

Research Paper

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US Election Note: Economic Policy After 2016

Summary

- A Hillary Clinton presidency would offer the greatest continuity with current economic policy as she presses a largely standard Democratic Party agenda that includes more public spending on infrastructure and education, higher minimum wages and corporate-tax reform. All else being equal, growth forecasts for the US economy would change very little under her.
- Donald Trump's economic agenda ostensibly embraces traditional Republican tenets of broad tax reductions and repealing President Barack Obama's healthcare reforms. But his mercantilist trade policy and anti-immigration rhetoric represent a departure from mainstream Republicanism. This combination leaves the likely impact of Trump's policies on US growth unclear, but the threat of a trade war with China or Mexico could unsettle financial markets substantially and generate significant immediate headwinds to global growth.
- Clinton and Trump have made commitments to fiscal responsibility, but neither seems prepared to put balancing the budget ahead of other priorities. Any significant fiscal reforms will face challenges from what is likely to be a divided Congress, although Clinton may have a slightly easier time in this regard than Obama if her victory boosts the number of Democratic seats. Trump's proposed large tax cuts are unlikely to pass in Congress, but he might be able to patch together a coalition of members from both parties to support modest change. In any case, the next president and Congress will face the immediate challenge of raising the debt ceiling, which has been suspended until March 2017.
- Neither candidate offers compelling ideas on addressing the root causes of slower growth or the looming challenge of reforming US entitlement programmes. Surprisingly, in a campaign filled with concerns about inequality and unfairness, Clinton's proposals are mainly incremental reforms while Trump focuses almost entirely on the perceived evils of trade.
- For the outside world, a key question is just how much the United States will turn inward given the tone of the campaign and in the wake of the UK's vote to leave the European Union. At the very least, progress on trade faces delay if Clinton seeks changes to the Trans-Pacific Partnership or an indefinite interruption if Trump delivers on even some of his threats against trading partners. While Trump claimed the British referendum results as an affirmation of his call to assert control over immigration and trade, the actual impact on the US campaign will depend on whether the UK has set itself a promising economic and political course come November. Meanwhile, Trump's rhetorical style would also make economic summits like the G20 less cooperative and likely leave global leaders hamstrung in any coordinated response to renewed global financial instability.

Introduction

There are three great puzzles in this year's deeply puzzling US presidential election when it comes to economic policy. First, the words do not match the numbers. The anger and frustration levelled at America's financial and political establishments in the campaign suggest a country in deep economic recession, where populist candidates can muster large followings with promises to upend everything. And yet the numbers tell a far brighter story: stronger growth than any major advanced economy, an unemployment rate that has halved since 2008, negligible inflation rates and petrol prices lower than anyone can remember. As the presidential primary season winds down, financial markets have delivered the second longest bull-run in the history of the S&P 500.

The second puzzling feature in the campaign is that the central issue of the last presidential election – the deficits and national debt – are barely mentioned while the economic debate centres on Wall Street greed, trade fairness and inequality.¹ The 2015 budget deficit was 2.5 per cent of GDP compared to 9.7 per cent in 2009, but the debt trajectory remains substantially unchanged, and there has been startlingly little serious discussion of reform to legally mandated entitlement programmes such as Medicaid, Medicare and Social Security.²

Why the anger and frustration with establishment candidates is so intense this year presents a third puzzle. The insecurity of the middle class, the hollowing out of the manufacturing sector and the stagnation of incomes have shaped the US economy for decades. Polls suggest that roughly two-thirds of registered voters believe the economic system unfairly favours the powerful, while the rest consider it generally fair, and the leading candidates have tapped into these insecurities successfully.³ A partial explanation for why this is particularly salient this year may lie in the growing political prominence of 'millennials', i.e. those aged 18–29, roughly half of whom say the country is on the wrong track and whose votes will for the first time outnumber those of 'Baby Boomers' now in their 50s and 60s.⁴

While an international audience might worry that the current campaign rhetoric heralds a period of self-absorbed isolationism for the United States, the reality is more nuanced. In a recent poll roughly two-thirds of Americans said the country should concentrate on its own problems, a stronger view among Republicans than Democrats. But, at the same time, approximately six-in-ten said the world would be a worse place without active US involvement.⁵ The result of the British referendum last week could, of course, bolster anti-immigrant and anti-trade views, although this will depend on whether the UK appears headed for political stability and economic growth from its new perch outside the EU.

