

Why U.S. fiscal policy will matter even more after the election



In the Loop
August 2024

Key Insights

- The expiration of the 2017 Tax Cuts and Jobs Act at the end of 2025 means that the next president will face a significant fiscal cliff.
- The election will shape how this fiscal cliff is addressed. Control of the House and Senate are key considerations, as are dynamics within each party.
- Investors need to understand the range of potential outcomes, not to mention how messy the process could be.



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The winner of the U.S. presidential election—whether it's Democrat Kamala Harris or Republican Donald Trump—will contend with a significant fiscal cliff.

Key provisions of the 2017 Tax Cuts and Jobs Act (TCJA), passed during the first year of Trump's presidency, are slated to expire at the end of 2025.

Who is in the White House and the makeup of Congress will shape any tax deal in important ways, so understanding each candidate's priorities is important.

However, investors also need to understand the uncertainty and the range of potential

outcomes in these scenarios, not to mention how messy the process could be.

What's at stake and why the election matters

Extending the TCJA's lower marginal tax rates for individuals and the expiring tax breaks for businesses could add more than USD 3.5 trillion to the federal government's primary deficit over the next decade.¹

Inaction, on the other hand, could result in one of the largest nominal tax hikes in U.S. history, potentially weighing on consumer and business spending.

More than USD 3.5 trillion

How much extending the TCJA's tax cuts could add to the U.S. government's primary deficit over the next decade.¹

¹ Source: Congressional Budget Office, "Budgetary Outcomes Under Alternative Assumptions about Spending and Revenues," May 2024. The Congressional Budget Office (CBO) is tasked with providing nonpartisan analysis for the U.S. Congress. The estimate is relative to the CBO's baseline budget projections and the economic forecast that underpins them.

Although the president's agenda will shape the debate and legislative outcome, the balance of power in the Senate and House of Representatives will influence the details of any tax deal significantly.

- When the president's party controls both chambers of Congress, the potential to push through major legislation usually increases.
- Divided government, on the other hand, typically narrows the scope for change because it requires lawmakers from both parties to compromise.

Keep in mind, however, that whatever either candidate says on the campaign trail can differ greatly from what they might be able to achieve legislatively, even if the next president's party also secures majorities in both congressional houses.

As we've seen with both Democrats and Republicans in recent years, intraparty agreements on complex issues also aren't a given. This lack of internal party cohesion would matter even more if partisan majorities in the House and Senate are slim.

Potential tax priorities in a Republican sweep

Trump has indicated that he would seek to make the expiring tax breaks for individuals and businesses permanent, shoring up a signature piece of legislation from his first presidential administration.

The presumptive Republican presidential nominee has also highlighted his support for additional corporate tax cuts, possibly to as low as 15%.

Pushing this measure through could prove challenging. Even with a Trump win and a Republican-controlled Congress, the second-term president may face pressure to come up with ways to help pay for continuing the tax breaks from 2017.

“...whatever either candidate says on the campaign trail can differ greatly from what they might be able to achieve legislatively....”

A push for increased tariff revenue and efforts to curb spending on tax credits for electric vehicles and other clean energy subsidies could provide some narrative coverage.

Still, the extent to which Congress would embrace further tax cuts or push for more offsetting revenue increases or spending cuts is a source of uncertainty that could create knock-on policy risks.

Potential tax priorities in a Democratic sweep

Harris presumably would pursue similar policy priorities to those laid out by President Biden.

Preserving some of the TCJA's tax cuts enacted by the first Trump administration would likely be on the agenda.

Pushing to expand the child tax credit could also be on Harris's wish list. That would help to boost the economy by putting more money in the pockets of individuals with a propensity to spend.

On the other side of the ledger, targeted tax increases could generate meaningful revenue.

Individuals in the highest tax bracket could see their income tax rate go up.

A Harris administration could also push to raise the corporate tax rate from the 21% enacted by the TCJA.

Raising corporate taxes would require congressional action. That would only be on the table for Harris if Democrats also controlled both chambers of Congress.

Divided government brings the noise

A scenario where the party winning the White House does not secure majorities in the House and the Senate would require compromise between Republican and Democratic lawmakers, with the president using their office to shape the tax debate.

The process would also be incredibly noisy, with brinkmanship around extending the debt ceiling becoming more likely.

But the political environment and the complexity of negotiations could prompt Congress to take the easiest route and extend most of the TCJA's expiring provisions for a shorter period.

At the same time, investors shouldn't overlook the possibility that the financial markets will take a negative view on the government's dysfunction in dealing with this fiscal cliff if the process were to go down to the wire.

What I'm watching next

I'll also be paying close attention to how intraparty dynamics and factors outside the realm of politics, such as the bond market, could shape the conversation surrounding fiscal policy.

The range of outcomes is wide. However, neither presidential candidate has espoused a shift away from deficit spending.

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