TD Economics

U.S. Election 2020: Economic and Financial Implications

Leslie Preston, Director & Senior Economist | 416-983-7053
James Marple, Managing Director & Senior Economist | 416-982-2557

September 16, 2020

Highlights

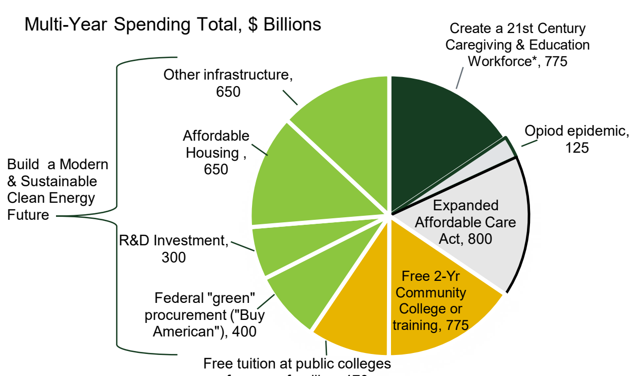
- Elections matter for the economy. The last two administrations passed major domestic policy initiatives in their first terms with governing majorities in Congress.
- The make-up of Congress will determine how much of the future President's agenda can be implemented and will therefore also influence financial market reaction.
- Higher taxes under Biden and a Democratic Congress will likely be negative for equity markets. However, his more pro-immigration stance and lower income inequality under a more progressive tax structure could raise longer-term economic growth, with knock on effects for bond yields.
- Trump's promises are less specific, but he is campaigning on his record: low taxes, less regulation, restricted immigration and using tariffs to achieve foreign policy aims.
- On net, Biden's platform points to more expansionary fiscal policy and higher deficits, but the progress of the coronavirus pandemic will be a wild card for whoever takes office.
- For Canada the implication of one outcome versus the other is not cut and dry. With positives and negatives for Canada's economy with either candidate.

Elections matter. While the separation of powers imposes limits, the American President has an important platform to promote their agenda. The last two presidents were able to pass major domestic policy initiatives within their first terms. The Affordable Care act was passed in the early years of the Obama administration, and significant personal and corporate tax cuts occurred under Trump (as well as trade wars).

Of course, those measures were achievable because the President's party also had a governing majority in Congress. The make-up of Congress will determine how much will be implemented of either candidate's agenda. Congress is currently divided, with Democrats holding the majority in the House and Republicans in the Senate. There are several areas where a President can act without Congress, but the power of the purse lies with Congress, so the ability to enact promises on spending or taxes would require a majority in both chambers. Cabinet and other appointments are also subject to Senate approval and can be held up if the opposition holds the balance of power. This could slow an administration's ability to get things done.

Polls currently place Democratic presidential candidate, Joe Biden, ahead of President Trump, but considering the inaccuracy of polls in 2016 and several more weeks until the election on November 3rd, nothing is set in stone.

Chart 1: Biden's Major Spending Promises So Far...



*Including money for long-term care and universal Pre-K
Source: Biden Campaign Website, various media reports, TD Economics

Until then, we can shed some light on what they might do once they take office. This paper outlines the aspects of each candidate's platform that could have an impact on the economy. That said, platforms are promises, and what will be implemented is highly uncertain. More so this year, as whoever is elected will also have to react to an ongoing global pandemic.

Biden: "Build Back Better" With Progressive Spending And Higher Taxes

Biden is typically characterized as a moderate Democrat, particularly relative to many of his primary rivals. However, his platform has many ambitious and progressive commitments. Spending commitments total over $5 trillion over the next ten years, partially paid by tax increases on wealthier Americans and corporations. Some media have cited a much higher total for Biden's spending commitments, but those are double counting certain items that are mentioned in multiple places in campaign documents. The Penn Wharton Budget Model (PWBM) analysis of the Biden platform tallies total spending at $5.37 trillion through 2030.

Campaign spending commitments are still being rolled out, and in some cases tweaked to reflect the new pandemic reality. What we know so far is outlined in broad strokes in Chart 1. The biggest chunk is a variety of commitments bucketed under "modern sustainable infrastructure and an equitable clean energy future," which Biden proposes spending over his first term. This includes a broad swath of commitments on infrastructure, the auto sector (support for electric vehicles), transit, a carbon-free power sector by 2035, building upgrades, sustainable housing and other environmental-related investments. This bucket includes "Buy American" government procurement and $300 billion on research and development into electric vehicles, 5G and AI.

