

## The impact of a Biden victory

By Angelo Katsoras

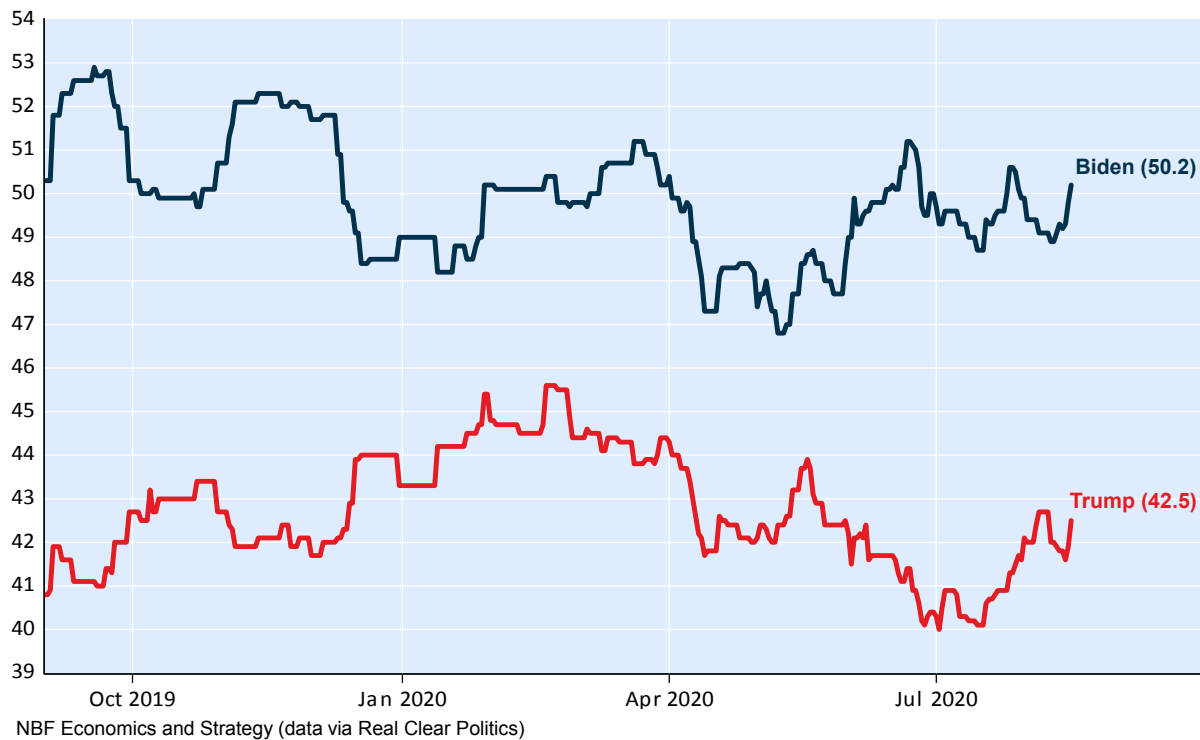
### Introduction

Back in February, when the U.S. economy was booming, Donald Trump's re-election prospects looked to be on solid ground. Then along came the pandemic, the massive economic downturn, and the nationwide protests –all of which tilted the presidential race heavily in Joe Biden's favour.

Biden is now leading in the national polls by an average of over seven percentage points and is ahead in most key battleground states. The betting markets, which until early June had Trump as the favourite, have now decisively flipped toward Biden.

### U.S.: General Election – Biden leading in the polls

Real Clear Politics Poll Average as of 8/17/2020



Biden's wide lead in the polls not only virtually assures that the Democrats will maintain control of the House of Representatives, it puts the Senate in play. Control of the presidency and both chambers of Congress would allow the Democrats to pass several major pieces of legislation regarding taxation, the environment, energy and healthcare.

This report focuses on the details of Biden's platform and what it could mean for certain market sectors. It also investigates what would be required for Trump to overcome Biden's lead in the polls and pull off an upset victory.

