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What Should Donald Trump Do & What Will He Do?

By Richard Morey

Donald Trump was ultimately elected to "drain the swamp." His supporters had this strong suspicion the "establishment" was not acting in their best interest, and they wanted someone to overthrow that establishment. Their concerns are real, and unbeknownst to most it has a formal name in economics; it's called crony capitalism. Here is Wikipedia's definition of this term: "Crony capitalism is a term describing an economy in which success in business depends on close relationships between business people and government officials. It may be exhibited by favoritism in the distribution of legal permits, government grants, special tax breaks, or other forms of state interventionism." However, this definition barely scratches the surface. Through thousands of corporate lobbyists, political action committees and "think tanks," the most powerful corporate interests and wealthiest among us have gained control of our government, with negative effects on everyone else. This definitely is not an indictment on capitalism itself, a system based upon fair business competition. To the contrary, crony capitalism is a complete corruption of capitalism, as it cements business success in the hands of the largest companies, thwarting their smaller competitors. Unfortunately, smaller and mid-sized companies are the ones who create most of the new jobs, so by hindering fair competition we hurt the job prospects and livelihoods of the population at large.

Of all the crony capitalists, those with the most power, who are also doing the most damage, work at the Federal Reserve Board. Donald Trump has a remarkably easy path to the success of his presidency he can achieve by uttering one sentence to a Joint Session of Congress. If he says it he is almost assured to go down in history as an economic success; if he doesn't he is practically assured to fail. What is the sentence in question?

He should say: "I hereby call for the immediate resignation of the Chairperson and Vice-Chair of the Federal Reserve Board, Janet Yellen and Stanley Fischer." Not only would this sentence lead to political success for President-elect Trump, it would be the single most positive thing he could do for our economy.

First a little history. When Ronald Reagan came into office in 1981 he was faced with a similar situation. Inflation was ravaging the U.S. economy, and Fed Chair Paul Volcker had been increasing interest rate to slow it down, raising them from 10% to 13% during the last year of Jimmy Carter's presidency. Shortly after taking office in 1981, President Reagan was faced with a dilemma. The Republican leaders in Congress demanded he either get Volcker to stop raising rates or ask him to resign. (While presidents cannot actually remove the Fed Chair, many throughout history have asked for their resignations - and they have always then resigned.) These Republicans knew we would soon be in recession should Volcker keep hiking rates. However, President Reagan happened to have at least one or two very good economists in his administration who told him he should ignore the mainstream views and not only keep Volcker but encourage him to raise rates as high as needed as quickly as possible. The result was indeed a recession, and the Dow Jones Industrial Average stock market index fell from 1024 in April of 1981 down to 776 by August of 1982. But Volcker's bold approach worked. It stopped inflation, which was a great boon to our economy. And this assured a successful term for President Reagan. The initial recession and bear market for stocks was blamed entirely on Jimmy Carter, while Reagan's economic performance was judged from the bottom in 1982. Plus, with interest rates at their highest level in history by August of 1982, for the rest of his presidency Reagan had a very strong economic wind at his back, i.e. falling interest rates.

Now let's fast-forward to today. During the campaign Mr. Trump often blasted the Fed as being a major cause of the poor plight of average Americans. He said that by keeping interest rates artificially low they were causing a massive transfer of wealth from middle and lower income citizens to Wall Street. He also said the stock market was in a bubble guaranteed to burst. Candidate Trump was completely correct in this assessment.

However, now Mr. Trump is faced with the same dilemma President Reagan confronted. Most, if not all, of the Republican leaders in Congress want and expect him to maintain the status quo at all costs. I cynically, but I believe accurately, consider most members of Congress to be employees of the largest corporations and wealthiest citizens. Fed Chair Yellen has indeed been good to Wall Street and the ultra-wealthy, though Fed policies have been a nearly unmitigated disaster for middle and lower income Americans. Which side will Trump choose?

Should President Trump call for Yellen and Fischer's resignation, the stock market would crash, and we would find ourselves in recession in short order. The crash and recession would be even worse if he replaced them with economists who were prudent. This would mean people who actually followed the Fed's original mandate, which was to simply provide liquidity, i.e. loans, to banks - at high interest rates to punish them for acting imprudently - during a financial crisis. Otherwise they would let the markets determine the correct level of interest rates. Instead, by keeping interest rates artificially low, beginning with Greenspan in the late 1990s the Fed has created bubble after bubble. As the bubbles are expanding Wall Street makes a fortune, and then when they burst the pain primarily hits Main Street. This must end in order for our country to get back to a sound economy based on expanding businesses, productivity and employment growth.