Other priorities include higher spending on health care, building on the Affordable Care Act and creating the option for people to buy a public health insurance option like Medicare (estimated to cost around $800 billion). Lastly, education is a priority, with funding for universal pre-kindergarten, two-years of free community college and free tuition at public colleges and universities for families with incomes below $125,000.

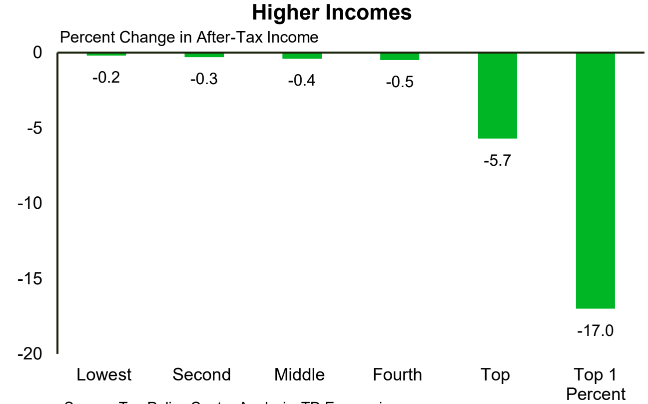
More recently, the Biden campaign has said it will support "Phase 4" Covid-19 fiscal support, currently being negotiated in Congress, without specifying dollar amounts. This includes funding for state and local governments to avoid layoffs, extended crisis unemployment insurance and a "comeback" package for Main Street businesses and entrepreneurs.

To fund his spending plans, Biden's platform contains tax increases that are estimated to raise almost $4 trillion over ten years. The measures, and revenue impact as estimated by leading public policy think tanks, are detailed in Table 1.

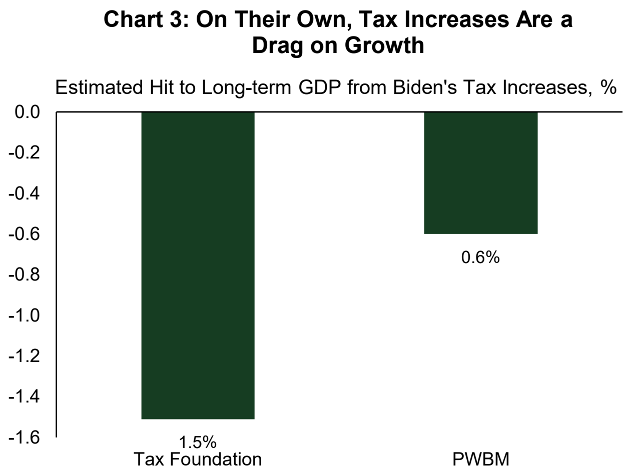
The biggest revenue raiser is an increase in the corporate income tax rate from 21% to 28%. That basically halves the tax cut corporations received in the Tax Cuts and Jobs Act of 2017 (TCJA) when the rate was cut from 35%. Companies would also face a 15% minimum tax on book income and twice the existing minimum tax on profits earned by foreign subsidiaries of U.S. firms from 10.5% to 21%. These higher corporate taxes are the reason more modest income Americans would see their incomes drop. It is the knock-on effect from lower profits that gets distributed along three channels for a company: shareholders, consumers and workers.

The plan is very progressive. It increases taxes for the top one percent of earners by 13 to 18 percent of after-tax income, while indirectly increasing taxes for most other groups by 0.2 to 0.6 percent (Chart 2). The biggest revenue raiser on the personal side is subjecting earnings over $400,000 to the Social Security payroll tax. Taxpayers with incomes over this threshold would also see reduc-

Chart 2: Biden's Tax Increases Fall Primarily on Higher Incomes



Source: Tax Policy Center Analysis, TD Economics



tions from the roll back of 2017's TCJA. The top marginal rate would return to 39.6%. Biden's plan would limit the value of itemized deductions for taxpayers above the 28% bracket, and tax capital gains and dividends as income for people over the $1 million mark. The PWBM analysis estimates that every income group except the top 0.1% sees lower effective income and payroll tax rates relative to the pre-TCJA tax code.

All told, the revenue raised by the tax increases on the personal side are about equivalent to the business side. Various organizations have estimated that the increases would likely be modestly negative for economic growth by reducing incentives to work and save (Chart 3).[1] Dynamic scoring of the tax plan on its own, which includes the impact of tax increases on economic growth, would see it raise less money than shown in Figure 1, approximately $2.7 to $3.1 trillion. However, the overall impact will depend on how efficient the redistribution of additional tax revenues is towards Biden's spending agenda. Some areas of spending have relatively high multipliers, such as infrastructure.

