Goldman Sachs Exchanges

What will the US presidential election mean for the economy?

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Allison Nathan: What will the US presidential election mean for the economy? I'm Allison Nathan and this is Goldman Sachs Exchanges.

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Each month I speak with investors, policymakers, and academics about the most pressing, market-moving issues for our Top of Mind report from Goldman Sachs Research. This month I spoke with top economists from each party to find out how the upcoming election could impact economic policy.

Jared Bernstein is the current chairman of the Council of Economic Advisers under President Biden. And Kevin Hassett served as the chairman of the Council of Economic Advisers under President Trump. I spoke to each about a range of economic policies that are on the table that could shape the years ahead. As you might guess, a lot of their views differed pretty starkly. But there were also some interesting points of common ground.

I started off by asking how they'd characterize the economic landscape that the next US president will inherit. Here's what current CEA chair Jared Bernstein said.

Jared Bernstein: Well, if you think about the macro economy, I'd say they're likely to inherit a solid expansion where inflation has come down from its peak close to target without sacrificing much at all on the economy's growth side. Unemployment's come up a bit. But it remains low. The pace of job gains just over the past three months, 186,000, that's at the north end of the break-even level that most labor economists subscribe to. And very importantly, from the perspective of Biden/Harris administration, we have rising real wages and incomes. And we've had those ongoing for a while now.

However, we have unfinished business when it comes to the housing market, the childcare market. Clearly, extreme weather events are a fundamental issue that we're dealing with and that the next administration will have to deal with. Trade and geopolitical challenges are ongoing as well.

So, solid macro economic background with a set of risks that are well-known.

Allison Nathan: I asked the same question of former CEA chair, Kevin Hassett.

Kevin Hassett: Going into the middle of the summer, there were clear signals in the labor market that we were entering a recession, say around August. And that's why when the Fed cut interest rates 50 basis points, it made sense to me because the Sahm Rule and other things were kicking off that we were at a recession.

But then everything just turned on a dime. And in fact, if you look at the improvement in unemployment since then, since the peak, it's been like one of the sharper improvements in unemployment that we've seen in the history of job market data. So, it's a kind of strange time. It looks like the latest inflation report was pretty troubling for a Federal Reserve that just cut rates. And the weakness that we saw last summer seems to have evaporated.

And so, I think that there's an open question whether the next administration inherits an economy that's got momentum or the economy that the Sahm Rule was signaling was headed into recession this summer. And so, I say it's kind of a befuddling economy right now.

Allison Nathan: I think asked each to share their views on a range of economic policy proposals. We started with the big one. Tariffs. I first turned to Kevin for his thoughts.

Kevin Hassett: I think that the expansion of tariffs on China is a very important policy because basically the amount of theft of US intellectual property and spying that's going on in the US is really disturbing. And it's way outside of the bounds of the things that any other country on Earth does.

Allison Nathan: Is it mostly about that theft? Or are there other unfair trade practices?

Kevin Hassett: I think that it's IP theft and it's production of stuff that's geopolitically, strategically important. As an example, going back to the steel tariffs during the Trump administration, it's a widely accepted fact the allies won World War II because of US productive capacity. And when you ask yourself what was it we were producing that helped us win World War II, then it was mostly steel. Everything had steel in it, right? The tanks. The airplanes.

And the Chinese have invested in a massive over capacity of steel, which really puts them visibly on a war footing. And they're dumping that steel everywhere trying to close down steel industries everywhere else. If we were to allow our steel industry to just disappear while the Chinese have enough steel capacity to launch a war, then I think we'll have made a serious defense policy error.

Allison Nathan: What about universe tariffs on all US imports, is that a policy that should be pursued?

Kevin Hassett: The RNC in the platform, they have a reciprocal tariff act, like the first tariff policy. And in the reciprocal tariff act, then basically what we would do is US is ignite a game theoretic contest. Pretty much every country has a higher tariff on us than we have on them. The average tariff that countries charge us when we export into the country is, like, around 6.5, say. And for us it's about 3. And so, if we had a reciprocal trade act, then either we would go to six or they would go to three. And it's interesting to think about which it would be.