### Biden's tax plan

Biden supports raising corporate taxes from 21% to 28%. Before Trump's tax cut in 2017, that rate was 35%, although the use of various deductions meant that many U.S. corporations rarely paid this much.

On top of higher corporate taxes, Biden would impose a 15% minimum tax on profits, a move that would limit the ability of companies to employ various accounting maneuvers to minimize their tax bill. His plan would also double from 10.5% to 21% the existing minimum tax on profits earned by foreign subsidiaries of U.S. firms.

Regarding individual income tax, he supports restoring the top tax rate to 39.6%, up from its current 37%, for people making over \$400,000. Those with incomes exceeding \$1 million would have their capital gains and dividends taxed at the same rate as ordinary income.<sup>1</sup> If elected, this proposal could push some investors to move up their plans to sell stocks in order to avoid being forced to sell under a higher tax rate. Biden would also subject earnings over \$400,000 to Social Security payroll taxes. Currently, only wages up to \$137,700 are subject to the Social Security tax, with the employee and employer each paying 6.2%.<sup>2</sup>

As the chart below illustrates, the most significant income tax hikes in the past were implemented in the wake of the Great Depression and both World Wars. In fact, the top marginal income tax rate did not begin to decline significantly until the early 1960s, where it went from a high of 91% to a low of 28% in 1986. It currently stands at 37%.<sup>3</sup>

If the past is any indication of the future, it could be argued that the severity of this downturn, the worst since the Great Depression, means tax hikes are inevitable regardless of who wins, although it is safe to assume that taxes would be much higher under a Democratic administration.

**FIGURE 2**  
Highest Federal Marginal Individual Income Tax Rate  
Tax years 1913 – 2020



Sources: Joseph Pechman, *Federal Tax Policy*; Joint Committee on Taxation, Summary of Conference Agreement on the Jobs and Growth Tax Relief Reconciliation Act of 2003, JCX-54-03, May 2003; IRS Revenue Procedures, various years.  
Notes: This figure contains a number of simplifications and ignores factors such as the amount of income or types of income subject to the top rates, or the value of standard and itemized deductions.



**TABLE 1**  
Tax Year 2020 Schedule and Rates



Single filers			Married couples filing jointly		
Over	But not over	Marginal rate (%)	Over	But not over	Marginal rate (%)
\$0	\$9,875	10%	\$0	\$19,750	10%
\$9,875	\$40,125	12%	\$19,750	\$80,250	12%
\$40,125	\$85,525	22%	\$80,250	\$171,050	22%
\$85,525	\$163,300	24%	\$171,050	\$326,600	24%
\$163,300	\$207,350	32%	\$326,600	\$414,700	32%
\$207,350	\$518,400	35%	\$414,700	\$622,050	35%
\$518,400	and over	37%	\$622,050	and over	37%

Source: Internal Revenue Service, Rev. Proc. 2019-44.

Finally, it is also important to note that the top marginal tax rate has historically been very different from the effective tax rate the top 1% has actually paid due to various tax exemptions and loopholes.<sup>4</sup>

## Democrats want to significantly expand the healthcare safety net

Biden supports building on the Affordable Care Act (i.e., Obamacare) by increasing financial support to those struggling to afford insurance premiums and providing a government-run option to compete against private insurance plans. He also wants to lower the Medicare eligibility age from 65 to 60. These steps would dramatically increase healthcare coverage. The total cost of Biden's healthcare plan is estimated at \$750 billion over 10 years.

It is important to note, also, that regardless of who wins the upcoming election, drug companies will be hit by price controls. Biden supports allowing Medicare to negotiate drug prices, while Trump, in an effort to pre-empt the Democrats, recently signed executive orders aimed at lowering the cost of prescription drugs. One requires healthcare providers to pass along the price discounts that they receive on certain drugs directly to patients. Another requires Medicare to purchase drugs at the same prices that other countries pay, although he has delayed its implementation to give the industry time to come up with an alternative plan to lower costs.<sup>5</sup>

<sup>1</sup> "Here's what a Biden presidency might mean for your taxes," CNBC, July 21, 2020