¹ Pew Research Center (2016), 'Budget Deficits Slip as Public Priority', 22 January 2016, <http://www.people-press.org/2016/01/22/budget-deficit-slips-as-public-priority/2/> (accessed 6 Jun. 2016).

² Congressional Budget Office (2016), 'Budget and Economic Outlook and Updates', https://www.cbo.gov/about/products/budget_economic_data#3 (accessed 6 Jun. 2016).

³ Pew Research Center (2016), 'Campaign Exposes Fissures Over Issues, Values and How Life Has Changed in the U.S.', 31 March 2016, <http://www.people-press.org/2016/03/31/campaign-exposes-fissures-over-issues-values-and-how-life-has-changed-in-the-u-s/> (accessed 6 Jun. 2016).

⁴ Harvard Institute of Politics (2016), 'Clinton in commanding lead over Trump among young voters, Harvard Youth poll finds', <http://iop.harvard.edu/youth-poll/harvard-iop-spring-2016-poll> (accessed 6 Jun. 2016).

⁵ Wickett, X. and Stokes, B. (2016), *Allies Beware: Americans Support a More Limited Role for the US*, Chatham House Expert Comment, 12 May 2016, <https://www.chathamhouse.org/expert/comment/allies-beware-americans-support-more-limited-role-us#sthash.4rgelO32.dpuf> (accessed 3 Jun 2016).

That said, the two presumptive nominees offer sharply contrasting economic policies with potentially significant consequences for the global economy. By all appearances, Hillary Clinton would deliver something resembling a third Obama term in substance and style. Donald Trump's campaign, meanwhile, has been fuelled by promises of upending business-as-usual policies, which he blames for America's current ills. While he may ultimately fall back on more pragmatic measures, his self-avowed preference for unpredictability seems likely to unsettle global financial markets even if his ultimate actions do not themselves weaken global growth.

Background

This election comes as the United States continues to drive the global recovery. The IMF has reduced its US growth estimates for 2016 to 2.4 per cent, still lagging behind emerging economies at 4.1 per cent, but well ahead of the overall developed-market forecast of 1.9 per cent.⁶ It noted stronger corporate balance sheets, a healthy housing market and fiscal policy that is no longer a drag on growth as it was during the previous campaign. Longer-term forecasts, however, remain closer to 2 per cent given the country's aging population and lower productivity projections.⁷ For advanced economies like the United States, the IMF recommends continued accommodative monetary policy, supportive fiscal measures and structural reforms that can boost growth. It also prescribes incentives to increase investment and innovation to support productivity growth.⁸

Many of the IMF's ideas were included in President Obama's recent budgets, but they stood little chance of passing given his relationship with Congress. What little political capital he had following the government rescues of the banking and automobile industries early in his first term, the president went on to spend on a close partisan vote to expand and reform healthcare insurance. While the Affordable Care Act may have created some near-term headwinds to the recovery, the impact on longer-term economic efficiency remains to be seen.⁹ In any case, there was little appetite amid the acrimony that followed to tackle key economic challenges like comprehensive tax reform or infrastructure investment. Moreover, so-called Tea Party Republicans committed to making the government smaller, focused their efforts on blocking anything that looked like compromise with the administration through repeated brinksmanship over the budget. While Republicans and Democrats managed to agree on a budget package through next year, the next president and Congress will face difficult decisions almost immediately since the country's debt ceiling will need to be raised or suspended again before March 2017. While Congress will likely postpone any direct confrontation until there has been time to explore what concessions might be extracted from the new president, the risks of confrontation will likely linger.