But there are some countries like the Bound Tariff for India which is the maximum they can charge if they want, is 50 percent. And so, I think that there's a lot of room for trade policy to improve if we pass a reciprocal trade act.

The issue about whether we should have a universal tariff, there's a question of how it would coexist with the reciprocal act. And so, I'm a big supporter of the reciprocal act. Maybe the universal tariff becomes a minimum and that's something to be worked out.

But recall that the tariff policy has to be passed by Congress. If you have a specific security concern or anti-dumping concern, which are the things that happened in the first Trump administration that the Biden administration kept, then the president does have some authority to put a tariff on a country if they've been dumping or if they're, like, a threat to national security.

But to do something sweeping like the reciprocal act would require legislation.

Allison Nathan: I then asked Jared for his thoughts on tariffs.

Jared Bernstein: I think there's a way to think about tariffs that invokes China, but it goes further than that. Targeted tariffs can help protect against unfair trade. And China continues to engage in unfair trade, especially through over capacity and seeking market share in areas where we're making some pretty deep investments. Those are targeted tariffs.

I think the key word there is targeted. So, targeted tariffs can be a tool to protect against unfair trade. China is an example where that remains important.

But sweeping tariffs, they go beyond helping targeted sectors to broadly and pretty severely hitting consumers and producers. We've talked a lot about how they hurt consumers because they work like a national sales tax. It's very important to remember tariffs on intermediate goods hurt our domestic producers.

The way I put it is we're happy to import this inflation. We won't import deindustrialization. We still appreciate the benefits of robust trade flows. But we're going to stand up to trading partners who engage in unfair practices that have potential to hollow out key American sectors. We've seen it happen before. We don't want to stand by while it happens again.

So, while targeted tariffs can be a useful tool, sweeping tariffs can be really quite destructive.

Allison Nathan: We then moved onto perhaps the clearest point of differentiation, corporate tax rates. Here's Jared's view.

Jared Bernstein: In our budget, we've proposed an increase in corporate tax rate to 28 percent. I think there's some research suggesting some positive investment and growth effects from lower rates. But they tend to be economically very small. If you weigh them against the lost revenue, I can't tell you how many times I've sat with folks from the business community who say, "We need to get on a more sustainable fiscal path. And you need to cut our taxes." And those two don't necessarily go together.

Now, if you want to talk about a tax system that has a much broader base and lower rates, that's certainly a conversation Washington tries to engage in. It often doesn't get very far because everybody's got their exemption they want.

In the world we live in, we need to find a corporate rate that certainly facilitates robust investment and profitability. And yet, brings in new revenue. We've certainly seen our corporations be highly successful at rates above 28 percent. So, we think going to 28 would be a useful change.

Allison Nathan: Now here's Kevin.

Kevin Hassett: Increasing the rate to 28 percent, which would be a 7 percent increase, the largest increase in the developed world in the last 50 years. And a really damaging one if you model it.

So, if you consider that when we had a 35 percent rate we went to 21 and the Joint Tax Committee's score for the whole thing was about 300 billion over ten years. So, it was almost revenue neutral because of all the international stuff that we did and also the interest deduction. You know, there were a lot of things that were base providers.

And by the way, revenue to GDP, corporate revenue to GDP is higher now than it was before the tax cuts by quite a bit. And so, the Laffer curve effect that Alex Brill and I wrote a paper 20 years ago showing that the US was on the wrong side of the Laffer curve of corporate tax base. And that got proven, exposed by the data.

And so, since it was almost revenue neutral to go from 35 to 21, 28 percent is going way to the other side of where we were when we were at 35. Because when we were at 35, we had a much smaller base.

Allison Nathan: I also asked about another hot button issue, taxing unrealized capital gains. Here's Jared again.

Jared Bernstein: We propose a prepayment tax against future realizations. One thing to recognize is that this only hits taxpayers above 100 million. So, that's-- the air is awful thin up there. So, it's just a few thousand folks. It definitely kicks up the fairness in the code because once you get up there and especially if you incorporate wealth, people paying effective tax rates, it can be in the single digits.

And I want to make another point about this that is probably underappreciated. While there are definitely folks who argue, and I understand the argument, that unrealized income is not income. Every day folks are using those assets as collateral for income-generating investments. And in that sense you have these assets working to grow income in a way that's currently not taxed.