<sup>2</sup> "Biden's Tax Plan Will Hold Back the Economy," Bloomberg, July 13, 2020

<sup>3</sup> "Key Elements of the U.S. Tax System," Tax Policy Center (Brookings Institution), 2020

<sup>4</sup> "The top tax rate has been cut six times since 1980 – usually with Democrats' help," Washington Post, February 27, 2019

<sup>5</sup> "Trump signs series of executive orders aimed at lowering drug costs," CNBC, July 24, 2020

## Energy sector and environment

Biden's most expensive proposal is a \$2-trillion, four-year green energy plan that includes the following targets:

- Moving the economy to net-zero carbon emissions by 2050
- No longer using fossil fuels to produce electricity by 2035<sup>6</sup>
- Requiring all new buildings built after 2030 to be carbon neutral

One notable provision that this plan does not include is a ban on oil and gas fracking. Biden was supportive of the U.S. shale revolution when he was Vice-President, when he no doubt realized that it permitted Washington to impose economic sanctions on the energy sectors of its adversaries without causing oil prices to surge. Perhaps even more importantly, he is aware also that a ban would hurt his electoral chances in key battleground states with significant fracking operations like Ohio and Pennsylvania.

However, Biden's environmental plan does contain proposals that would have a negative impact on future U.S. oil and gas output. These include banning the issuance of new permits for drilling on federal lands and waters, tightening environmental regulations, and significantly reducing subsidies to fossil fuel companies.<sup>7</sup>

## Has infrastructure's time finally come?

Despite the fact that both Republicans and Democrats have long supported increased infrastructure spending, they have so far been unable to agree on a bill for the following reasons. Republicans tend to support an infrastructure plan led primarily by the private sector, while Democrats support much more government involvement.

A sweep of the presidency and Congress would in theory allow the Democrats to get their plan approved. The price tag would likely be in the range of \$1 trillion.

Some analysts argue that regardless of who wins the presidency and controls the Senate, the two sides will finally agree to spend more on infrastructure to get people back to work.

## Education

Biden wants to make college tuition-free for students from households earning less than \$125,000 and intends to triple federal funding for schools in poorer neighborhoods. His overall education plan, which includes forgiving some student debt, carries a 10-year price tag of about \$850 billion.<sup>8</sup>

## Technology sector

For starters, we feel that tense relations with China increase the likelihood that big IT companies will not be broken up by either a Democratic or Republican president because neither party wants them to become much smaller than their Chinese rivals. (For further information on how China and the United States are battling for global IT dominance refer to our recent report: "U.S. tech is the big winner of the China-India border dispute.")

However, there is strong bipartisan support for more scrutiny of IT companies. This includes stronger enforcement of existing anti-trust regulations, greater privacy protections and increased efforts to crack down on tax avoidance. Biden's proposal to impose a 15% minimum tax on profitable companies is aimed particularly at certain tech companies that have been accused of employing accounting strategies to avoid paying their fair share of taxes. Finally, while not in his platform, Biden has in the past called for the lifting of legal immunity for internet companies regarding content posted by their users, a position which is gaining some bipartisan support.

<sup>6</sup> "Biden promises \$2tn green energy and infrastructure plan," Financial Times, July 14, 2020

<sup>7</sup> "Biden's big election shake-up," Petroleum Economist, July 28, 2020

<sup>8</sup> "Trump vs. Biden: Where they stand on health, economy, more," Associated Press, July 30, 2020

## Similar to Trump, Biden will use executive orders to advance agenda

Not all change needs legislation. Biden will no doubt move to reinstate many regulations that Trump eliminated across various sectors and to enforce rules that have been largely ignored. For example, there is considerable scope to tighten financial regulations without passing new legislation. It has been reported that Biden would nominate Senator Elizabeth Warren as Treasury Secretary to lead efforts to re-regulate the financial sector.

On the environmental front, Biden's executive orders would include re-entering the 2015 Paris Agreement and driving the final nail in the coffin of the beleaguered Keystone XL pipeline project.

