PRAETORIAN GUARD[SM]

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Thoughts on the 2014 Midterm Election

First the good news—the Midterm elections are over. The bad news? We are now in the 2016 Presidential election cycle. This biennial edition of Praetorian Perspectives will focus on the impact, opportunities, and dangers of the recent election cycle.

IMPACT OF 4 NOVEMBER

The message sent on election night was a clear one—the economy is issue #1, #2, and #3 for the vast majority of U.S. citizens. While the recession officially ended in the summer of 2009, we have seen an average annual growth rate of just 2.2% over 2010-2013. Inflation-adjusted median household income is 8.34% *less* than its pre-recession peak, and has declined every year since 2008 (to include almost 4 years of expansion). Thus, there are many issues that may poll well, but the old adage that people vote their pocketbooks was validated.

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CHALLENGES FOR THE PRESIDENT AND THE CONGRESS

For President Obama, the choice is between repairing his legacy by accepting the judgment of the voters, adjusting _some_ of his positions and signing into law those bills sent from the Congress, OR doubling down on stubbornness and executive actions. The first will help improve the economy and his legacy; the second will only hurt his party in 2016 and likely permanently tarnish his historical reputation.

For Congress, now controlled by Republicans, the tension will exist between those who want to pass legislation with the goal of improving the economy and reforming the Government and those who want to score political points. Let us hope the adults prevail and they realize that getting half a loaf now is a good start.

OPPORTUNITIES FOR UNLEASHING THE U.S. ECONOMY

We are going to break down those actions that would help stimulate the economy into the realm of *The Likely, The Possible, and Forget About It* and outline the economic impacts to our clients if this legislation become law.

Keep in mind the true window for passing substantive legislation runs from January 2015 through approximately October 2015; after October, the 2016 Presidential campaign for both parties will consume all the oxygen in the Capital Beltway.

LIKELY ACTIONS TO BE PASSED

The following are areas where the Congress will pass legislation which will have sufficient support to get signed or have a good chance to override a Presidential veto:

- **Keystone XL Pipeline**—all studies are complete (several times), the pending Nebraska court challenge is manageable and the Canadians have been clear they are going to build a pipeline. The only true question is if the last portion of the pipeline on the Canadian side is a straight pipe (headed to the U.S. Gulf Coast) or a 90˚ turn towards their west coast (headed to Asia). Given that our refining capacity in the Gulf Region can handle the heavy crude, and the "tight crude" from our vast shale deposits requires different refining, it is a easy call. Put some 20,000 union members to work, secure greater energy security and take this one off the table. *Prediction: Passed by March 31, 2015*
    - **Economic Impact:** Greater energy security for the USA; less U.S. dollars flowing to regimes hostile to our international interests and allows for export of U.S. "tight' crude from Hydraulic Fracturing; likely marginally lower prices at the pump as Canada will expand production over next 4-7 years.
- **Lift the U.S. oil export ban from the Oil Embargo period of 1974.** It has been 40 years, the global oil market is vastly different than in the early years of the Ford Administration and it's time to allow U.S. producers to export oil from our Gulf Coast. This improves the balance of trade, gives incentive to further increase production domestically, can aid our allies and economically weaken our foes. *Prediction: Passed by March 31, 2015*
    - **Economic Impact:** Provides the incentive to produce tight crude and natural gas from the vast USA shale deposits in a period of lower crude prices; improves U.S. balance of trade; keeps natural gas boom expanding, having benefits for manufacturers, chemical companies, and households.