As President Trump enters office, he is faced with the highest corporate and government debt level in history. If you subtract mortgage debt (which fell substantially when people lost their homes in 2008-2010), consumer debt is now also at an all-time high. A very large amount of the corporate debt is "bad," i.e. will never be fully repaid. If Trump removed Yellen (and Fischer) from the Fed, this debt would explode right away and the inevitable recession and stock market crash would occur at the beginning of his presidency. It would then be blamed on President Obama, while President Trump would be judged beginning at the bottom.

Alternatively, if President Trump does not upset the status quo, perhaps the recession doesn't begin until late enough such that Trump gets the blame. It's going to happen either way, as the bad debt must eventually be cleared away. The only question is who gets the blame?

What Will Donald Trump Do?

This is easy to answer: I have no idea. But it doesn't look promising thus far. Mr. Trump has now named Steven Mnuchin as Treasury Secretary. Mr. Mnuchin is a dyed-in-the-wool Wall Street insider, originally with Goldman Sachs. One Republican publication described him as "the anti-populist from hell," meaning he stands for the exact opposite of pretty much everything candidate Trump has said for the last 19 months. Perhaps he is a zebra who will actually change his stripes. Much, much more likely he will make sure to protect Wall Street at all costs, regardless of what happens to everyone else. Since Janet Yellen is one of the best friends Wall Street has ever had, I'm afraid Mr. Trump is probably going to lose out on the opportunity to practically guarantee the success of his presidency by maintaining a severely broken and corrupt status quo. The result will be the failure of his reign.

The reason I say his success and failure, economically, hinges on the Fed is because the Fed has much more economic power than the President and Congress. With no elections or extensive public hearings or negotiations and compromises, a few unelected academics can move interest rates immediately or print trillions of dollars. These actions have large, almost immediate impacts on the economy.

Why Have Stocks Risen Since the Election?

During the campaign Donald Trump regularly said the economy was in shambles and the stock market was in a bubble which was certain to burst. And for a year and a half the market heard everything he said and was basically scared to death of a Trump victory. When the FBI Director told us just a few days before the election they had found thousands more emails that might implicate Hillary Clinton, stocks went straight down for a few days. Then when the FBI exonerated Hillary once again, stocks went straight back up. Around midnight on election night when people first realized Trump might win, the Dow Jones stock futures went down a huge 800 points. But they then rebounded and were up over 200 points – a 1000 point swing in a few hours. Stocks proceeded to rise for most of the next 2-3 weeks.

This should appear odd to anyone. For over a year and a half Donald Trump expressed himself, and the stock market knew it would be terrible if he was elected. Then the moment he was elected all those fears magically disappeared?

I'm not going to even hazard a guess as to what happened on election night to flip the switch from negative to positive for stocks. What we are going to do here is analyze the reasons the financial media has given since as to why President Trump will be good for the stock market.

There are two major areas the market is excited about under a President Trump, involving taxes and spending. Trade deals and regulatory changes have also been mentioned as potential positives.

1) **Individual Taxes**. Mr. Trump has promised to lower the tax rates on individuals. 75% of these tax savings will go to the top 1% of earners. This isn't shocking when you consider nearly half of all workers pay no federal income taxes at all, so any reduction doesn't affect them. For the average worker, the tax reductions will increase their pay by $5.75 a week.

   Economic Impact: Very little. The wealthy won't spend any more money if they pay a few hundred thousand or million dollars less each year in taxes, as they already have much more money than they were planning to spend. Plus, our government is heavily over-indebted and in need of more, not less, tax revenue. You could make a case to lower payroll taxes and then, for example, have a tax on imported goods to offset the revenue loss, but I have only heard ideas like this in passing.

