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The road ahead for the Biden administration

By Angelo Katsoras

Introduction

While Joe Biden has won the presidency, it was not the Democrat sweep predicted by many pundits. Republicans actually gained seats in the Democrat-controlled House of Representatives and chances are that they will retain a narrow majority in the Senate.

If the Democrats fail to gain control of the Senate, the Biden administration will face great difficulty advancing its legislative priorities on many fronts, including healthcare, the environment, energy, and taxes. This, in turn, will force the administration to move forward its policies by way of executive order, which does not require congressional approval.

The main exceptions to this gridlock will be approval of another COVID-related stimulus bill and legislation aimed against China, the United States' main geopolitical and economic rival.

This report takes a look at the following topics: why a divided U.S. government is likely; the size of the next stimulus package; what executive orders will be issued; the challenge of continuing protectionism; the direction of China-U.S. relations; and how carbon border taxes could reshape the global economic landscape. The impact of the Biden administration on Canada will be explored as well.

Why the Senate is likely to stay in Republican hands

Control of the Senate hinges on the two run-off races in Georgia scheduled for January 5, where Democrats are trying to unseat two Republicans. This run-off is being held because, under Georgia law, if no candidate garners at least 50% of the vote, the top two vote recipients then face off again to determine the winner.

If Democrats win both seats, they will gain a working majority in a 50-50 Senate, as the Vice-President would be called upon to cast the tie-breaking vote when needed. This would place the Biden administration in a much stronger position to advance certain of its legislative priorities. The Democrats, for example, could use the reconciliation process to pass fiscal-related measures by just a simple majority.

Biden's presidential win in Georgia is indicative of how the traditionally Republican-leaning state has become a more competitive electoral battleground. However, we are still projecting that Republicans will take at least one of the two seats up for grabs and thus maintain control of the Senate. The reasons for this are twofold:

1. Republicans have historically come out on top in Georgia run-offs. Of the seven statewide run-off elections held since 1988, Democrats have won only one, in 1998.¹ No Democrat has held any of Georgia's Senate seats since 2005.
2. Republican gains in Congress indicate that a significant number of people across the country who voted for Biden chose to support Republican candidates in down-ballot races to avoid one-party rule. We project the same dynamic will play out in Georgia.

A new stimulus package is looming

We feel that Republicans and Democrats will agree on a new stimulus package early in the new mandate. The driving forces will be concerns about a faltering economy and the end of the election cycle during which time both parties feared handing the other party a political victory. However, the price tag is likely to be smaller than the amounts discussed just prior to the election.

This means stimulus more on the order of \$1 to \$1.5 trillion than in the range of \$2.2 to \$2.8 trillion. Supporting this scenario is the fact that Republicans have a history of being more concerned about deficit spending when a Democrat sits in the White House.

We feel that the odds of a major rescue package being approved before the end of the lame-duck session (which refers to governing bodies soon to be replaced by newly elected officials) on January 20 are low. First, no lame-duck Congress has ever undertaken such a large and complex spending bill. Second, relations between Trump and the Democrats are at an all-time low.

¹ "Georgia's Two Runoff Races Become Focus for Senate Control," Wall Street Journal, November 8, 2020

At best, some limited measures such as extending the expanded unemployment benefits past the December 26 expiration date could be approved in the lame duck session.

Governing by way of executive order

Like its predecessors, the Biden administration will be forced by a divided government to advance its agenda via executive order. This will no doubt include trying to undo many of Trump's orders, which is what Trump did to Obama's orders four years earlier.

Energy/Environmental Policies

Priority number one will be to reverse many of Trump's executive orders in the energy sector. This includes rejoining the Paris Agreement on climate change, halting permits for new oil/gas drilling on federal lands, setting national limits on emissions for power plants and automobiles and reviving the mandate that every agency in the government incorporate climate change considerations into its policies.

Even though energy regulations must undergo a review process before they can be officially amended, the simple act of enforcing existing rules more vigorously can have a significant impact. For example, in the first 266 days of the Trump administration, the Environmental Protection Agency filed about a thousand fewer cases and handed out \$9 billion less in fines compared with the same period of the Obama administration.²

Similarly to how Trump cited national security concerns to implement tariffs via executive order, some analysts feel that Biden would have the legal authority to do the same regarding one of his major policy proposals: carbon border taxes on imports from countries with lesser environmental standards. (More on this later.)

Financial Regulations

Changes can also be made to many financial regulations without congressional approval. Indeed, senior policymakers at the Federal Reserve, the Office of the Comptroller of the Currency, the SEC and the Federal Deposit Insurance Corporation all have significant powers to amend financial regulations.

Change will also be coming to the Consumer Financial Protection Bureau (CFPB), whose mandate it is to protect consumers from unscrupulous behaviour in the financial sector. A Biden administration, which will be able to appoint a new director immediately, will push for the CFPB to be more aggressive in protecting consumers from alleged dishonest business practices. The CFPB will also pressure banks not to foreclose hastily on people who have missed debt payments because of the COVID-19 recession.