The most important element of President Obama's international economic agenda still in the queue is the Trans-Pacific Partnership (TPP), which was signed with 11 trading partners in February. The

⁶ International Monetary Fund (2016), 'World Economic Outlook Database, April 2016', <http://www.imf.org/external/pubs/ft/weo/2016/01/> (accessed 6 Jun. 2016).

⁷ *Ibid.*, p. 18.

⁸ *Ibid.*, p. 28–29.

⁹ Sorkin, A. (2016), 'President Obama Weighs His Economic Legacy', *New York Times*, 28 April 2016,

http://www.nytimes.com/2016/05/01/magazine/president-obama-weighs-his-economic-legacy.html?action=click&contentCollection=Magazine&module=RelatedCoverage®ion=EndOfArticle&pgtype=article&_r=0 (accessed 6 Jun. 2016).

deal, however, has yet to be approved by Congress. While key Republican members continue to support the agreement in principle, they have quibbled with elements of importance to key interest groups and preferred to delay consideration during the current primary campaign. The administration continues to press for early approval and there is talk of a vote during the ‘Lame Duck’ session between the November elections and the start of the next Congress. That may be more difficult if the Senate chooses to take up the nomination of the president’s Supreme Court nominee at that time instead. With neither Clinton nor Trump offering support for the TPP, the most benign outcome seems to be a delay in approval pending the next president’s review and some cosmetic renegotiation. Interestingly, the harsh anti-trade rhetoric during the campaign appears to have driven down public support for trade deals, but 47 per cent of registered voters still approve of free trade agreements (compared to 53 per cent a year ago). Perhaps more interesting, the shift appears to be driven almost entirely by a decline in Republican support for free trade, which currently registers at just 38 per cent compared to 56 per cent of Democrats.¹⁰ Further analysis on the future of trade policy can be found in an upcoming paper in this series.

Policy positions

A Clinton presidency

If Hillary Clinton wins the presidency, her economic proposals will come as little surprise, outlined as they are in great detail in her policy announcements and on her campaign’s website. They include specific plans to revitalize coal-mining communities even as she drives a transition to becoming ‘the clean energy superpower of the 21st century’, measures to support the collective bargaining power of unions, and a programme to bolster small business with greater access to finance and less ‘red tape.’¹¹

The core of Clinton’s programme suggests great continuity with the current administration. It is also difficult to imagine she will have better luck securing backing for her policies from Republicans in Congress. She supports greater benefits for workers, including higher minimum wages and expanded guarantees for paid family leave. She proposes expanded federal support to help pay for college education. She backs a more active government role in infrastructure construction with a plan for \$275 billion in federal spending over five years and an additional \$25 billion commitment over the same period to establish a national infrastructure bank. Finally, on healthcare, Clinton promises to defend the Affordable Care Act from Republican revisions and offers to provide tax credits to make insurance premiums more affordable. Among the more creative ideas she is proposing are a series of incentives for businesses to invest in on-the-job training, including a \$1,500 tax credit for each apprenticeship established.¹² She argues the money for any new spending initiatives can be found by closing loopholes for rich taxpayers and passing corporate-tax reform. Meanwhile, her efforts to address the challenge of inequality, raised so effectively by her challenger

¹⁰ Pew Research Center (2016), ‘Campaign Exposes Fissures Over Issues, Values and How Life Has Changed in the U.S.’.

¹¹ HillaryClinton.com (2016), ‘A plan to raise American incomes’, <https://www.hillaryclinton.com/issues/plan-raise-american-incomes/> (accessed 6 Jun. 2016).

¹² HillaryClinton.com (2016), ‘Strong infrastructure is critical to a strong economy’, <https://www.hillaryclinton.com/issues/infrastructure/> (accessed 6 Jun. 2016).

Bernie Sanders, are more akin to a list than a strategy. To the extent that some of the initiatives can be offset against clear spending cuts, she may be able to secure a few of them, especially if her victory coincides with a rise in the number of Democrats in Congress.