   Corporate Taxes: Mr. Trump has called for a dramatic reduction in the corporate tax rate which currently stands at 35% - one of the highest in the world. However, both Democrats and Republicans have called for lowering this rate for around 20 years, but it has never happened. The reason may surprise some. The reason we still have such a high corporate tax rate is solely due to the fact <u>the largest corporations like it this way</u>. While the stated rate is a high 35%, we actually collect the smallest percentage of corporate profit in taxes <u>in history</u>. This is because the larger corporations have built in loopholes such that they pay a much lower rate, and often pay nothing at all. For example, a few years ago Exxon Mobil had more profit in one year than any company in the history of the world and paid exactly nothing in corporate income taxes that year.

   In other words, our corporate tax rate is ridiculously high because the most powerful corporations want it this way. While the largest companies have small armies of lobbyists and tax attorneys to make sure the tax laws give them the loopholes to avoid the taxes, small and mid-sized companies cannot afford these significant expenses. As a result, our current tax system punishes competitors of the wealthier and more powerful corporations by making them pay a higher tax rate. This is a serious economic problem, as most employment growth is achieved by the smaller and mid-sized companies.

If the Trump administration were to lower corporate taxes from 35% to 15-20% and eliminate all loopholes, this would be a very good thing for our economy. Will this happen? Unfortunately I doubt it. Both political parties have clearly understood this situation for many years and have done nothing. Corporate lobbying is one of the largest "swamps" President Trump would need to drain. While I truly wish him the best of luck should he tackle this topic, he faces a Congress that has almost always done whatever the largest corporations tell them to do.

Economic Impact: Lowering corporate taxes to 15-20% and eliminating all loopholes would generate more (much-needed) tax revenue and would lead to more fair competition among our corporations. This would definitely be a positive should it occur, but it would not lead the economy to rise appreciably very quickly. It would, however, help our economy in the long-run.

2) **New Spending:** Along with lower taxes, which are estimated to reduce tax revenue (especially from individual tax payers) and increase the Federal deficit by over one-half a trillion dollars, the other, larger reason why stocks have gone up since the election involves Mr. Trump's statements on dramatically increasing Federal spending – and Federal debt levels. The biggest ticket item is a $1 trillion infrastructure spending proposal. This is actually the same thing President Obama has been trying to get passed for the last 6 years, but the Republicans have blocked it every time. They say it would be wasteful and would blow an even bigger hole in our national debt.

But with the new Republican President calling for increased infrastructure spending, there is a chance it will finally get passed. One potential problem involves the House Freedom Caucus – 40 Republicans in the House of Representatives, many of whom were elected with Tea Party backing. These House members were elected to stop more deficits, and they have tended to stick to their principles regardless of pressure or consequences. There is no way they will approve more spending without cutting something else. But the only programs large enough to cut out $1 trillion are the military, Medicare and Social Security. Mr. Trump has promised to spend around $300 more on the military, so that means they would need to cut around $1.3 trillion out of Medicare and Social Security. But Mr. Trump has promised not to make any cuts in those programs.

On March 15 the House of Representatives will have to vote to increase our debt ceiling to over $20 trillion. This is the day a war is likely to erupt in the Republican Party. It is also the day the stock market's exuberance over our new President is likely to blow up. During this fight over the debt ceiling we will probably discover there will be no great and immediate, huge growth in deficit spending. Since this is the single largest reason stocks went up after Trump was elected, I would be very wary of the stock market from that day going forward.

One final point on this topic involves Vice-President-elect Mike Pence. If you study Mr. Pence's history, as a governor and particularly as a member of the House of Representatives, you will find he has been intensely opposed to debt with perfect consistency for many, many years. For example, he co-sponsored a constitutional amendment to require balanced federal budgets. So we've got the stock market excited about the certain prospect of massive new debt-funded government spending while the person who may actually be the leader to accomplish this goal is completely, vehemently against even one penny of new debt!

Economic Impact: From the above you can see the stock market's excitement over a trillion dollars or more in new deficit spending as a spark to lift up the economy is more than a little suspect. There is a good chance the anti-deficit wing of the Republican Party will stop it dead in its tracks.

But if the debt hawks fail and the Federal government does approve, for example, a $1 trillion infrastructure spending plan, what will this do for the economy? At least on a short-term basis this would be a boost to the economy. As I have often repeated, every time anyone borrows a dollar and spends it, the economy goes up. However, the $1 trillion infrastructure spending program, spread out over 10 years, would probably only increase economic growth or GDP by perhaps one or two-tenths of one percent a year. Unfortunately, once an economy has exceeded all prudent debt levels, adding more debt does not stimulate it as it does when you begin with low debt levels. Once debt levels are far too high, the interest payments become a drag on the economy. Plus, too much of the economy has been siphoned off from the private business side of the equation such that more government spending only exacerbates the imbalance.