## Protectionist trend would continue

In an attempt to compete with Trump, the Biden team has come up with its own nationalist agenda. Similar to Trump's slogan of "Make America Great Again", Biden wants people to "Build Back Better". This includes a pledge to spend \$700 billion on American products and research.

Biden's environmental plan also includes imposing tariffs on countries with lower environmental standards, a move that could be met by counter-tariffs from the targeted countries. Developing nations in particular would be angered to be hit by a carbon border tax from a country with much higher per capita greenhouse emissions.

## The tough line on China would continue under Biden presidency

Taking a tough line on China is one of the few areas where there is overwhelming bipartisan agreement. For instance, recent legislation sanctioning China's actions in Hong Kong or its treatment of Muslims in Xinjiang province passed with near-unanimous support in Congress. For most other legislation not involving China, gridlock is the norm.

## Could Kamala Harris shape Biden's platform?

While certain of her past positions differ from Biden's – i.e., supported a total ban on fracking and greater government intervention in healthcare – Harris will no doubt fully support his program. However, should Biden win and then not be able to fully serve out his term for health reasons, her past policy positions would become much more important.

## Senate is in play

If Biden becomes President, the ability to advance his legislative agenda would largely depend on whether the Democrats also succeed in regaining control of the Senate.

Currently, Republicans hold 53 seats and the Democrats 47. In total, there are 35 Senate seats up for grabs in the November election. In 12 cases, the incumbent senator either is a Democrat or caucuses with the Democrats. The other 23 seats are held by Republicans. Democrats need only win three more seats to gain control of the Senate if they also win the White House given that the vice-president casts the tie-breaking vote in the event of an even split.

However, even if the Democrats were to retake the Senate, it is highly unlikely that they will be able to gain the 13 seats needed to overcome Senate rules that require 60 votes to close debate on most legislation (otherwise known as the filibuster).

One way both parties have sometimes gotten around the 60-vote threshold is to use a fast-track process known as reconciliation. This allows fiscal measures tied to the budget to pass with just a simple majority. The Democrats used budget reconciliation to pass much of Obamacare in 2015, while the Republicans did the same to pass their tax overhaul in 2017.

If the Democrats retake the Senate, they will face intense pressure from their supporters to do away with filibustering and thus lower the bar for passing all legislation to a simple majority. The 60-vote threshold can be eliminated with a simple majority of 51 votes.

## Debt as far as the eye can see

The next administration will inherit an increase in the federal deficit of \$3 to \$4 trillion. The International Monetary Fund has forecast that U.S. general government debt will reach 131% of GDP this year, up from 109% in 2019.

Estimates of how much Biden's tax proposal will increase revenues over the next 10 years are generally in the range of \$3 to \$4 trillion, while the total cost of his policy proposals are estimated at \$6 to \$7 trillion over the same period.<sup>9</sup>

