changes in federal policy as well as in how the federal government operates.

- **Trump's priorities will be based on sustaining his populist and outsider appeal.** His coalition is comprised of those concerned about their economic prospects, who view large institutions and "elites" with suspicion, and who are wary of globalization and technological and social change. Expect social media to continue to play a dominant role in the policy discourse and continued targeted attacks on businesses that are seen as failing his populist and nationalist constituency.

- **Trump will rely on Republican proposals already circulating in Congress.** They will serve as his starting point for key domestic policies concerning taxes, healthcare, energy, and financial services. That said, the broad field of play and multitude of competing interests that are mobilizing—regarding comprehensive tax reform, for example—create tremendous complexity, trade-offs, and collateral impacts that are difficult to predict. ▶

- **The trajectory of international economic policy is much less clear.** The White House has considerable discretion in this area, yet key policy terms remain undefined. Trump portrays his trade policy agenda, in part, as an effort to get "better deals" for American industry. It's unclear how key counterparties will respond to an "America first" strategy. Beijing has been surprised by the recent turn of events, but expect China to assertively push back. While updating NAFTA has many merits, dictating harsh terms to Mexico risks fomenting a nationalist backlash there. The U.S. market may become much more attractive, but the global business context is likely to become much more complex.

## Outlook for key sectors

- **Many segments of the financial services industry, with the possible exception of big banks, will see more flexible regulation.** Trump has said he wants to "get banks lending again", which means that changing Dodd-Frank will be part of his early agenda, but he and his campaign have been critical of big banks, which is a part of his populist appeal. Therefore he is likely to focus regulatory relief on smaller banks, insurance companies, and other non-banks, while maintaining high capital requirements and regulation of larger banks. The private equity industry is likely to see carried interest and the tax deductibility of interest payments cut back.

- **The profitability of retail and consumer firms that import intermediate and final goods is threatened by a significant new tax.** The proposed border adjustment tax (see box below) would eliminate the deducibility from corporate income tax of intermediate and final goods purchased abroad. On the other hand, these firms should benefit from the emphasis on stimulus and jobs growth. An increase in the federal minimum wage is off the table, which should help low-wage sectors such as retailing and food and beverage.

- **Automobiles, aerospace, and other manufacturers will see mixed impacts.** The President-elect's desire to renegotiate major trade agreements, his pressuring of Beijing, and the desire by some Congressional Republicans to reduce tax benefits for importers are likely to result in higher costs for those with global supply chains selling into the US. Inflation and budget deficits are expected to surge, increasing the value of the dollar and hurting exporters. ▶

### *The border adjustment tax: a fifty-five percent probability of passing*

House Republicans are proposing to no longer allow firms to deduct imported components from their cost of goods sold when calculating their taxes, while also not imposing taxes on any revenue generated from what they export. Though a radical idea that will attract significant pushback from importers, it is a core structural element of the House Republican tax reform plan, it aligns with Trumps "jobs" agenda, and it has populist appeal. According to the Tax Foundation, the border adjustment tax could generate approximately $1 trillion in revenue over ten years, which would help make comprehensive tax reform revenue neutral—this is not only an important objective for Republicans, but it also is necessary for meeting the Senate's procedural requirements for an expedited reconciliation process. Concerns about WTO compliance are unlikely to be a major deterrent to enactment, though the issue may be litigated down the road.

- **Health care policy will see disruption but will still focus on beneficiaries.** Trump has made clear that he wants to repeal the Affordable Care Act, but has also made clear that he wants to ensure that beneficiaries have access to care. The traditional Republican approach to ACA has been to focus on cost and choice, which will still be Trump priorities, but he is likely to focus more on the availability of coverage than would a traditional Republican. This has important implications such as a greater focus on minimizing disruption in the individual insurance market between the time the ACA is repealed and when it is replaced. This focus will also likely reduce the incentive to constrain growth in Medicaid. Regardless, healthcare providers should plan for several more years of significant policy uncertainty. Heath care providers are likely to see a drop in revenues over time.

- **Pharmaceutical firms will benefit from less regulation**, but in line with his focus on beneficiaries and his voter base, Trump has said he wants to control rising drug prices. Visible price hikes are likely to arouse "tweet storms" and there is likely to be more focus on competition in the generics market as well as on transparency in pricing.

- **Energy industry benefits will vary by sub-sector.** There is sure to be much greater leasing and permitting flexibility for oil and gas production, a sharp reversal of the Obama Administration's focus on constraining development. Coal producers may also benefit from the dropping of various emissions regulations. There also are some indications, that Trump may be open to reducing the federal ethanol mandate and moving away from targeted benefits for wind and solar energy production, though he has given mixed signals regarding these policies.

- **The upside for infrastructure engineering, construction, and materials firms may be less than expected.** While Trump and his team have talked about a large infrastructure initiative, this is not as high a priority for Congressional Republicans as tax reform, repealing and replacing ACA, and deregulating financial services and energy. And, a central component of Republican orthodoxy is to limit the size of government by offsetting any new spending. No plan has been put forth, but the Trump team has been focused on roads, bridges, and mass transit. A deal with Democrats on infrastructure will likely require him to consider expanding the initiative to broadband, schools, hospitals, and, potentially, water infrastructure.

- **Technology and telecoms will see a reversal in their political position.** There is likely to be a significant backing away, if not full repeal, of the Obama administration's net neutrality rules, as well as other aggressive FCC actions. This will generally result in relief and flexibility for network providers rather than application layer firms, which is a reversal of the position they have seen in during the Obama administration.

- **There is risk on the horizon for the residential and commercial real-estate** despite Trump's business interests in this area. Trump and key Republicans have spoken forcefully about curtailing the carried interest provision and interest deductibility. Rising interest rates, meanwhile, will dim the sector's attractiveness. Tax changes may also impact residential real estate. Changes to the mortgage interest income tax deduction may be limited, but an increase in the amount of the standard deduction or other steps that deter itemization could have an indirect effect on housing. In addition, Trump's team appears focused on reforming GSEs Fannie Mae and Freddie Mac, which will ultimately reduce government support for the housing market. ■