However, the biggest reason why the market's enthusiasm for a new infrastructure program funded by new debt is misguided involves time. If the Republicans in the House should cave and agree to more and larger debts, the first dollar of any new infrastructure spending program would hit the economy in around two years. So this might indeed be a good idea, but it will do nothing to lift up the economy any time soon. If enacted, beginning in 2019 it might increase GDP by a small amount.

3) **Trade Deals**: Donald Trump has said our trade deals are terrible for U.S. workers. We have seen the effects of trade deals for many years now, and I would say he is completely correct. The pending deal, the Trans-Pacific Partnership or TPP, is a perfect example of a terrible deal for our citizens. First, always keep in mind it was written by representatives from our largest corporations. Our elected representatives in Congress were never allowed to read a copy of the deal until after it was finalized. Now I disagree with Mr. Trump when he says those who negotiated it were terrible negotiators. To the contrary, they are probably brilliant at their jobs. The problem is they were negotiating with the sole goal of maximizing their own corporations' profits, with no regard whatsoever to our citizens. This has been the sad state of all our trade deals since at least NAFTA.

   Economic Impact: Over time, trade deals negotiated from the perspective of gaining the most for U.S. workers versus maximizing multi-national corporate profit would be very good for our economy. I don't believe it's possible to quantify this or to know when we would start to see the benefits, but we definitely should overthrow the TPP and never negotiate a similar deal.

   There is one large economic risk here, though. There is a chance we could end up in a "trade war" with one or more countries, which could then spread to other countries, etc. Historically trade wars usually end up with all countries involved entering severe recessions or worse. So we do need to deal carefully with our trade agreements, but at least overthrowing TPP is a good start.

4) Regulations: The final topic upon which the stock market's recent enthusiasm is based involves changes in how businesses are regulated. This is another area in which change is needed – but will be hard to successfully accomplish.

   I agree with Mr. Trump that we have far, far too many pages of regulations governing many or most of our business sectors. Like corporate taxes, the situation is actually not what it appears to be in most cases. Often the regulations were actually written by the largest corporations themselves with the sole purpose to squash competition.

   We clearly see crony capitalism at work in the mountains of regulations. If a regulatory bill passes with 2,000 pages of rules, the most powerful corporations have little trouble responding to it. They probably wrote the bill themselves! Even if they didn't, they have a small army of highly-skilled attorneys and related employees who can figure out how to get around those regulations. The situation is far different for their smaller competitors, and particularly for new businesses. For these companies, the amount of time and money needed to follow all the rules puts them at a serious disadvantage.

Our entire regulatory system is fundamentally misguided. If you truly want to stop behavior, you keep it very simple and focused. Having spent the last 19 years in the financial industry, I know the problems in great detail. For decades a law called "Glass-Steagall" worked almost perfectly. That law was designed to prevent banks whose deposits were backed by the Government through FDIC insurance from taking risks which would then lead the taxpayers to bail them out. That law was a few pages in length and very, very simple. Because it was so straightforward, everyone in banking knew what it meant, so if they violated it they knew they would likely be caught and severely punished.

Of course, when it was repealed in 1999 the floodgates were opened for Wall Street to gamble with no regard whatsoever for the risks they were taking. They knew the money with which they were gambling was backed by the Government, so they knew they would be bailed out if their risky speculative bets backfired.

After those risks devastated the economy in 2008-2009, Congress went to work to re-regulate the banks. The result was a monstrous bill called "Dodd-Frank." With hundreds and hundreds of new rules, the bill should have been called "the financial attorney full-employment act." With so many rules and the resulting confusion, behavior we really should regulate out gets lost in the shuffle. In other words, writing 1,000 new rules is a lot like having none at all, as the sheer number gives the largest companies and their attorneys so many opportunities to subvert them. Once again, the main impact of this type of regulation is to force large new expenses on smaller and newer competitors.

No! If you want to stop clearly illegal or immoral actions, you should make those rules simple and clear, and then make the punishment severe enough so nobody is willing to risk going to jail over them. Dodd-Frank did many (many, many, many) things, but it did not do this, i.e. it did not, will not and cannot prevent the banks from committing fraud of all kinds or from taking so much risk they may need another huge federal (taxpayer) bailout.