On Wall Street reform, Clinton has been vulnerable to Sanders' attacks about her relationships with big-bank interests, and she has responded by highlighting her financial reform proposals. While not going as far as adopting his call to break up big banks directly, she has proposed measures that build on the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act to bolster the powers of regulators, force more transparency for hedge funds and impose a tax on high-frequency trading. She has also supported higher taxes on the 'carried interest' earned by hedge-fund managers. With nearly as many Republican voices calling for Dodd-Frank to be revisited these days as Democrats calling for further Wall Street reform, incremental changes may be possible even if a grand compromise is out of reach.

Interestingly, Clinton's campaign website has no distinct section on trade amid 30 separate 'issue' headings, although the heading on 'manufacturing' promises to crack down on trade violations and the appointment of a 'trade prosecutor' reporting directly to the president.¹³ Meanwhile, having once described the TPP as the 'gold-standard' of trade agreements while secretary of state, she has now raised concerns that the deal does not do enough to raise the wages of American workers or address currency manipulation. Just how she will try to address these concerns in renegotiations with the other parties remains to be seen. Her support of earlier trade agreements all the way back to the North America Free-Trade Agreement (NAFTA) that President Bill Clinton signed suggests she will try to amend TPP rather than abandon it altogether. However, it may be a year or two before she can secure enough revisions to the deal to allow her to pivot from her campaign scepticism.

A Trump presidency

For a candidate who is long on rhetoric and short on details, Trump has offered a substantial set of ideas with significant economic consequences. These blend traditional Republican proposals for tax cuts with significant departures from the party's historical commitment to expanding free trade and generally welcoming immigration, which he derides as the root causes of all that afflicts American workers. This makes it especially difficult to project which of his ideas might secure legislative approval even if the composition of the next Congress were known. Moreover, many of the ideas themselves have been presented as dramatic goals or measures without a specific strategy for achieving them, which has made them difficult for even traditionally Republican analysts to assess.¹⁴ Some have argued that Trump's business record suggests a more practical technocrat who has merely assumed a campaign posture of bombastic confrontation, but his proposals have raised red flags in the business community as well. Recent suggestions that he stands ready to renegotiate the terms of the national debt drew widespread condemnation and he quickly rowed back. His

¹³ HillaryClinton.com (2016), 'Manufacturing is critical to the U.S. economy', <https://www.hillaryclinton.com/issues/manufacturing/> (accessed 6 Jun. 2016).

¹⁴ McGrane, V. (2016), 'Why D.C.'s think tanks can't figure out Trump', *Boston Globe*, 27 May 2016, <https://www.bostonglobe.com/news/nation/2016/05/26/donald-trump-policy-free-approach-befuddles-washington-think-tanks/hDpo4jU7rWCz2QLyOVMgBK/story.html> (accessed 6 Jun. 2016).

promise to ‘Make America Great Again’ by threatening retaliation against key trading partners has left the US Chamber of Commerce wringing its hands.¹⁵

On immigration, Trump proposes a variety of new measures to restrict the influx of foreign workers, which he argues ‘holds down salaries, keeps unemployment high, and makes it difficult for poor and working class Americans – including immigrants themselves and their children – to earn a middle class wage.’¹⁶ Most dramatically, he proposes to deport 11 million illegal immigrants within about two years. He also reiterates his concern about illegal arrivals from the south, and threatens to block remittances to Mexico unless its government underwrites the \$5–10 billion that could be needed to build the wall between the two countries that has become a signature feature in his campaign. Trump’s focus on limiting immigration comes as overall employment has risen and Mexican immigration has dropped substantially since the 2008 recession.¹⁷ While the long-term impact of immigrant arrivals may have depressed wages in some job categories, many employers continue to complain that they cannot fill unskilled positions in agriculture or tourism at any wage without immigrants. More moderate versions of immigration reform have failed repeatedly in Washington, so it is difficult to see how Trump will have more success. Of greater consequence may just be the impact of any serious efforts to try. Even the threat of blocking remittances to Mexico from immigrants in the United States, for example, could set off substantial deposit outflows that would rock US banks.