Courts will increasingly decide which executive orders pass legal muster

Just as the Democrats did during the Trump era, the Republicans will respond by challenging the legality of these orders in the federal circuit courts. While the Supreme Court may be the highest legal body in the land, it hears only a very small number of cases annually (100 to 150). The vast majority of federal lawsuits are heard one level lower in the circuit courts. When Trump first came to power, only four of the 13 circuit courts had a majority of judges appointed by Republican presidents. Today this figure has risen to seven. Investors can make a reasonable guess as to how these courts might rule on the legality of Biden's executive orders based on whether the majority of presiding judges were nominated by Republican or Democratic administrations.

Trade: Regardless of winner, protectionism is here to stay

The similarities between Trump's and Biden's "Buy American" strategies point to a continued protectionist bent. Biden's pledge to purchase \$400 billion worth of U.S.-made goods and reduce reliance on imports in key sectors such as healthcare equipment and medicines are cases in point.

Regarding the European Union, Biden will seek to lower trade tensions in return for certain policy changes. This could include reforming the World Trade Organization to better deal with non-market economies and aligning more closely with the United States against China on the trade front.

One area of agreement between the United States and EU is the use of carbon border taxes on imports from nations with lesser environmental standards. Proponents of this tax argue that it would reduce the risk of countries with tougher climate regulations seeing production migrate to regions with more lax environmental rules. In 2019, Morgan Stanley estimated that a hypothetical

² "Under Trump, E.P.A. Has Slowed Actions against Polluters, and Put Limits on Enforcement Officers," New York Times, December 10, 2017

tax of \$40 per ton of emissions would make it cheaper to buy aluminum from Britain than from China.³ The EU parliament has already proposed a carbon border tax starting in 2023 on imports of electricity and energy intensive products.⁴

Finally, it is important to note that Democrats, who have traditionally been more skeptical than Republicans of trade deals, have tilted much more to the left in recent years. A case in point is the new vice-president, Kamala Harris. She was one of the few Senate Democrats to vote against the revised NAFTA agreement because it did not contain provisions on climate change. All these factors will make it much more difficult for the United States to sign major new trade deals or to re-enter the Trans-Pacific Partnership trade agreement.

Relations with China will continue to deteriorate

Taking a tough line on China is one of the few areas where there is overwhelming bipartisan agreement. In fact, most recent legislation targeting China has passed with near-unanimous support in Congress. For most other legislation not involving China, however, gridlock remains the norm.

Like Trump, Biden views the rise of China's tech companies as both a threat to their U.S. rivals and a vehicle for espionage. This means various restrictions on China's IT sector, such as prohibiting chip manufacturers whose products contain American technology from selling to Huawei, are likely to stay in place.

Moreover, the carbon-border tax supported by both the EU and the Biden administration is widely seen as a measure targeting China in particular. China's recent pledge to be carbon neutral by 2060 is seen by some analysts as an attempt to avoid being hit by these tariffs.

Bipartisan anger towards China means that proposed legislation focused on competing with China is much more likely to pass. For example, many Democrats and Republicans support the formulation of a national investment strategy for cutting-edge technologies to help the United States compete with China. Similarly, an infrastructure bill could finally win approval if sponsors claim that it would help America stay competitive with China.

The impact of a Biden presidency on Canada

While most Canadians were rooting for a Biden victory, they should not overlook the fact that the new U.S. administration presents challenges as well as opportunities.

Protectionism will remain a challenge for Canada

- Biden's "Buy American" policy risks barring certain Canadian companies from bidding on contracts and U.S. infrastructure projects. In 2010, the Harper government succeeded in negotiating a reciprocity agreement that largely avoided the risk of Canadian firms being excluded from U.S. infrastructure projects financed under the American Recovery and Reinvestment Act.⁵ However, the odds of negotiating a similar agreement this time around are much lower on account of the more difficult economic situation and greater cross-party support for protectionism in the United States.

Biden's environmental policies present opportunities and risks for Canada

- On the environmental front, more stringent U.S. regulations would reduce the difference in operating costs between Canadian and U.S. companies. The absence of significant environmental regulations during the Trump administration forced Canada to water down some of its environmental policies over fears that many Canadian companies would be at a competitive disadvantage to their American counterparts.
- While the long-term trend towards alternative energy is clear, in the shorter term, a combination of heavy indebtedness and more stringent regulation could make it harder for the U.S. oil sector to meet any future growth in demand. This could place the Canadian oil sector in a position to gain U.S. market share when oil prices finally recover somewhat.
- While there is a risk that Biden's proposed carbon border tax might target Canada, the more likely scenario is that we will eventually adopt this tax as part of a continent-wide strategy. One longshot strategy for Canada would be to highlight its climate change legislation and potential adoption of the carbon-border tax as reasons for the United States not to cancel the Keystone pipeline project.