Economic Impact: Fixing how we regulate businesses is vitally important. It's also very hard to do, as the most powerful corporations and their lobbyists are already on the job to make sure whatever changes are made do not affect them and, ideally, punish smaller competitors. This is a very large, complicated and difficult job. If done properly it would definitely provide a significant, though unquantifiable, boost to our economy.

Summary

The above covers every main economic proposal we have heard thus far from the new Trump administration. (I did not include health care because we still have no idea whatsoever what they are going to propose. Immigration is not included because the research on the economic impact of immigration is difficult to sort out, with the majority of economists concluding immigration is a net positive while others disagree completely.)

When looking at these topics from a purely non-partisan economic perspective, the overall picture is fairly reasonable. The changes in individual taxes are misguided, as they will lead to larger deficits with no off-setting economic gain. But we definitely need to change corporate tax policy, as this would generate more tax revenue if done correctly while making the playing field more fair for businesses.

The new spending ideas get a mixed score. Our nation would probably benefit from additional infrastructure spending. However, adding more debt when our government is already far too over-indebted is questionable.

The trade deal topic is, in our opinion, more clear-cut. These deals have been unmitigated disasters for U.S. workers, and almost anything different would probably be better. Similarly, business regulation is pretty much out-of-control. We should have regulations which protect consumers. Plus, we desperately need clear regulations to prevent corporations from stifling competition. At present most regulations seem to do the exact opposite.

What Economic Impact Will It All Have?

If pursued from the perspective of removing crony capitalism and thereby increasing productive business competition, overall these proposals would improve the U.S. economy. Unfortunately crony capitalism is very deeply established in our nation at this time, and it would require a comprehensive, coordinated effort to overthrow it. I do not see a comprehensive picture here sufficient to effectively tackle our largest economic challenges, especially the challenge of creating a truly level playing field between large, middle and small companies, and consumers. That being said, some of these proposals – if implemented properly – appear to be economically sound.

However, none of the above should give stock investors a single shred of optimism about the stock market. If everything President-elect Trump and his top advisors have proposed was intelligently written into law and passed, the economy could indeed benefit by some unknown amount – in a few years. Of course, if nothing changes, or the changes are twisted – as they usually are – by the lobbyists who control Congress, all the above could not only not help the economy but bring it down further. Battles inside the Trump administration itself, where we have, for example, a Vice-President who absolutely disagrees 100% with most of Trump's economic ideas, could also derail anything positive from occurring.

Unfortunately (for stock investors anyway), candidate Trump was correct when he said the economy is weak and stocks are in a bubble. And nothing in any of the proposals touches on the largest economic wall we are confronting – debt. Trump enters the White House with government debt at an all-time high, corporate debt at an all-time high, and consumer debt (minus mortgage debt which did go down when people lost their homes in 2008-2010) at an all-time high. To the contrary, his proposals call for attempting to stimulate the economy by dramatically adding to this insurmountable pile of debt! That won't work.

So instead of going from the status quo to sustainable growth, the economic road must take a detour through a resolution of trillions of dollars of bad debt. This means a severe recession must occur before it is even possible to get to solid economic growth. Combined with the fact the rest of the world is even more debt-ridden, there is no positive path forward without first "taking our medicine" and cleaning up our bad (primarily corporate) debt.

The single largest cause of our debt-riddled situation is the Federal Reserve Board and their mistaken, disastrous policies. If President Trump would simply call for their resignations, in one sentence he could begin the reset necessary in order for any of his administration's proposals to have a chance to succeed. The "swamp" President-elect Trump has said he is going to drain is huge, as it consists of the Fed members and thousands of lobbyists who control Congress. A president and administration dedicated to draining it with resolute will and a brilliant comprehensive plan would find it a very difficult task. Instead, in the last few weeks the people being proposed in Donald Trump's cabinet appear to be a combination of those from the swamp and those who hate the swamp-dwellers! So instead of a coordinated attack on crony capitalism, it certainly looks as if we are going to see a constant war being waged, inside the new administration and in Congress. Perhaps this is exactly what we need to bring down the corruption inherent in crony capitalism, but it is unlikely to be smooth sailing, for our new President or nation.