Trump’s trade ideas are underpinned by a mercantilist focus on trade deficits and a list of extreme retaliatory measures designed to redress past deals that he insists largely failed to protect American workers from the loss of countless factories and manufacturing jobs. His main target is China, which he proposes to call out for currency manipulation and to threaten with countervailing duties until it changes its behaviour. Trump also promises to confront China over intellectual property theft and illegal export subsidies. For further leverage, he proposes somewhat incongruously to cut US corporate taxes in order to make America a more attractive place to invest than China and to bolster the US naval presence in the South China Sea. He also proposes to reduce China’s ability to ‘blackmail’ the United States through its Treasury bond holdings by reducing the national debt. While most of these measures seem unlikely to secure approval in Congress, merely proposing them could trigger significant retaliation from China, set off a rush to sell Treasury bonds before China sold its own holdings and deal a substantial blow to global trade.

The call to repeal President Obama’s healthcare reforms places Trump more squarely in the Republican mainstream, although much of the party’s rhetoric has faded of late. Trump blames the Affordable Care Act for raising costs and limiting choices, and calls on Congress to implement a series of new measures to make healthcare more accessible and affordable. His own proposals to expand tax benefits of health savings accounts and to require price transparency from healthcare

¹⁵ Nakamura, D. (2016), ‘U.S. Chamber of Commerce on Trump: “Who is this guy? How will he behave?”’, *Washington Post*, 13 May 2016, <https://www.washingtonpost.com/news/post-politics/wp/2016/05/13/u-s-chamber-of-commerce-on-trump-who-is-this-guy-how-will-he-behave/> (accessed 6 Jun. 2016).

¹⁶ DonaldJTrump.com (2016), ‘Immigration reform that will make America great again’, <https://www.donaldjtrump.com/positions/immigration-reform> (accessed on 6 Jun. 2016).

¹⁷ Batalova, J. and Zong J. (2016), ‘Frequently Requested Statistics on Immigrants and Immigration in the United States’, Washington, DC: Migration Policy Institute, 14 April 2016, <http://www.migrationpolicy.org/article/frequently-requested-statistics-immigrants-and-immigration-united-states> (accessed 6 Jun. 2016).

providers seem more incremental than comprehensive. Regardless of their actual merits, however, any re-opening of healthcare reforms will likely trigger a fierce and unpredictable debate.

Trump's tax plans are perhaps the most difficult to categorize. On the one hand, they include an extreme set of tax cuts favoured by many Republicans. The top income tax bracket under his plan would tumble to 25 per cent from the current 39.6 per cent, the estate tax would be fully eliminated, and no business large or small would pay more than 15 per cent of income in taxes.¹⁸ On the other hand, traditional Republicans have raised the alarm about his rhetoric on closing tax loopholes so that the rich pay more in taxes and to force US firms to pay taxes on cash currently sitting abroad. They are also sceptical of his claims of wanting to balance the budget, or that merely attacking government waste, fraud and abuse will be enough to fund his tax cuts.¹⁹ It is conceivable that Trump might be able to cobble together an eclectic mix of measures that pass Congress, but it remains difficult to project what might constitute a winning fiscal formula in his presidency.

International implications

Predicting the economic consequences of either a Clinton or a Trump presidency is not a straightforward matter. It is further complicated by the great uncertainty about the future composition of Congress. While the House of Representatives seems likely to remain under Republican control, the Democrats could reclaim the Senate. So far, Trump shows no sign of boosting the prospects of Republican congressional candidates.

In spite of vast differences between their economic approaches, Clinton and Trump seem open to fiscal measures to support growth. Clinton would press for more spending, while Trump would likely push tax cuts. Neither would be expected to achieve all of their current campaign proposals given the probability of a divided Congress, but current neutral fiscal policy may turn slightly more supportive. Presumably, fiscal measures that boost global growth will be welcomed by many in the international community regardless of the rhetoric that surrounds them.