³ "From China to India, exporters brace for Biden carbon policy," Nikkei Asian Review, November 1, 2020

⁴ "EU carbon border measure should cover power, heavy industry," S&P Global, October 23, 2020

⁵ "Canada - U.S. Agreement on Government Procurement," Government of Canada, 2017

Canadian Tax Policy

- Assuming the Republicans maintain control of the Senate, Biden will not be able to follow through on his promise to raise corporate taxes seven percentage points to 28%. This, in turn, will prevent Canada from raising corporate taxes significantly so as not to hurt the competitiveness of Canadian companies.

Canada-China relations

- Biden has promised to form an alliance with other countries to combat some of China's business practices. If Canada were forced to join this alliance, our relations with China would go from bad to worse.
- As it did back in 2018 with the attempted takeover of the Canadian construction company Aecon Group, Canada may be forced to increasingly block other takeovers of Canadian companies by Chinese firms on national security grounds and fears that such takeovers would result in less U.S. market access for the companies in question.

Conclusion

A divided U.S. government comes with positives and negatives. On the one hand, the markets are relieved that significant tax hikes are off the table for the time being. On the other, a divided government will prevent Biden from enacting most of his ambitious legislative agenda, which means trillions less in spending than otherwise would have been the case under a unified Democrat government. Although, one could argue that the economic impact of less spending will be more than offset by the imminent arrival of effective COVID-19 vaccines.

Apart from another COVID-19 fiscal stimulus package, bills with the best chances of being approved are ones relating to China. In fact, this could be the key to finally passing legislation involving increased funding for infrastructure, alternative energy, and cutting-edge technology.

A divided government means investors should spend more time focusing on who heads key regulatory agencies and less time on bills, which often have no chance of becoming law. Unlike the case with legislation, the heads of regulatory agencies can implement changes without congressional approval.

On the environmental front, the implementation of a carbon-border tax would be a double-edged sword. While it levels the economic playing field for companies based in countries with stricter climate regulations, developing countries will argue that they are being unfairly penalized, especially since their per capita greenhouse gas emissions are much lower than those of their western counterparts. The likelihood of counter tariffs would be high.

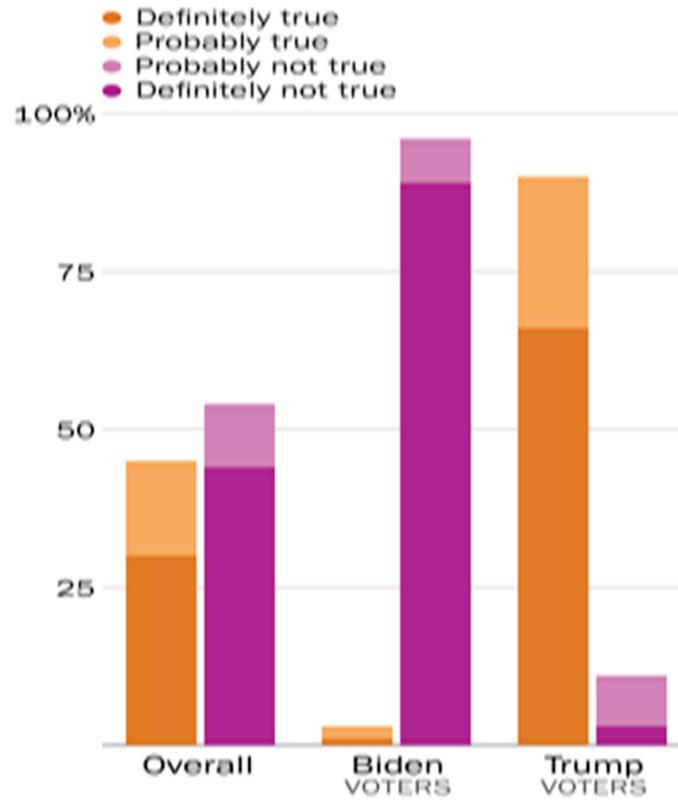
The Kamala Harris factor

While Harris fully supports Biden's agenda, it is important to bear in mind that her past positions differed from Biden's current positions. For example, she was in favour of a total ban on fracking and much more stringent environmental legislation. Should Biden not be able to fully serve out his term for health reasons, her past policy positions would become much more important for investors to consider.

Finally, the tense partisan climate is not going away anytime soon

The following poll, which shows that 86% of Trump supporters believe Biden's victory to be marred by fraud, provides an indication of the mood among the electorate. These tensions would be exacerbated if the Biden administration chose to prosecute Trump and his associates for alleged corruption.

Mail ballots are being manipulated to favor Biden



Source: Economist-YouGov, November 2020

Source: "More than 8 in 10 Trump voters think Biden's win is not legitimate," Washington Post, November 10, 2020



Economics and Strategy

Montreal Office

514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Paul-André Pinsonnault

Senior Economist
paulandre.pinsonnault@nbc.ca

Marc Pinsonneault

Senior Economist
marc.pinsonneault@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme

Intern Economist
alexandra.ducharme@nbc.ca

Toronto Office

416-869-8598

Warren Lovely

Chief Rate Strategist, Economics and Strategy
warren.lovely@nbc.ca

Taylor Schleich

Associate, Rates Strategist, Economics and Strategy
taylor.schleich@nbc.ca

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