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Trump Bump, or Trump Slump?

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Trump Bump, or Trump Slump?

While much of Ontario's finances depend on controlling spending, the other half of the equation is revenue. Aside from new taxes, revenue is dependent on growth, and that brings us to the elephant in the room. On November 8, 2016, Donald J. Trump was elected the 45th President of the United States, and he took office on January 20, 2017. His campaign slogan was 'Make America Great Again', and that is exactly what he has set out to do. He plans to achieve this by lowering corporate taxes, cutting red tape, making energy affordable, and instituting a 'Buy America' plan.

This has an obvious and immediate impact on Canada, but the real question is whether this will help or hinder Ontario? Will we get a Trump Bump, or will this create a Trump Slump?

Trump Bump

I first sat down to write this chapter after the U.S. election, and tried again after the swearing-in. But the sands seemed to be shifting back and forth, and quite frankly, the jury was still out. Early in the year, the Dow roared, which is a signal that investors believe the U.S. economy is poised to take off. In the Wall Street Journal, the U.S. Treasury Secretary was looking forward to "more normalized economic growth." Growth hit a high of 3.3% in 2005, and hasn't been above 3% since then. President Trump claimed that 4% growth was within reach. Hyperbole aside, that should be good news for most countries. If the world's largest economy takes off, a rising tide lifts all boats, and Canada, by proximity, should be right along for the ride. That's the Trump Bump!

Trump Slump

But, the U.S. expects to achieve that hyper-growth by tax cuts, deregulation, and infrastructure spending with a Buy America rider. That all makes for great opportunities for U.S.-based businesses, at the expense of others. Add to that Trump's forceful language with U.S. firms, which has them taking action. Remember Carrier announced they were moving jobs to Mexico, and after Trump was elected, announced they were staying put? Ford scrapped their plans to open a factory in Mexico. And the list goes on. All good for the U.S. – all part of Making America Great Again. Except it's at the expense of others; including Ontario. That's the Trump Slump.

Buy America

President Trump repeatedly stated he would tear up NAFTA; the "worst trade agreement ever." While such a move would require the sign-off of the U.S. Congress, the President can act unilaterally and sign Executive Orders regarding tariffs and similar balance-of-payment issues. For most of the post-election period, up to about April, we continued to hear "Oh, all that talk is focussed on Mexico." There was certainly worry that Canada might get a little splashed when the elephant jumped into the water, and it seemed our leaders kept their heads down, hoping nobody would notice us. I recall the exact same talk when former President Barrack Obama instituted his Buy America campaign for States to access any of the $840 billion Troubled Asset Relief Program (TARP) funds. He insisted he was a 'free trader' and this was directed at Mexico and China, but it affected Ontario businesses that simply could not take part in any of the TARP infrastructure programs. By the time he announced it was never intended for Canada, most of the billions were spent.

If anyone thought that Trump's musings were directed solely at Mexico, they were dispelled this spring. The President started in on the supply management system that protects the Canadian dairy industry. Then he slapped a tariff on softwood lumber imports from Canada. These new import duties range from 3% on the low end to 24%, and had an immediate and serious consequence for Ontario's forestry sector. Not only was the tax immediate, it was retroactive 90 days. The decades-old argument has been that Canada's forest industry is subsidized because producers source their timber on Crown land (as opposed to paying higher fees for accessing private lands).

Border Adjustment Tax

These moves will pale by comparison to the border tax the President is talking about. This would be a "massive" Border Adjustment Tax (BAT) designed solely to protect U.S. jobs. Trump tweeted "Toyota Motor said it will build a new plant in Baja, Mexico, to build Corolla cars for U.S. NO WAY! Build plant in U.S. or pay big border tax." It remains unclear whether the target is strictly Asia's parts suppliers, or whether Mexico and Canada would be included. It would work like this: When a U.S. company buys any type of product from another U.S. company as an input either to their own production or for final sale to U.S. consumers, they can write off the entire amount of that purchase. The same purchase from an outside company would not be deductible, resulting in what amounts to a 20% tariff.