There are other policy areas which would have an impact on the economy but are not specific tax or spending measures. For example, Biden's platform supports strengthening workers' bargaining power, including cracking down on misclassifying employees as independent contractors and raising the federal minimum wage from $7.25/hr to $15/hr. He also supports universal paid sick days and 12 weeks of paid family and medical leave.

Table 1: Fiscal Impact of the Biden Tax Plan (Billions 2021-2030)

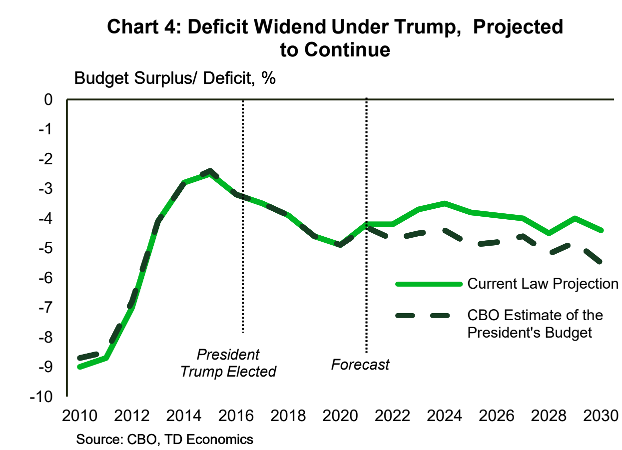
	TPC	PWBM	TF	AEI
Increase the corporate income tax rate to 28 percent	$ 1,300	$ 1,088	$ 1,306	$ 1,297
Impose a 15 percent minimum tax on companies' book income with credit for taxes paid to other countries	$ 166	$ 227	$ 318	$ 160
Double the minimum tax on the profits earned by foreign subsidiaries of US firms from 10.5 % to 21 %	$ 309	$ 323	$ 303	$ 310
Restore the top individual income tax rate to 39.6 percent $	$ 143	$ 153	$ 151	$ 100
Phase out small business income deduction above	$ 219	$ 208	$ 197	$ 212
Tax capital gains as ordinary income for taxpayers with over $1 million in income and tax unrealized gains at death	$ 448	$ 382	$ 503	$ 379
Cap itemized deductions (28% limit and Pease Limitation)	$ 376	$ 263	$ 357	$ 312
Increase the Social Security earnings cap	$ 962	$ 1,035	$ 808	$ 797
Other provisions scored by estimator	$ 70	$ 67	$ (146)	$ 281
Revenue Reported by Estimator	$ 3,884	$ 3,746	$ 3,797	$ 3,848
Establish first time homebuyers' and renters' tax credits	$ (300)	$ (300)	$ (300)	$ (300)
Impose a financial risk fee on large banks	$ 100	$ 100	$ 100	$ 100
Increase the Child and Dependent Care Tax Credit	$ (100)	$ (100)	$ (100)	$ (100)
Other provisions not scored by estimator	$ (50)	$ (50)	$ 176	$ (196)
Adjusted Estimates	$ 3,644	$ 3,396	$ 3,673	$ 3,352
Change in Revenue-to-GDP (conventional)	1.40%	1.31%	1.41%	1.29%
Dynamic Estimate	n/a	$2,727	$3,099	$3,119

Source: Tax Policy Center (TPC), Penn Wharton Budget Model (PWBM), Tax Foundation (TF), American Enterprise Institute (AEI), Congressional Budget Office, CRFB calculation, TD Economics

On trade, a Biden presidency maintains a lean towards trade protectionism through its "America first" stance, not unlike the Trump Administration's bias even though the approach may differ. Like previous Democratic candidates, Biden's platform contains "buy American" government procurement commitments. However, in the past, Biden has supported NAFTA and the Trans Pacific Partnership (TPP), which was negotiated during his tenure as Vice President.

Ditto for the soured relationship with China. Biden has criticized Trump's handling of the relationship with China and the tariffs (though he has not explicitly said he would remove them). He has also cited a need to "get tough with China" when it comes to intellectual property theft and has called for American companies to re-shore production. However, in an example of how the approach may differ, Biden has stressed the importance of working with U.S. allies when dealing with China.