We understand that this is something that is controversial in many market settings. But we think we can make a good case for it.

Allison Nathan: And here's Kevin's view.

Kevin Hassett: I think the taxing on accrual is just a wealth tax, is the way to think about it. And wealth taxes are really inefficient in our economic models. If you tax wealth, say at 3 percent, if like the risk-free interest rate is 3 percent, then that's like 100 percent tax on capital income.

And so, if you introduce 100 percent tax on capital income, then let me tell you, then your model's going to blow up. You're not going to have growth.

So, the thing about wealth taxes and taxing things on accrual is that it seems like a small tax because you say, "Hey, I'm charging 3 percent of wealth. That's only a 3 percent tax." But to think about what the actual flow effect of a tax on a stock is you have to translate it into a tax on capital income. And when you do that with wealth tax proposals, you end up with implicit taxes on capital income that can be close to 100 percent. And those are really dangerous ideas in terms of the potential harm to the economy.

Allison Nathan: There's also been discussion of expanding child and earned income tax credits. I asked Jared if that was a good idea for the economy.

Jared Bernstein: I don't think it's a good idea. I think it's a great idea. Both candidates were talking about some version of this. And of course, during the American Rescue Plan, we very significantly increased the CTC, but also the EITC as well. And we know that these measures helped to reduce child poverty by half. Cut child poverty from something like 12 or 13 percent to around 6 percent. And that kind of an intervention has been shown to pay for itself many times over because kids who get a better economic start like that will have a much higher chance of reaching their potential and end up contributing to the economy in ways they wouldn't otherwise. Those are great programs that have huge bang for bucks.

Allison Nathan: I asked Kevin the same question.

Kevin Hassett: Right now, families with children certainly are the ones that have been hit hardest by inflation. And I think that one of the problems, right, with an inflationary environment is that there's stuff that you can shift away from and stuff that you can't. And you find the elasticity of consumption for families with children tends to be much lower than for you or for me, right? We can go to the grocery store and look at the things that went up and price and then switch to other things. But again, families raising kids, they're going to want their milk and their bananas and so on.

And so, I think the child credit is a very sound policy in terms of equalizing opportunity, getting money into the hands of people who are raising kids.

I don't have a model that tells you what the optimal size of the child credit should be. That's more a political question.

Allison Nathan: But what about the effects of all of these policies on the government's finances? I asked Jared how important it is to reduce the deficit.

Jared Bernstein: Very important. Two things are clear. One is we don't face an imminent threat. I pay attention to this at a very granular level, watching bid-cover ratios in our auctions of US treasuries. And there is still very robust demand for US debt. Highly liquid. Highly efficient market. And we are able to fund and service our debt without breaking much of a sweat. That's fact one.

Fact two is we have to get on a more sustainable fiscal path. Both of those are true. And the problem is that as long as fact one is true, lawmakers have a very high discount rate for the future when it comes to fact two. It's sort of like that scene in *Jaws* that says you're not going to believe there's a shark out there until it bites you. I hope we don't have to wait for a forcing event. But unfortunately, that's often the way these things play out.

Allison Nathan: And here's Kevin's view on reducing the deficit.

Kevin Hassett: It will be a priority for whichever administration comes in by necessity because the debt to GDP is so high, the deficit to GDP is so high, the debt limit is hit probably around next March. But they can always spill around and get into June. So, there's going to be a big budget showdown next year.

But if you look at revenue to GDP and spending to GDP, revenue to GDP, the Trump administration was above historic norms, even with the tax cuts. It's the spending that went up because COVID and then stayed up because it created room for the next administration to continue spending. It's really when you look at the problem, it's not revenue to GDP, at least compared to historic norms. It's spending to GDP, which is more percent of GDP higher than it normally has been.

Allison Nathan: So, we could be set for a showdown with both sides potentially agreeing that the deficit should come down but disagreeing on whether more taxes or reduced spending is the way to get there. And of course, the election will play a major role in determining who wins that fight.

Let's leave it there for now. Thank you for listening to this episode of Goldman Sachs Exchanges. I'm Allison Nathan.

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