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Economic Research

Economic Briefing

Trump or Harris – not much room for maneuver

Following Joe Biden's withdrawal, Vice President Harris has rapidly secured the Democratic candidacy. Her economic policy program is likely to be largely a continuation of Joe Biden's agenda, even if she will set some different priorities. However, the next administration's room for maneuver is set to be limited due to the difficult budget situation.

First outlines of Harris's economic program...

Vice President Harris has quickly secured the support of her party and the necessary delegate votes for a nomination as the Democratic presidential candidate, she is thus likely to be officially appointed as such. It is not yet possible to say whether this will change Donald Trump's current role as favorite. It will be several weeks before polls allow us to make viable statements.

Harris's economic program will probably be largely based on that of the Biden administration. In addition, various statements made by Kamala Harris in recent years, especially those made in the course of her failed bid to become the Democratic presidential candidate in 2020, suggest that she has her own ideas. The key points will probably be:

- **An extension of tax relief for all incomes under 400 thousand dollars per year:** President Biden has already brought this into play. According to estimates by the Committee for a Responsible Federal Budget (CRFB), this would cost between 1.6 and 2.5 trillion dollars over the next ten years, depending on the specific structure. The tax cuts for high incomes, on the other hand, are set to expire at the end of 2025 as planned.
- **An increase in corporate tax:** During her candidacy in 2020, Harris brought an increase from 21% to 35% into play; this would return corporation tax to the level it was at before Trump's tax cut (unlike the cut in income tax, the cut in corporation tax has no expiration date). However, such a large increase seems unrealistic. Harris is more likely to take his cue from Biden's proposals, who has floated an increase to 28%.
- **Affordable housing:** This was a core demand of Harris in 2020. As in many other countries, housing is in short supply in many regions in the US, which is seen as a major stumbling block for the economy. Harris proposed housing subsidies for those on lower incomes. She also proposed subsidies of 100 billion dollars to help

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disadvantaged people with mortgage loans. The Biden administration had recently brought into play a cap of 5% on rent increases for housing companies.

- **Ecological conversion of the economy:** The ecological conversion of the economy should be further promoted and the extraction of oil and gas through fracking should be further restricted. The latter would be a change from the practice of the Biden administration. After all, the extraction of fossil fuels has increased significantly in recent years. However, drastic restrictions are likely to fail due to resistance from some Democratically governed states that produce oil.
- **Restrictions on foreign trade:** The increased tariffs on imports from China are likely to remain in place. In addition, the export of high technology to China will probably be further restricted. Harris has not appeared as a free trader anyway; she was one of 10 senators to vote against the update to the North American Free Trade Agreement (NAFTA) negotiated under Trump. She was also against other free trade agreements such as the Trans-Pacific Partnership (TPP). In any case, further free trade agreements will not make headway in the US; the political wind has changed here.

... but there is not much room for expensive plans

Regardless of which candidate wins the election in November, the budget situation is likely to significantly limit the next administration's room for maneuver. This will cause considerable political adjustment pain in Washington. After all, no one there has been interested in reining in the exorbitant deficits in recent years. Against the backdrop of various emergencies, first and foremost the coronavirus crisis, and the long period of low interest rates, this was politically understandable.