Also, in contrast to Trump, Biden's platform is more immigration-friendly. With an aging population that is slow labor force growth and the productive capacity of the economy, higher immigration has the potential to raise America's longer-term growth rate. Policies that are more supportive toward skilled workers are growth-positive over the longer-term. The Biden platform does not cite specific increases, but it does mention ending the current travel bans, providing a road to citizenship for undocumented migrants, increasing the number of employment-based visas, and allowing cities to petition for a higher number of immigrant visas. Relative to President Trump's past proposals on immigration, which propose changing the composition of newcomers, but not the overall level, Biden's plan is more likely to do both, which would reverse a declining trend in recent years and support longer-run economic growth.



So far, the PWBM analysis is the only full macroeconomic analysis of Biden's platform, which makes various assumptions in areas that are unclear in the platform, such as higher immigration levels. It estimates his policies would reduce the level of GDP by 0.4% in 2030, but turn neutral by 2040 and would raise GDP by 0.8% by 2050. They would also raise the federal debt by 0.1% in 2030, before decreasing it farther out on the horizon. Given the long time line associated with these projections, these are subject to considerable uncertainty and should be taken with a grain of salt. Nonetheless, they suggest that over the medium-term, the growth impact of Biden's tax and spending plans are likely to be minimal, if not modestly positive.

Trump Would Extend Tax Cuts, Spend Less On Health Care And More On The Military

Running as an incumbent President without a primary challenger, Trump does not have the same kind of detailed policy platform as Biden's campaign. However, during the Republican National Convention, Trump released a 50 bullet point list of priorities. These mostly align to his last four years in office, including tax cuts, deregulation (especially environmental and energy-related), getting tough on China and stopping illegal immigration.

In addition to this, the President's 2021 budget provides insight on the administration's policy priorities. It is important to note that the President's Budget is rarely implemented as written since Congress controls the purse strings, but it does give a sense of where the Administration would like to take policy.

The President's 2021 budget was released in February of this year, prior to the COVID-19 recession. Therefore, its starting point does not include the resulting spending increases and subsequent larger budget deficits. Even without this game-changing shock, the budget's deficit projections must be taken with a grain of salt as its revenue projections assume economic growth well above the private-sector consensus.[2]

That said, it is still a useful document for understanding the administration's priorities. The President's budget would reduce mandatory spending on several programs relative to the current law, with the biggest declines coming from a reduction in healthcare spending. Savings would come mainly from cuts to Medicare as well as stricter working requirements for people to qualify for Medicaid. Overall, savings from healthcare spending would amount to just under $600 billion over the next decade (0.2% of GDP).[3]

Cuts to discretionary spending were much bigger in the 2021 budget, totaling over $2.0 trillion relative to baseline over the next decade, or close to one percent of GDP. The biggest cuts are to the non-defense portion of the budget, which would be reduced by over 20% over the 2021 to 2030 period. This would drastically reduce federal spending on items such as basic scientific and health research, transportation, education and training, and international diplomacy to levels that would be, by far, the lowest on record relative to the size of the economy.

One area where Trump would allocate more funds is infrastructure, which he would raise to the tune of a little over $100 billion. This is not pocket change, but still relatively small in comparison to planned cuts to healthcare and discretionary spending.

Overall, largely between cuts to healthcare, welfare and discretionary spending, the President's budget would cut spending by slightly over 1% of GDP annually (on average) over the next decade relative to the baseline according to the Congressional Budget Office (CBO).

Some of the savings from these cuts would be spent on lowering taxes. The main provision on the revenue side is the extension of the individual income, estate, and gift tax provisions from the TCJA, which would be set to expire in 2025. This would reduce revenues by just under $1.2 trillion over the next decade relative to current law.

Analysis by the CBO suggests that with reasonable economic growth assumptions, Trump's budget would still leave a considerable deficit, averaging roughly 4.0% of GDP annually over the next decade (Chart 4). As these estimates took place well before the explosion in spending taken to protect the economy from COVID-19, debt and deficits will surely be much bigger than this. Still overall, the President's budget suggests a more austere future than the one conveyed by Biden's spending plans.

Financial Markets Like A Divided Government

In terms of financial markets, equity markets tend to have a short-lived boost following a Republican candidate win and setback following a Democratic win. Still, risk assets tend to do better in the year following an election, relative to non-election years. Also, equities have tended to outperform in years following a split Congress and underperform when parties sweep the White House and Congress. Of course, financial markets in 2021 will have the additional (and likely dominant) influence of whether successful COVID-19 vaccines have been identified and widely distributed.

