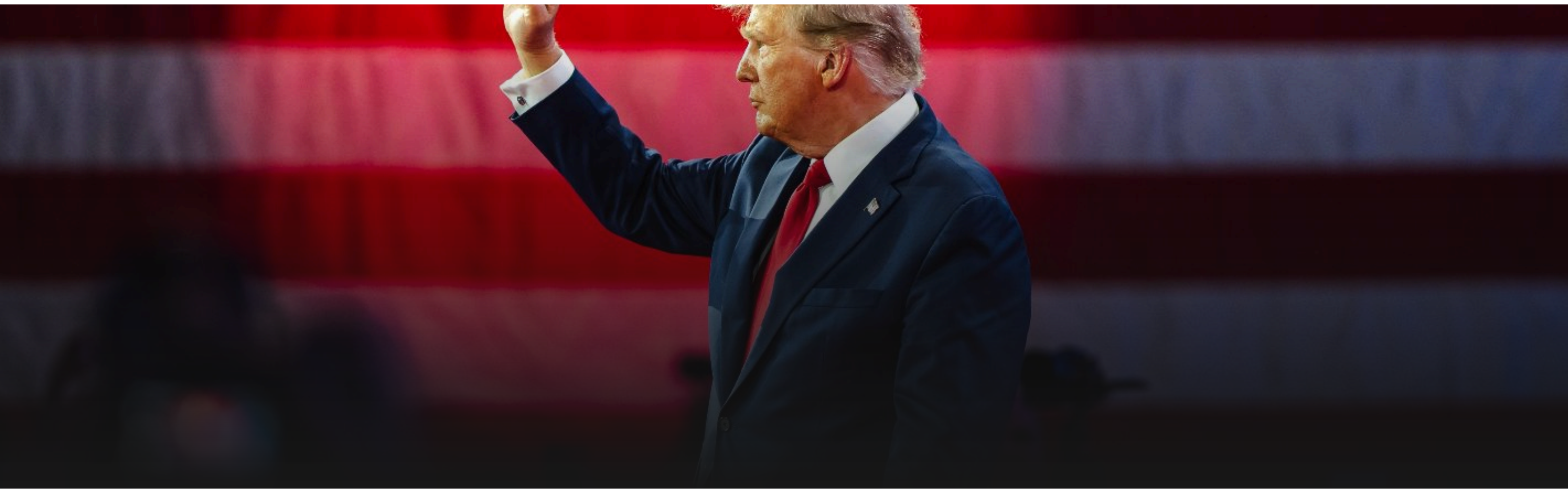

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The likely economic implications of Trump's second mandate

*Donald Trump was elected by an unlikely alliance between the US lower and upper classes. The poor want decent-paying jobs, while the super-rich want a classic agenda of ever freer markets and low or no taxes. How will Trump reconcile such disparate interests? **Francesco Caselli** discusses the incoming president's likely economic policies and their possible impacts for the UK and Europe.*

Donald Trump was elected by a coalition of the poor and lower middle class (who provided the votes), and the super-rich (who provided the money). These two constituencies have diametrically opposite economic interests. Predicting the incoming administration's economic policies is an exercise in assessing each of these two groups' relative importance to and influence with Mr Trump.

The campaign's economic message was ostensibly primarily directed at the lower half of the US income distribution. By any credible measure, the bottom fifty percent has experienced the least improvement in living standards over the last couple of generations. The Trump campaign has made two major promises to this constituency: a drastic reduction in immigration, coupled with the potential repatriation of large numbers of illegal immigrants; and the erection of large tariffs on imports, particularly from countries with which the US has a significant manufacturing trade deficit, such as China and Mexico.

Fewer immigrants would, in theory, benefit working class Americans, because they would reduce the competition they face for jobs, housing and public services. Likewise, trade protection would potentially re-create blue-collar jobs that have been lost to foreign competition. But these policies are deeply unattractive to most of the billionaires who have sunk huge amounts in the Trump campaign. First, they have the potential to increase the cost of labour, or even create labour shortages, for the businesses they own. Second, in the likely case that the countries targeted by the tariffs retaliate in kind, it will be harder for their businesses to export.

What the super-rich supporters of Mr Trump want, instead, is the classic post-Reagan Republican agenda: tax cuts, especially to estate taxes, top marginal income taxes, and corporation taxes – so they and their heirs can continue to accumulate ever more mind-boggling fortunes; laissez-faire product market regulations, so that their businesses can continue to consolidate their increasingly monopolistic positions; laissez-faire labour market regulations, so that they can continue to exploit monopsony power to keep wages down; laissez-faire environmental regulations, etc.

Needless to say, these policies are bad for the bottom fifty per cent. More tax cuts will further reduce the ability of the State to provide services and social insurance. Indeed, “entitlement reform,” which is just a euphemism for cuts in or privatisation of Social Security, Medicaid, Medicare, and other social programmes, is another project cherished by some of Trump’s rich supporters. More monopoly and monopsony power by corporations will lead to higher prices and lower wages for working-class families. Weaker environmental standards will cause further health and housing risks, which the poor are least able to protect themselves against.

Despite the apparent irreconcilability of interests, my guess is that the incoming administration will go for an “all of the above” strategy. For his rich supporters, a clampdown on immigration and an increase in tariffs may be acceptable prices to pay in exchange for lower taxes and an ever-freer hand to exploit consumers, workers, and the environment. This may work politically with his working-class supporters as well. The highly publicised set piece policies in their favour could provide a smokescreen behind which to discreetly implement the pro-rich part of the agenda.

In any case, decades of highly orchestrated propaganda by anti-tax interest groups have succeeded in obscuring the nexus between taxes and government services in the eyes of low-income voters. Furthermore, a lot of effective cuts in taxation can be made essentially invisible to the public, for example by starving the IRS of resources to enforce tax law or by making sure it is led by someone who will not prioritise audits of rich taxpayers and corporations.

This indeed has been the experience of the last few decades (with a very brief respite during the early Biden years), and it is significant that one of the leading candidates to be the next director of the IRS is on record for saying that the IRS should be abolished. A similar true and tested strategy to underfund anti-trust and environmental agencies is available if more visible approaches are deemed politically difficult.

For UK and European businesses, the most consequential of these policies in the short term is the increase in tariffs. Even if their countries succeed in not being directly engulfed in the trade war (a big if),there will be spillovers but also opportunities. On the negative side, the tariff wall in the US will redirect targeted country exports elsewhere, and some will make their way to Europe. This spells an even tougher competitive environment for companies in affected sectors, particularly those in which China is a strong exporter.

On the other hand, European companies may possibly fill some of the gaps left by China in the US market and, if China retaliates against the US tariffs, Europe will be able to fill the gaps left by US companies in the Chinese one. Lastly, as Chinese companies lower their prices to facilitate penetration of the European market, UK and EU inflation may temporarily decline, and this may bring about lower interest rates for businesses.

In the longer term, the pro-rich part of the agenda is more concerning for European business. In the increasingly winner-take-all nature of many industrial and service sectors, competition with US rivals who are ever bigger, ever more lightly taxed, and ever more lightly regulated can become very challenging. There will be temptation to lobby for similar treatment in order to level the playing field.

But two wrongs don't make a right, and the European public would hardly benefit by protecting European businesses through policies that would make our governments even less able to provide the services citizens expect, and our societies even more unequal. A more promising response is to play smarter, through a renaissance of European productivity (better schooling, better infrastructure, more R&D, etc.) along the lines of Mario Draghi's recent report for the European Commission.

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