Tax Cuts

The BAT program would also include a massive cut to the corporate tax rate from 35% to only 15%. At the end of April this year, Trump unveiled his broad tax-cut plan. It called for deep reductions in business tax rates and major changes to the individual tax system. The proposal includes a 15% tax rate for all businesses, lower individual rates, a larger standard deduction for households, and a repeal of the estate tax. The cost to the Treasury is about $2 trillion over 10 years, so this is a huge incentive for business. Under this plan, the average U.S. business will pay about a 20% tax rate, after accounting for state taxes. Canada's average combined federal-provincial rate is 27%. What was once our greatest advantage, will now appear to be excessive. The concern is this will siphon away Ontario jobs and investment far more than the previously-mentioned tariffs.

This spring, the federal government and many of the provinces scrambled to put together a lobbying blitz to persuade U.S. States and the Trump administration to leave Canada out of their protectionist trade measures. The message is that there are hundreds of thousands of U.S. jobs dependent on free trade, that will be at risk if any of Trump's plans target Canadian companies. Saskatchewan Premier Brad Wall offered up the best explanation of cross-border supply chains. "Saskatchewan farmers buy John Deere tractors, made in Iowa, to harvest oats that are then sold to General Mills in Cedar Rapids, turned into Cheerios and exported back to Canada." Former Canadian Ambassador to the U.S., Derek Burney, further explained "For Americans more generally, we need to demonstrate specifically and statistically how important our trade is to American jobs and interests and emphasize that damage to one partner inevitably damages the other." Unfortunately, that doesn't line up with the President's "Make America Great Again" theme.

According to Ministry of Finance documents, the U.S. remains Ontario's primary destination for international merchandise exports, representing 80.5% of the total in 2015. An increasing share of goods and services exports is integrated into the production of other products, and Ontario is an important contributor to these global value chains.

Making Energy Affordable

On the energy front, President Trump has unravelled key elements of the Obama-era climate change policies. He has promised cheaper energy, and like many of his promises, he seems prepared to go to extremes to achieve them. In Ontario, the new cap-and-trade tax will take almost $2 billion out of our economy annually. These policies are going in opposite directions, and will drastically affect the competitiveness of Ontario's manufacturers. One way to mitigate this is by making the federally-mandated carbon tax (to be put in place next year by Prime Minister Trudeau), revenue neutral. As I discussed in past issues of *Focus*, RBC's Chief Economist Craig Wright stated that any carbon tax should be revenue neutral – "The issue is that carbon pricing is to change the structure of the economy; it's not about growing the size of government, and that's when you get into this revenue neutral side. If it's just about the government grabbing more money and then reallocating it, that's less than ideal, especially in the context of a more competitive environment." President Trump will continue with his goal of providing cheap power to kickstart the U.S. economy, while here in Ontario we have the highest all-in electricity rates in North America.

Cutting Red Tape

The final piece in the Make America Great Again campaign is cutting red tape. Billed by the White House as the most ambitious attack on red tape since the Reagan era, President Trump signed an executive order aimed at cutting business regulations and capping the total cost of new rules that each government agency can impose annually. Trump signed an order called ‘one in, two out’ – for each new regulation proposed by an agency such as EPA or the Labor Department, the same department will need to identify two existing regulations to be eliminated. The President also signed an executive order requiring every federal agency to form a “regulatory reform task force” that would root out regulations for repeal. Joined in the Oval Office by business executives, Trump said “unnecessary” and “burdensome” regulations are “killing jobs” and “driving companies out of our country like never before.” He said reducing the regulatory burden will “unleash economic activity.”

Conclusion

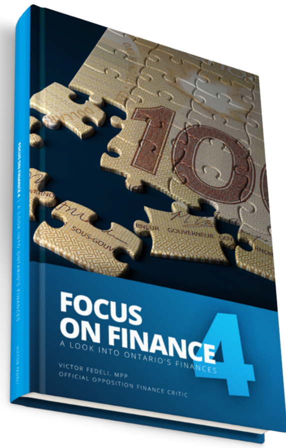
Will Ontario feel a Trump Bump or will we see a Trump Slump? This story continues to unfold. We do know one thing: uncertainty and the unknown spooks business.

Key Questions

Is the government lowering the corporate tax rate to the originally-announced 10%, before their agreement with the Third Party caused them to halt the reductions?

Will the government agree to a red tape reduction ‘one in, two out’ approach?

Will the government agree to stop signing electricity generation contracts for power we don’t need?



Similar stories of waste, mismanagement, and scandal are disclosed in my new book, ***Focus on Finance 4***.

Please go to **www.fedeli.com** to download your own copy of the book.

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