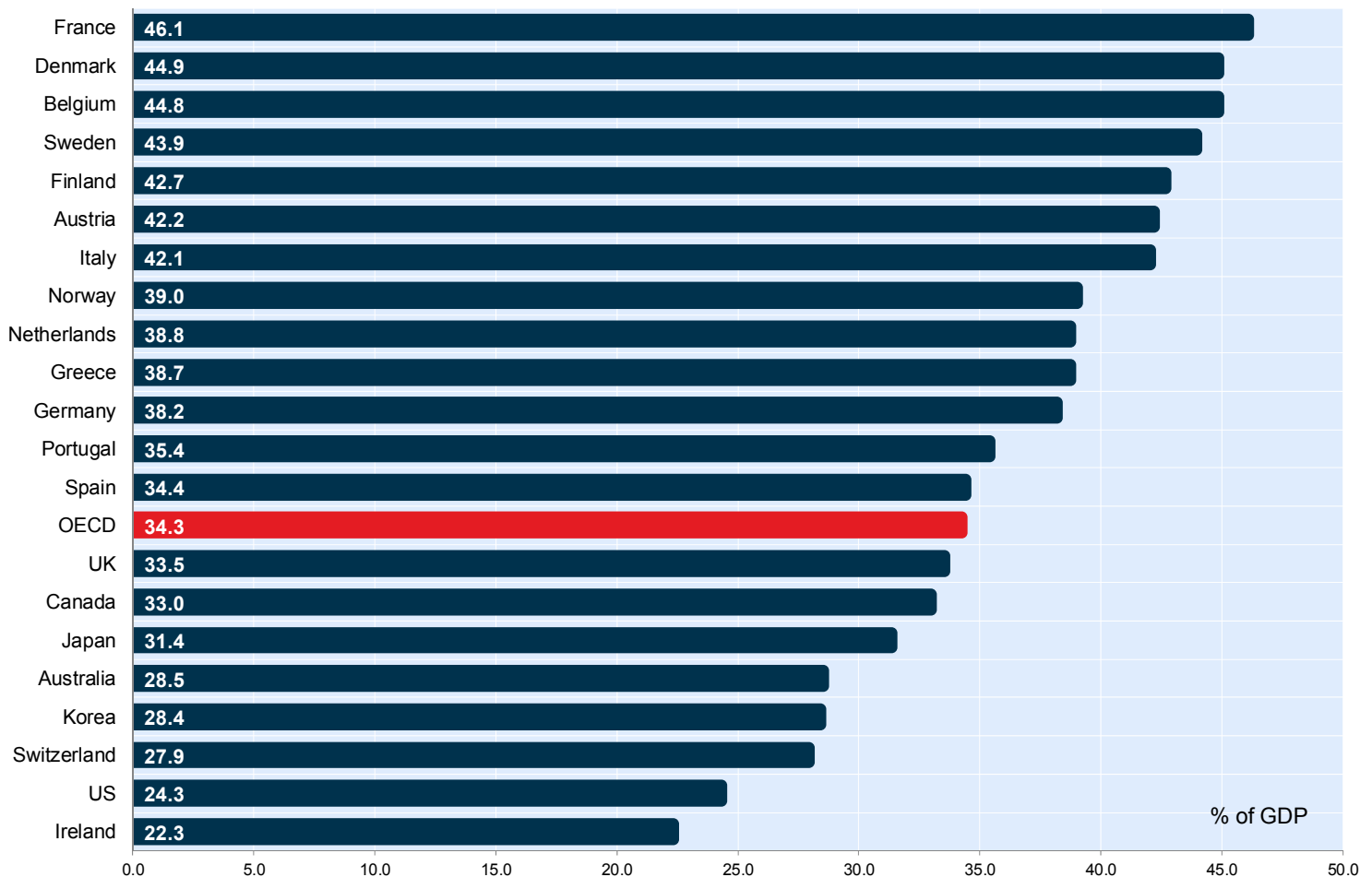
Despite the wide ideological differences between Republicans and Democrats, the parties have one thing in common. Neither side has proposed budget cuts and/or tax increases that come anywhere close to financing their agendas.

NBF Economics and Strategy projects that the increased debt could lead to a replay of what happened in the aftermath of the Second World War, when the U.S. government kept interest rates below the rate of inflation for many years in order to gradually reduce debt levels.

Finally, even in the backdrop of rising debt, the United States has one major advantage over many Western countries. Its tax revenue as a percent of GDP is relatively low, which means that it theoretically has more room to increase taxes than most other countries do.

## World: Tax revenue as a % of GDP

as at 2018 or latest available data



NBF Economics and Strategy (data via OECD)

<sup>9</sup> "Biden's tax plan may not add up," The Hill, August 3, 2020, and "Biden Offers Big Government Plan to Address Racial Inequality," Wall Street Journal, July 14, 2020