All else equal, due to the combination of tax increases, higher regulation risks and a more pro-labor bent, a Democratic sweep will likely be more negative for equities, given the impact on corporate profits. One potential offsetting influence could stem from a more predictable and business-friendly path on geopolitical matters and trade policy. Trade wars started by the Trump administration had added volatility to markets in the past, undermining overall business investment and export growth in the near term. Another positive for markets would be a less meddlesome approach to the Federal Reserve. Biden has stated that he supports an independent Fed and would be unlikely to criticize the Fed in public or nominate unconventional candidates for board positions. Finally, both increased immigration and reduced income inequality (as a result of Biden's more progressive tax structure) should help to boost the underlying pace of economic growth. This would eventually raise the natural or equilibrium fed funds rate – what economists call R* – in turn, lifting bond yields.

In the case of a Trump win, markets may expect to see policy lean toward greater tax cuts and more of the same policies from the past, offering some comfort in the status quo for business and personal taxes. It would also likely expect a continuation of trade wars and a harder stance on immigration, but much of the foundation on the former has already been laid, offering less surprise with the passage of time. Importantly, the China-U.S. Phase 1 trade deal will need to come to fruition, where the pandemic response has caused significant delay and target misses. Of course, much will depend on how much the composition of Congress follows the results of the Presidential ballot.

Implications For Canada

For Canada, at the margin, a Biden win offers higher personal and corporate tax rates in the U.S. that should improve Canada's relative tax competitiveness. However, the potential for "buy American" provisions in government procurement would be negative for Canadian businesses hoping to win U.S. contracts and may result in a tit-for-tat reaction. Buy American provisions were also part of the American Recovery and Reinvestment act of 2009, but Canada gained some exemptions for large projects and where there was no American supplier readily available (see here).

On the surface, a Biden Presidency could have negative consequences for Canada's energy sector. Biden has been critical of Canada's "tar sands" and has promised to scrap the Keystone XL pipeline. (Even under pro-pipeline President Trump, the project has faced legal challenges and has not yet been built). Unlike Trump, Biden is committed to act on climate change (plans to achieve net zero emissions by 2050, and carbon pollution free power sector by 2035) through a variety of measures, which may level the playing field a bit for Canadian businesses operating with a carbon tax. Still, his plan does not include an explicit carbon price through either a tax or cap and trade system.

Given the indirect hit to Canadian exports and negativity towards Canada's oil patch, a Biden win is likely to be negative for the Canadian dollar. More so if the Democrats also sweep Congress.

The Bottom Line

Presidential elections matter for the course of the economy and in the short-run, financial markets. Recent administrations have enacted big policy shifts early in their term when Congress was aligned. Under a Biden presidency, fiscal policy looks more expansionary, at least relative to the policy agenda laid out in the President's budget, with the priority on increased spending on health care, infrastructure (with a clean energy bent) and education. These priorities would be paid for by higher taxes on the wealthiest taxpayers and corporations, which could weigh on economic growth over the medium-term, offset by the potential growth lift from said spending. Biden also has a more pro-immigration stance than Trump, which would boost America's growth over the longer term.

President Trump's platform is not long on details, but the CBO assessment of the most recent President's budget suggests deficits would continue – so neither a budget-balancing fiscal contraction or expansion. Trump would also continue to pursue a de-regulation agenda, which could lessen the burden on businesses in the short-run (at the cost of potentially greater environmental degradation), and his generally "pro-business" policies are viewed favorably by financial markets, perhaps apart from his trade stance. Both candidates have an America-first protectionist bent on trade, so that is unlikely to be a distinguishing feature for financial markets. Whoever is elected, the biggest wild card in this election is the Covid-19 pandemic, and the status of the pandemic in January will heavily influence the policy course of either administration.

Footnotes

1. There is both an income and substitution effect of higher tax rates that work in the opposite direction. The income effect of higher taxes may cause people to work more (save more) and take less leisure (spend less) in order to maintain their standard of living, offsetting the substitution effect (higher taxes reduce the reward for working). The reduction in labor supply (saving) as a result of higher taxes on incomes at the top end of the distribution appears to be relatively small in empirical literature due to these offsetting forces.
2. We take the deficit projections from the Congressional Budget Office's Analysis of the President's budget which hews much closer to the private-sector consensus.
3. This is a moving target. The 2021 budget differed considerably from the 2020 budget, which included planned healthcare cuts of close to $1.5 trillion over the next decade relative to current law.