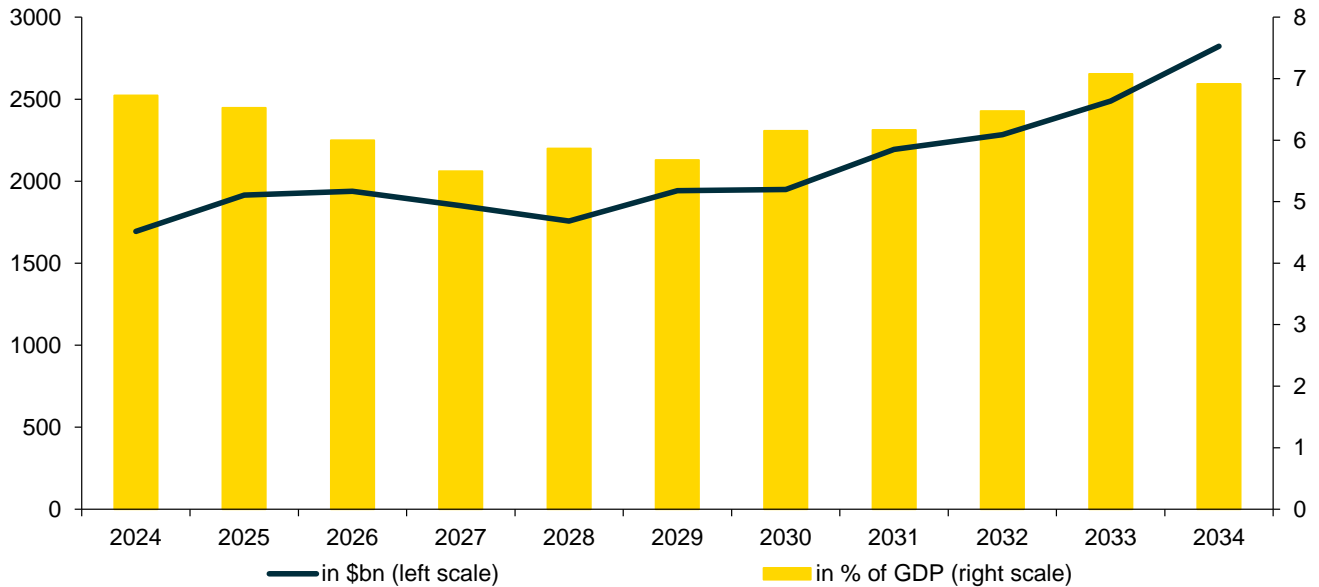
Now, however, the situation has deteriorated significantly. The Congressional Budget Office's (CBO) baseline projection for the deficit over the next ten years shows just how little leeway there is. This even assumes quite favorable conditions. This is because the CBO calculates its projections on the basis of the current legislative situation, which provides for a complete expiry of the income tax cuts from the end of 2025. This would reduce the budget deficit by around 1% of GDP per year. However, these cuts are likely to be extended either in full (at least according to Trump's promise) or in part (the Democratic plan).

The CBO assumes that the deficit of presumably 6.7% in the current fiscal year 2024 will fall slightly in the years from 2026 (the effect of the income tax increase), but then increase again and finally reach 7% (Chart 1). In other words: hardly any relief is to be expected. New programs would further increase the already very high deficit and undermine the long-term sustainability of public finances even more.