## How the stars would have to align for Trump to win an upset victory

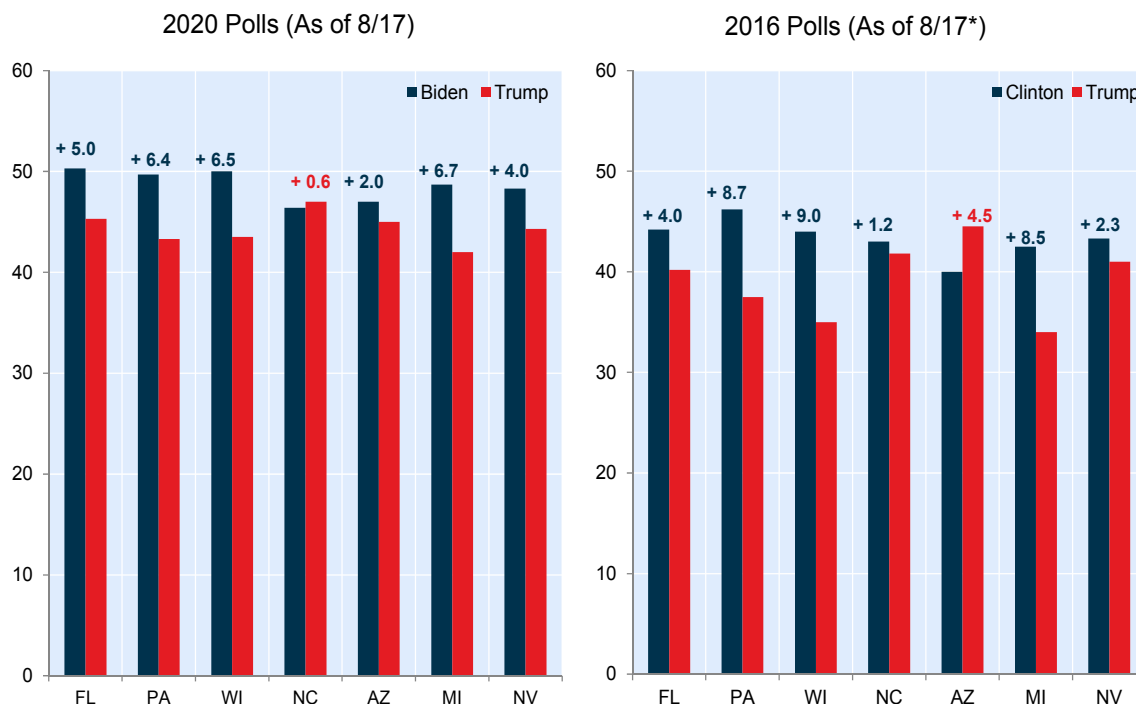
In just under three months, U.S. President Donald Trump has gone from boasting about the best economy ever to heading into the fall election in the midst of a deep recession. While incumbent presidents are usually re-elected, a recession in the two years before the election significantly reduces their odds. Indeed, the last sitting president to win re-election in the wake of a recession was Calvin Coolidge, a Republican, all the way back in 1924.

**In order for Trump to overcome these odds, most of the following scenarios need to play out:**

- Americans react to the economic downturn induced by COVID-19 in a manner more akin to an external threat and credit him for his long-held critique of globalization and far-flung supply chains. His argument that medicines are but one example of how past U.S. governments have allowed production in key sectors to relocate abroad resonates with the public.
- Democrats are perceived as tilting too far left and enough moderate voters reluctantly vote for Trump to give him a slim victory. This voting group is alarmed by calls to defund police and are worried Biden's environmental promises will raise costs and upend the economy. It is important to note that Democrats were able to win back the House in 2018 not thanks to progressives who retained safe Democratic seats but to centrists who won seats previously held by Republicans.
- Despite the recent spike in infection rates, the U.S. economy continues to reopen and gradually recovers.
- A successful vaccine or effective therapeutic is announced just before the election.
- Biden performs poorly in the debates.
- Polls underestimate the number of Trump supporters, as many are unwilling to tell pollsters what they really think.
- While multiple polls show that Biden holds a strong lead in the national polls, the polls are tighter in the battleground states. Trump loses the popular vote again, but still wins the Electoral College by narrowly carrying the vast majority of these key states. As the following charts illustrate, Trump was also polling behind Clinton in most of the battleground states, but then went on to win all the states listed below with the exception of Nevada.