- **Repatriation of overseas profits at a low tax rate.** There is some $2 Trillion on the balance sheets of U.S. Corporations overseas that won't come back to the states because it will be subject to the tax differential between the U.S. (35%) and the foreign country (lower rate). We have seen this before (most recently in 2004). The argument is it will "cost" the U.S. Treasury revenue because the lower tax rate (say 5%) is significantly less than the differential. This is a red herring—the choice is between 5% of a large amount of earnings or 35% of nothing. *Prediction: Congress will pass legislation at 5% through December 31, 2015, President Obama will sign it and the revenue will be earmarked for infrastructure funding*
  - **Economic Impact:** Funds return to the U.S. can be employed here for expansion, capital spending, dividends, and share buy backs. Additionally, will demonstrate that corporations respond to positive incentives to return capital and expand operations in the U.S. when the tax disincentives are removed.
- **Elimination of the Export-Import Bank.** This should be an easy one, but it's not. The September 2014 deal gave the Bank life through June 30, 2015 but it has to stand on its own with a very different Congress. *Prediction: Goodbye to this 1934 creation by July 4, 2015*
  - **Economic Impact:** While this may seem to be "Beltway" minutia, it is important for the Congress to learn it can eliminate a longstanding program and live to legislate another day. This is a small but symbolic step towards comprehensive tax reform.

POSSIBLE ACTIONS TO BECOME LAW

Moving from the likely to the possible signals that the easy, Congressionally bi-partisan legislation has been completed. It takes time and these proposals, while possibly more important in the long run, are beginning to bump into declared Presidential candidates and the August 2015 summer recess. We will rate these with the probability of passage before the recess. Afterwards, it will rapidly approach 0%.

- **Adjustment of the definition of full time work under the Affordable Care Act (ACA) from 30 hours to 38-40 hours.** This has been a significant drag on business decisions to employ workers longer hours each week. It has created a cottage industry of managing work hours to prevent exceeding 28 hours (and therefore fall under the ACA mandate). It is a perfect example of why many of our elected leaders need private sector experience before running for office as the response from employers was *entirely* predictable. *Likelihood of passage: 40%*
  - **Economic Impact:** The standard work week has always been 40 hours; the Affordable Care Act perversely altered this and the reality is that workers who want to work more hours were hurt bv the business decision to minimize exposure to the ACA.
- **Increase in the Federal Minimum Wage from its current $7.25/hour to not more than $9/hour.** We are in no way arguing this is good economic policy, but it is a valuable bargaining tool for the Congress. This will be either the lead legislation (with a rider that is unable to get Presidential approval alone) or a *(Continued on pg. 4)*

on pg. 4) (Continued from pg. 3) sweetener on a tough bill for President Obama. Either way, it will be a hard choice for him. It will be signed into law without a Rose Garden ceremony and there will be no photos released to the press. *Likelihood of passage: 35%*

- **Economic Impact:** Off the table for the 2016 election cycle; benefits those with jobs at the first rung of the economic ladder but hurts others trying to grab hold of the same rung.

- Make permanent the "tax extenders" for research and development, energy and depreciation in order to take this annual exercise off the docket. *Likelihood of passage: 25%*

  - **Economic Impact:** The reality is that these always get extended; making them permanent frees up businesses to plan with greater confidence and frees Congress to focus on more important tax code overhaul.

ACTIONS WITH NO CHANCE OF BECOMING LAW

- Complete repeal of the Affordable Care Act. There will be a symbolic vote on this, it will be vetoed, and not overridden.
- Opening up Federal land for hydraulic fracturing and horizontal drilling. This will ultimately happen but it will be after President Obama's term is complete.
- Comprehensive corporate and individual tax reform. While this is the single most economically beneficial action Congress *could* take, the gap between the two Parties and between the Congress and the President is too great for reform (à la 1986). It is of minimal value to tackle one side of this given the significant number of businesses that are pass through entities (e.g. S Corps, LLCs, etc.) and thus pay taxes at the individual rate. Look for some action, no legislation and this to be a major Presidential campaign issue for 2016.

Bottom line: There is a window of eight months for significant legislation and Congress has a backlog of bills already passed by the House of Representatives. The Senate should be able to move fairly rapidly on those bills. After Labor Day 2015, the next election cycle will dominate Washington and most bills will be political markers designed to highlight and/or hurt one party or the other.

CLOSING THOUGHT

Be thankful we're not getting all the government we're paying for.

—Will Rogers