IS NATIONAL POLICYMAKING HELPING OR HURTING?

It may be too soon to tell, but one can speculate.

ANIRBAN BASU AND JOSEPH NATARELLI

The current economic expansion, now in its 10th year, was (at least arguably) founded on a series of policy actions designed to replenish bank capital and liquidity, reflate asset prices, protect the future of the U.S. auto industry, save at least one major insurer, and keep borrowing costs ultra-low. Whether or not people agree with such aggressive policymaking, we find ourselves in the midst of the second longest economic expansion cycle on record.

Despite policies and programs such as the Troubled Asset Relief Program and several rounds of quantitative easing, for years, the U.S. economy stumbled along, generating approximately 2 percent growth driven largely by growth in consumer outlays. Banks seemed reluctant to lend. Many homeowners remained underwater on their mortgages, constraining their wealth profile and access to capital and limiting their mobility. Business investment often languished, helping to produce soft productivity growth; this, in turn, generated sluggish wage growth.

In part to support faster economic growth, Congress passed the Tax Cuts and Jobs Act of 2017, which as a central pillar slashed the corporate tax rate from 35 percent to 21 percent. The bill also cut the top individual tax rate to 37 percent, doubled the standard deduction, vastly diminished the impact of the alternative minimum tax (which will now affect an estimated 200,000 tax filers instead of 5 million), made it far cheaper for companies to repatriate capital, and raised the standard deduction for flow-through business tax entities to 20 percent.[1]

Business confidence has since surged, resulting in bolstered capital expenditures and more rapid economic growth. To simplify, what was once viewed as a 2 percent growth economy is now a 3 percent growth economy. The recently passed tax reform can be viewed as the capstone to a decade of pro-growth policymaking that began

ANIRBAN BASU *is the chief construction economist at Marcum LLP and the CEO of the Sage Policy Group.*

JOSEPH NATARELLI *is Marcum LLP's national construction industry leader and an office managing partner in the firm's New Haven, Connecticut, region.*

shortly after the failure of Lehman Brothers on September 15, 2008.

A new set of policies emerges

It is not nearly as obvious that newly emerging policies are pro-growth. Still, before one tackles issues related to international trade and immigration, a little context is in order. All things being equal, higher interest rates are generally not good for asset prices. Higher interest rates raise borrowing costs, and this diminishes corporate earnings. They can also encourage developers and public agencies not to move forward with construction projects due to higher costs and divert investors away from ambitious investments, since higher interest rates position people to generate larger returns without undertaking substantial risk.

RECENT TIT-FOR-TAT TARIFFS INVOLVING THE UNITED STATES, ALONG WITH A NUMBER OF OTHER MAJOR ECONOMIC PLAYERS, INCLUDING CHINA AND THE EUROPEAN UNION, STAND TO FURTHER BOLSTER INFLATIONARY PRESSURES GOING FORWARD.

Among the factors that can drive interest rates higher is inflation. When one lends to another, they earn a real rate of interest, which equates to the nominal interest rate minus inflation. When inflation rises, the nominal interest rate must rise to hold the real rate of interest constant. Therefore, anything that results in more inflation also tends to raise interest rates, which is not good for investment, and many asset prices *ceteris paribus*. One can make the case that the newly emerging sets of policies are helping to fuel inflationary pressure, which in turn could serve to truncate the current economic expansion.

Last year, the United States imposed final tariffs of 20 percent or more on Canadian softwood lumber (and the tariff rate depends on which of the Canadian mills saws the lumber).[2] On June 1, 2018, a broad set of tariffs on imported steel and aluminum products was put in place.

Predictably, prices of impacted products have recently exploded. Prices for inputs to construction materials ex-panded by more than 2 percent in May and are up by nearly 9 percent over the past year. Softwood lumber prices have increased by more than 15 percent on a year-over-year basis. Steel mill product prices have increased nearly 11 percent. Iron and steel prices have increased nearly 13 percent.[3]

Not only does this impact contractors directly, it represents another source of inflation impacting the broader economy. Recent tit-for-tat tariffs involving the United States, along with a number of other major economic players, including China and the European Union, stand to further bolster inflationary pressures going forward.

These moves might be undermining manufacturing job growth. By now, the decision by Harley-Davidson management to move some production abroad is well known.[4] However, many other companies are being impacted. Media reports indicate that a Mid-Continent Nail plant in Missouri laid off 12 percent of its workers because of higher steel costs. The company raised prices as a result, producing a 50 percent falloff in orders.[5]

However, this is not where the story ends. Oil prices have recently hovered at more than $70/barrel in North America, in part because of the tough stand the United States takes with certain oil producers. According to May's Cass Truckload Linehaul Index, trucking costs are up 9 percent on a year-over-year basis.[6] In other words, not only have materials costs risen sharply; so, too, has the cost of transporting them to the jobsite.

Moreover, then there is the issue of labor costs. The United States is now home to 6.7 million available job openings. As of May, the official rate of unemployment stood at a paltry 3.8 percent, the lowest level in 18 years. Despite an economy that continues to routinely produce 200,000 net new jobs per month, the U.S. labor force participation rate actually fell to 62.7 percent in May, a few tenths of a percentage point more than a 40-year low.[7]

In short, the United States needs workers. Compensation costs are already marching higher. According to the employment cost index, private sector wages and salaries advanced 2.9 percent over a recent 12-month period — the fastest pace in a decade.[8] With economic growth remaining firm, and with scant availability of workers, wage growth is poised to accelerate during the months ahead, generating more inflation and presumably higher interest rates in the process.

Of course, as a free society, the United States could turn to workers from other nations to fill the void. This can happen in two ways. First, businesses could simply expand their enterprises in other nations in order to take advantage of more readily available labor there. The other option is, as a free, open, and accommodative society, the United States could take advantage of immigrants' efforts.

However, immigration policy, including rules and regulations pertaining to legal immigration, is in the process of transitioning. According to a *Washington Post* analysis of State Department data, the number of people receiving visas to move permanently to the United States is on pace to decline 12 percent during President Trump's initial two years in office.[9]

Bottom line

This will hopefully end well. If current strategies help permanently reduce tariffs faced by U.S. producers in Canada, the European Union, China, and elsewhere, the United States might be able to close its trade gap with the balance of the world, stimulate additional domestic manufacturing, accelerate economic growth, and expand its middle class.

The issue of immigration is even more complex, but this story may also end well. Shifts in economic activity and geopolitics render it sensible to reconsider immigration policies in the United States. That said, for now, many expanding employers, whether seasonal seafood businesses or year-round mechanical contractors, will find the human capital cupboard bare. ■

NOTES

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3 "Producer Price Indexes," U.S. Department of Labor, Bureau of Labor Statistics (2018). Available at: https://www.bls.gov/ppi/.

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7 *Op. cit.* note 3.

8 *Ibid.*

9 Hauslohner, A. and Ba Tran, A., How Trump is changing the face of legal immigration, *The Washington Post* (July 2, 2018). Available at: https://wapo.st/2z4mpac?tid=ss_tw&utm_term=.198b6e9022b0.