### Like 2020, Trump was polling behind Clinton in most battleground states in 2016

Battlegrounds - August 2020 Polls vs. August 2016 Polls in crucial states

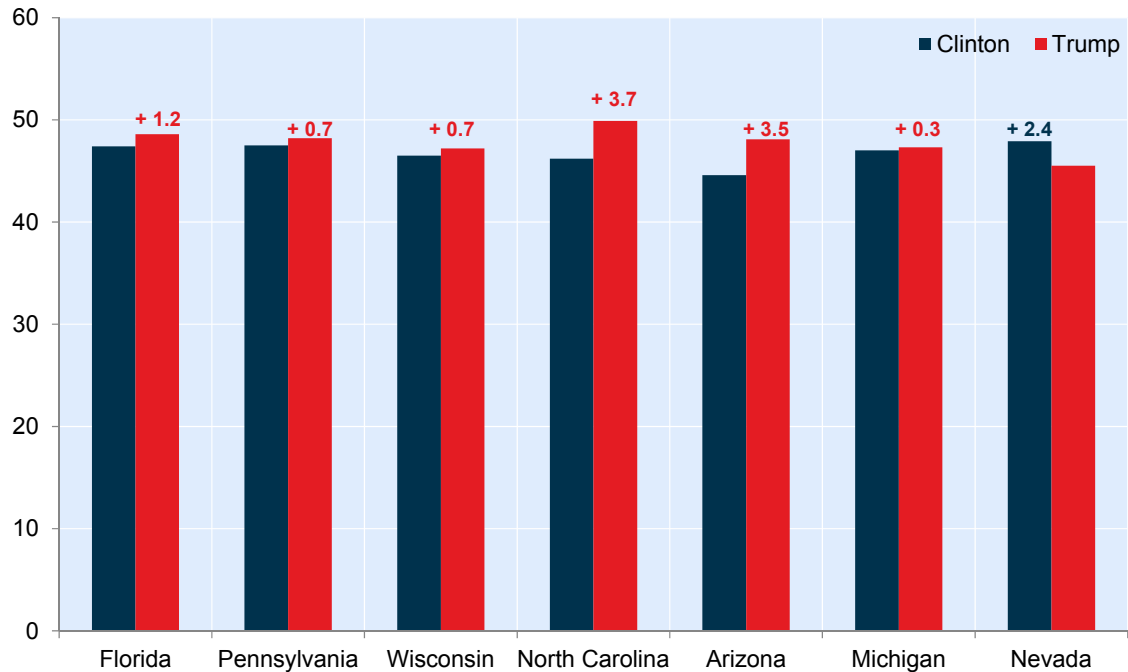


\*Arizona 2016 data as at August 23 (earliest available)

NBF Economics and Strategy (data via Real Clear Politics)

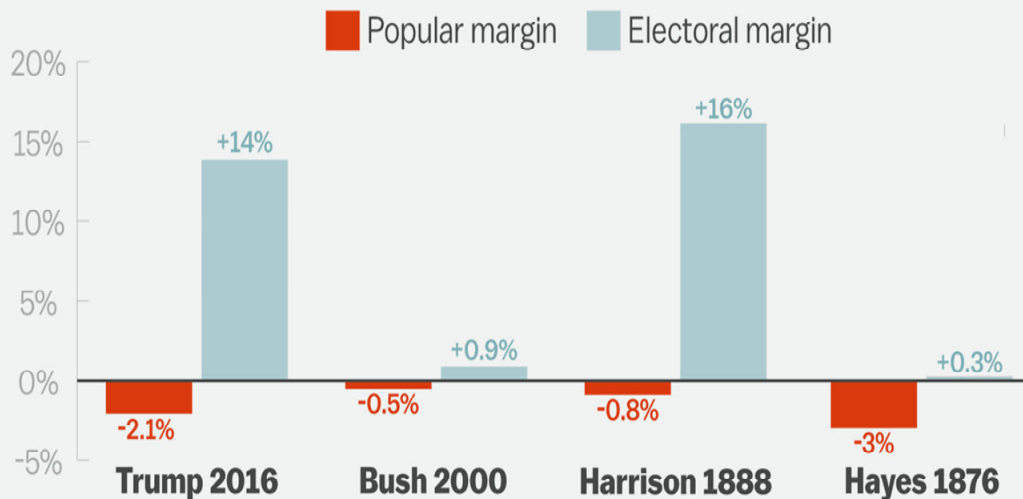
## Final Results: Trump narrowly won several battleground states in 2016