Chart 1 - Little room for maneuver in the budget

Federal budget deficits, CBO baseline projection, fiscal years



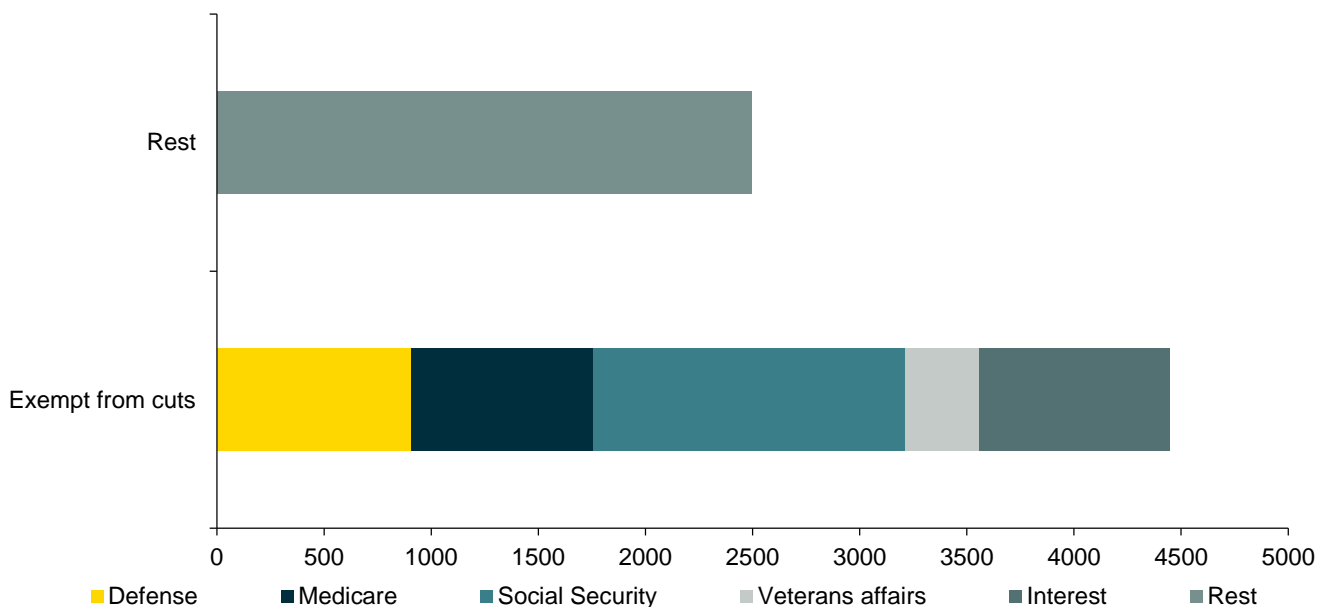
Source: CBO, Commerzbank Research

... major budget cuts are all but impossible

However, there is currently no sign of any countermeasures to open up room for maneuver again. This is because a bipartisan agreement has been reached with rare unanimity not to cut spending on Social Security, Medicare (health insurance for older Americans), veterans and defense. Interest expenditure cannot be reduced anyway. If this remains the case, over two thirds of the budget will be safe from cuts (Chart 2).

Chart 2 - US federal budget: Where to cut?

2024 federal budget, data in billion dollars. Two thirds of the budget are safe from cuts according to bipartisan promises



Source: White House, Commerzbank Research



For the remaining third of spending, the Democrats are likely to oppose any cuts to healthcare services. This budget item includes the subsidies for Medicaid, the health insurance for poor Americans, as well as the co-payments for Obamacare. This means that a further 800 billion dollars are exempt from major cuts. And items such as agricultural subsidies or technology funding will probably only be cut marginally. In other words: budget restructuring is unlikely to succeed with a red pencil.

... scope for tax hikes seems limited

If spending cannot be cut, the obvious solution would be to raise taxes. The problem is that there are hardly any majorities for this: Major tax increases under a Trump administration are unlikely anyway. And a Harris administration could not count on a single Republican vote in Congress for tax increases. The Democrats would therefore have to win majorities in both houses of Congress in the November elections. This does not look likely. This is because there are significantly more Democratic than Republican senators up for re-election, and the Democrats would have to defend all of these seats given their current narrow majority. According to polls, this is unlikely. In the House of Representatives, the Republicans are currently slightly favored. Incidentally, narrow majorities would hardly be enough for controversial projects such as extensive tax increases, as dissenters from within their own ranks are to be expected – this has already thwarted some of President Biden's plans.

... and the problem will not solve itself

The hope remains that the economy will boom. After all, such a boom had already helped with budget consolidation in the second half of the 1990s. Between 1994 and 2001, the economy grew by 4% p.a. in real terms. However, such growth rates are not realistic in the foreseeable future. The CBO is forecasting average growth of 1.9% per year for 2024 to 2034. Artificial intelligence may turn out to be a growth driver. After all, enthusiasm in this area is already leading to considerable investment in data centers and research and development. However, possible positive effects from this direction could be outweighed by negative influences, such as the increasingly pervasive protectionism. It is therefore unlikely that the US will grow out of the budget problems.

Governing will get more difficult

The last governments (Trump and Biden) implemented their priorities with a series of extremely expensive measures and cushioned economic difficulties with large amounts of money. Both parties have rediscovered industrial policy and have also spent a lot of money on it. The Biden administration's flagship project – the "Inflation Reduction Act" (essentially a program to subsidize more environmentally friendly technology) – and the programs to expand infrastructure and semiconductor manufacturing will require high spending for years to come.

A significant increase in the defense budget is expected in the coming years due to global political tensions (despite the noticeable increase in recent years, this is currently only 3.2% of GDP, a very low figure in a long-term comparison).

Due to these developments and the fact explained above that major spending cuts and/or extensive tax increases hardly seem politically possible, deficits are likely to be even higher than expected by the CBO. The US will continue to try to muddle through for the time being. But the situation is now more difficult than in 2019 (when the deficit stood at 4.6% and the debt level at 80%, already very high figures for a fully employed economy). The risk of further rating downgrades for the US is increasing. Many of the proposed projects could therefore fail due to the budget situation. In order to demonstrate its ability to act, a Harris administration could then concentrate more on "cheaper"



regulatory measures. Harris had already campaigned for consumer protection measures during her time in California.



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