

Policy Outlook Under Democratic Control

Jake Siewert: This is Exchanges at Goldman Sachs where we discuss developments currently shaping markets, industries, and the global economy. I'm Jake Siewert, global head of corporate communications here at the firm. Today is the day before the inauguration of President-elect Joe Biden, and we're going to be talking about the policy outlook under a Biden administration with Democrats controlling both the House and the Senate, albeit by very narrow margins. And to discuss that and more, we're joined by Alec Phillips, chief political economist for Goldman Sachs Research. Alec, welcome back to the program.

Alec Phillips: Thanks.

Jake Siewert: Before we dive into the policy outlook, talk a little bit about the sentiment in Washington where you are right now as we record this on January 19th, the day before the inauguration.

Alec Phillips: Well, I mean, I think the first thing obviously is that people are still in, you know, a state of shock or disbelief over what happened a couple of weeks ago. And the dust is still obviously settling on that. And there are a lot of questions about, you know, how the impeachment trial in the Senate will kind of interact with everything else that's going on.

But putting that aside, I think there's a lot of anticipation about the incoming administration and what that means for mainly for policy but I think also just thinking about the last few days just also in terms of how things are going to look over the next four years. I mean, if you look at, you know, what we saw last week from President-elect Biden in the rollout of the COVID relief package, it was amazing to see, you know, how normal it was in the sense that we had a press preview several hours before the speech, a detailed I think 15-page fact sheet that went out embargoed. Then articles all hit like a couple of hours before the speech previewing it. Then he gave the speech. Then you had follow ups from members of congress. You had another announcement the next day. It was all kind of planned. So, you know, it is a reminder of how things used to work. And even, you know, maybe even in the beginning of the Trump administration you had elements of that, but obviously there hasn't been as much of that over the last few years. So I think there is also a sense of just kind of returning to, you know, regular order.

Jake Siewert: I remember putting together a couple of those fact sheets and rollouts over the years, so it's nice to see that they're not totally out of style.

So as you mentioned, president-elect put out a \$1.9 trillion economic rescue package aimed at the pandemic and the economic impact of it. With Democrats gaining control of the Senate after the Georgia runoff elections, what's the outlook for that in terms of both the size and likely timing?

Alec Phillips: Well, it is a little bit up in the air because there are essentially two ways that they could do this. One is they could try to get bipartisan support. And there, you know, definitely have been some Republicans who are interested in aspects of what Biden put out last week. The other is they could also try to do it with just essentially Democratic votes through what they call the reconciliation process. And, you know, the difference is that if you assume that they use only Democratic votes then they probably get a bigger package. It's probably, you know, oriented in slightly different ways towards different things. But, you know, they have the disadvantage of some limitations on what they can include potentially. And then, you know, the other disadvantage is there's a lot of kind of procedural stuff that goes into that that could make it take longer.

Bipartisan support obviously has, you know, a political appeal. And one would imagine that President Biden, or President-elect Biden, soon-to-be President Biden, will, if he can, figure out how to get Republican support for it. But I think the odds of getting 1.9 trillion in a COVID relief package are probably pretty low. Our expectation is maybe 1.1 trillion, something like that. I mean, that's obviously sort of an arbitrary number. It certainly could turn out to be higher or lower than that. I would imagine that if they initially try to get Republican support, some Republican support for it, you end up, you know, discussing maybe a somewhat smaller package. If that doesn't work then maybe they go the reconciliation route, somewhat larger package in the end.

You know, I can imagine anything from, like, several hundred billion dollars as an initial package all the way up to, you know, who knows, one and a half trillion. And I think it just depends a lot on, you know, what's happening at that point with COVID spread and things like that. And then ultimately how much Republican support there is.

You know, I think probably under any scenario we get something done I think by March. If they go the bipartisan route and it looks like maybe they can get 60 votes in the Senate for that then maybe that's a little bit quicker. If they have to use the reconciliation process and, you know, pass it with just Democratic votes that's going to take a little bit longer because of course you've got, you know, 50 Democratic senators. You're going to need 50 Democratic senators to all vote for the same thing. And lining that up is probably not that much easier than lining up 60 senators.

Jake Siewert: It's also not always easy to get taxes through in a closely divided congress. The president-elect has proposed raising the corporate tax from 21% to 28% and also raising taxes on individuals making more than \$400,000 a year. Given the closeness of the margins for Democrats in the Senate and the House, what do you think the outlook for tax policy is?

Alec Phillips: Well, I think on the individual side, the odds of taxes going up on someone in some way, you know, are very high. And then the question is where does that money go? So as an example, you know, I think rates on top income -- so whether it's 400,000 or another cut off -- are pretty likely to rise. But then that revenue probably gets turned around and put into other things like, for instance, restoring the deduction for state and local taxes, which was limited in 2017.

My guess is that you probably see some other changes that then get turned around. So tax increases that get turned around and put into maybe, you know, maybe low- and middle-income tax cuts. So overall, I think the odds of total individual taxes rising are low. The question is just, you know, how are they rearranged?

On the corporate side, it does seem more likely that we see a net tax increase, but there, I mean, like you said, you've got a very closely divided Senate. And for that matter I should say a very closely divided House, too. And so I don't think they're going to be able to get all that close to 28%. Best guess is, like, maybe 24% or 25% or something like that. You know, maybe some other corporate changes around the edges. And that they use that to, you know, basically pay for whatever it is that they decide to spend on, whether that's infrastructure or health care or something else.