Real Clear Politics Poll



NBF Economics and Strategy (data via Real Clear Politics)

## The short list of presidents who lost the popular vote, but won the Electoral College



Data from Dave Leip's Atlas of US Presidents, New York Times projections, and the Cook Political Report



## A tight presidential election could lead to uncertainty over who won

One scenario with the potential to rattle the markets is a close presidential election where one candidate openly questions the legitimacy of the results. This could involve mail-in votes still not fully counted days or weeks past election day November 3. In 2016, 24% of ballots cast in the presidential election were mailed in. This figure will no doubt go much higher this time around as more voters will shun polling stations in order to avoid the risk of infection.

Something similar to this scenario occurred in 2000 between George W. Bush and Al Gore. The election hung in the balance for five weeks amid a battle over vote counting in Florida. The winner was declared on December 13 only once Gore conceded defeat. During the five-week wait, the S&P fell 12%, although it is important to note that the dotcom collapse also played a role in the decline.<sup>10</sup>

Given the animosity between the two parties and their supporters, a replay of 2000 would likely be even tenser. A 2019 survey by the Brookings Institution highlighted this divide. It found that 82% of Republicans thought that the Democratic Party had been taken over by socialists, whereas 80% of Democrats felt that the Republican Party had been taken over by racists.<sup>11</sup>

Officially, states must certify their electors by December 8 and they must then cast their ballots by December 14. Congress then meets to ratify the results on January 6, and the president is inaugurated on January 20.<sup>12</sup>

## Conclusion

As we look ahead to the 2020 Presidential election, the most market-moving outcome would be for the Democrats to win the presidency and both chambers of Congress. This would put them in a strong position to enact much of their legislative agenda. Their position would likely be strengthened by a vote to remove the Senate rule requiring 60 votes to pass most legislation.

While the markets could be unsettled in the short term by such a clean sweep owing to the Democrats' pledge to raise corporate/capital gains taxes and increase business regulations, we feel that the promise to continue spending would, all other things being equal, help stabilize markets.

However, barring another collapse in economic activity, we believe that the most likely scenario is that Democrats win the White House and Republicans retain control of the Senate. This would force the Democrats to advance their agenda via executive orders, which would often be challenged in the courts.

A Biden win would be particularly beneficial for alternative energy. Biden's \$2-trillion plan would be used to build solar panels, wind mills, charging stations, and more. However, even if the Democrats did not retake the Senate, Biden could still issue executive orders to set ambitious environmental targets.

The outlook is somewhat mixed for healthcare. On the one hand, U.S. companies producing healthcare equipment should do well, as the government looks to replenish its stockpiles through domestic purchases. On the other hand, likely price controls on certain drugs and perhaps on insurance premiums would squeeze profit margins for companies in these sectors.

Defence stocks could also come under pressure, given that it is likely that a Biden presidency would spend less on defence than the Trump administration.

When it comes to the impact on Canada, if Biden wins and Democrats succeed in raising corporate taxes, increasing the federal hourly minimum wage to US\$15, and passing more stringent environmental regulations, it would reduce the difference in operating costs between Canadian and U.S. companies.

Finally, while the electoral odds are stacked against Trump, his ability to bounce back from major political setbacks in the past combined with any potential missteps from Biden could make this election closer than what is currently reflected in many polls.

<sup>10</sup> "If Joe Biden wins the U.S. presidential election, will the market collapse?" The Globe and Mail, July 31, 2020

<sup>11</sup> "Fractured Nation: Widening Partisan Polarization ahead of 2020 Presidential Election," Brookings Institution, 2019

<sup>12</sup> "The November Election Is Going to Be a Mess," Atlantic Monthly, July 22, 2020





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