And, you know, I think the big question that we don't know --

and this will probably determine, you know, how much gets spent but also how much taxes rise -- is how much they're willing to add to the deficit, not for the near-term COVID relief stuff but for the bigger projects later in the year because, you know, ultimately if they don't want to increase taxes by more than, you know, sort of an incremental amount, which is I think kind of where the sentiment is right now, then that's going to really limit how much they have to spend on other things. But deficit concerns are a lot lower now than they were several years ago, and that may ultimately just lead them to expand the deficit. And if they do that then maybe taxes don't rise that much.

Jake Siewert: You mentioned health care and infrastructure as potential areas of focus. Where do you think congress is most likely to allocate any tax revenue that it raises?

Alec Phillips: So, I mean, infrastructure has clearly been the initial focus of the incoming administration. And I think, you know, it's clear that something is going to happen there. Right now, if you were to sort of listen to the way people describe it, it's first COVID relief and then a second package, you know, midyear, maybe Q3 or something like that, that involves infrastructure and maybe some renewable energy incentives and sort of climate-focused items financed by corporate tax changes and, you know, whatever other revenue can be raised.

I would imagine that either they're going to need to do another bill on top of that, or they're going to have to expand that to include some other things. And the reason I say that is because if you look at the Biden agenda, I mean, infrastructure was clearly one big part of it. But you had, you know, health insurance reforms, whether it's expanding the ACA or lowering the Medicare age. Child care initiatives. A whole bunch of stuff on education. And it's kind of hard for me to see leaving all of those things aside and instead just doing infrastructure.

But the challenge I think they're going to have is that they're not going to get that many shots at doing something. I mean, they're likely to use -- again, you know, not to get into the specifics. But the reconciliation process, again, in theory they have two, maybe three shots at reconciliation before the midterm election. And, you know, we know one of those could end up being COVID relief at the beginning of the year. One might be infrastructure. And then maybe there's a third. But there's a limited amount of political capital and a limited amount of time to do all that. And so I think, you know, they're going to have to figure out what the balance is between infrastructure,

which is clear, and then all of these other things.

Jake Siewert: So I'm personally a veteran of a couple nasty debt limit votes -- or I should say votes to raise the debt limit. I've been on the side of administrations that needed that increase. Never a popular vote in congress. How much of a risk is the debt limit or votes to raise the debt limit this year?

Alec Phillips: Well, you know, the good news is that usually when you have congress and the White House controlled by the same party it's easier anyway to get it done. And I would say because we're already going to have some major legislation moving through, you can at least imagine a scenario where the debt limit gets tacked onto one of these other big bills and doesn't have to move on its own. It's, you know, far from guaranteed that that happens, but it is worth pointing out that you can use that reconciliation process for three things -- spending changes, tax changes, or raising the debt limit. Those are the three things you can do.

So, I mean, frankly I would hope that what happens, just for the sake of, you know, financial markets and for that matter the broader economy and general public, is that they figure out a way to get a debt limit increase or suspension or whatever into one of the reconciliation bills passing earlier in the year ahead of that July 31st expression when the debt limit kicks back into effect. If they don't, you know, then one challenge they have is, you know, the treasury usually has a few hundred billion dollars of wiggle room, which usually lasts a while, like a couple of months at least. But a few hundred billion dollars doesn't get you that much when the deficit is, you know, \$2 trillion. So, you know, if they can't figure it out then we're going to have a bumpy August probably.

Jake Siewert: It always seems to happen in the summer. I'm not sure why. But anyway, aside from fiscal measures, which we've been talking about, what effect might Democratic control of the Senate have on President-elect Biden's ability to confirm the officials he's nominated? We've seen some hearings today. And what about other nonfiscal and regulatory policies? What are the outlooks for those given his thin majorities?

Alec Phillips: Yeah, I mean, so probably the biggest point to make is that for everything that's not fiscal, you need 60 votes in the Senate. And that essentially means that things like, you know, the minimum wage or making DC a state or, you know, sort

of other big things like that that are theoretically on the agenda will just be much more difficult to do than some of these fiscal items. With that said -- and I should point out actually one other thing about that, which is that there has been discussion of eliminating the filibuster, but that looks pretty unlikely given the 50/50 split. There seem to be at least a few Senate Democrats who don't want to do that.

So assuming that that's the case then, you know, I think you basically have two effects of the Senate Democratic control on those regulatory issues. One is, you know, like you said, you have this easier passion for President-elect Biden's nominees than under a Republican Senate. That, you know, doesn't really affect the cabinet level because a lot of them were nominated before we knew who was going to control the Senate. But it probably does affect the next rung down, most of whom have not actually been nominated yet. And one would imagine that those people are maybe going to be slightly more pro regulatory than they would have been under a Republican Senate.

And then, you know, the other thing that I think is important is that while you can imagine that there are a bunch of these issues that probably won't get 60 votes in the Senate, a lot of them will nevertheless come up. And they'll be put to a vote. And it will create some uncertainty. And so, like, as an example, the minimum wage. A \$15 minimum wage is pretty unlikely to pass when it needs 60 votes. On the other hand, it seems pretty likely that we'll have a vote on it at some point. And it also seems party likely that that will then generate some uncertainty about some, you know, compromised proposal or something else. So there are a lot of issues that you can sort of say they probably won't actually change, but they'll create a lot of uncertainty for financial markets and just, you know, in sort of the public debate because Senate Majority Leader Schumer will, you know, be controlling the agenda and will put some of these things up for a vote.

Jake Siewert: All right, Alec, well, thanks for joining us today.

Alec Phillips: Thanks.

Jake Siewert: I hope you have a peaceful Inaugural Day down there in Washington and here in New York for that matter. That concludes this episode of Exchanges at Goldman Sachs. Thank you very much for listening. And if you enjoyed this show, we hope you subscribe on Apple Podcasts and leave a rating or a comment.

And tune in later this week for the weekly Markets Update where leaders around the firm give a quick take on what they're watching in markets.

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