The rhetoric, however, may have important consequences of its own, especially for cooperative international economic initiatives like the G20, the Asia-Pacific Economic Cooperation (APEC) discussions or the Summit of the Americas. Clinton's greater continuity with Obama should mean continuing efforts to build incrementally on current cooperative initiatives to support balanced growth, collaborate on financial regulation and renounce protectionist measures. Trump's announced intention to confront Mexico over immigration and China over trade is difficult to square with progress in other areas. Under extreme scenarios, these consultative mechanisms could turn much more acrimonious or break down entirely. Any new threat to global financial stability may be much more difficult to manage under Trump. The very unpredictability on which he prides himself could unsettle global financial markets at a time of weakening economic growth almost everywhere outside the United States.

¹⁸ DonaldJTrump.com (2016), 'Tax reform that will make America great again', <https://www.donaldjtrump.com/positions/tax-reform> (accessed 6 Jun. 2016).

¹⁹ Goldmacher, S. (2016), 'Trump launches tax plan rewrite', Politico, 11 May 2016, <http://www.politico.com/story/2016/05/donald-trump-taxes-tax-reform-223041> (accessed 6 Jun. 2016).

On trade, where the candidates' rhetoric is strikingly similar in substance if not in intensity, the outcomes promise to be strikingly different. For all of her expressed doubts about the TPP, Clinton has a long record of supporting free trade. Her judgment that the current agreement does too little to support American workers may drive her to renegotiate cosmetic changes to the current text, but it is difficult to imagine much more than a temporary delay. Talks with Europe over the Trans-Atlantic Trade and Investment Partnership (TTIP) are likely to continue unimpeded as she puts her own imprint on a final agreement. Trump's harsher views on all trade agreements, as shown by his denunciation of all recent US trade negotiators for weakness and incompetence, suggest that he would try to fundamentally re-design the US trade agenda. Even if he may not change the broad outlines of future agreements, a significant interruption seems likely before any talks resume. Moreover, sharp departures in trade policy could undermine US leadership on broader economic issues.

Conclusion

It is easy to imagine a Clinton presidency as a rough extension of Barack Obama's, shaped by similar fiscal instincts, structural proposals and congressional constraints. Her current opposition to the TPP suggests she may seek amendments that will delay final approval without derailing it altogether. A Trump presidency would likely present significant departures from the recent Democratic record, and also from many elements of traditional Republican ideology. The consequences of his ideas on taxes, healthcare, immigration and trade are difficult enough to project, but they would clearly go a long way to refocusing the economic debate. If he does no more than press substantial revisions to economic relations with China and Mexico, which seems to draw the greatest fervour among his supporters, financial markets may see immediate turmoil as a result and global growth prospects may weaken further still.

This election poses more of a challenge than most in sketching out the likely consequences of one presidency or another. Perhaps the most reassuring thought for those outside the United States who have watched the campaign with mounting dismay is that, beyond uncertainties over what either candidate might propose in office, the next president will still be constrained by the vagaries of Congress, the volatility of financial markets and the relentless forces of the global economy.

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Dr Christopher Smart is a fellow at the Kennedy School of Government, Harvard University, and will be a senior fellow at its Mossavar-Rahmani Center for Business and Government for the 2016–17 academic year. He spent the last six years in the Obama administration as a senior policy-maker for international economic affairs. As special assistant to the president at the National Economic Council and the National Security Council, he was principal adviser on trade, investment and a wide range of global economic issues. From 2009 to 2013, he was deputy assistant secretary of treasury, where he led the response to the European financial crisis and designed US engagement on financial policy across Europe, Russia and Central Asia.

Before entering government, he was director of international investments at Pioneer Investments where he managed top-performing emerging markets and international portfolios. Following the collapse of the Soviet Union, he worked in Moscow, advising Russian government agencies on economic policy and financial market reform. Earlier in his career, he was a reporter in St Petersburg, Florida, and Paris, France.

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About the 2016 US Election Note series

The November 2016 US presidential and congressional elections are occurring at a time of change inside the United States and uncertainty in the world. How the next administration adapts to a host of international challenges will be central not only to the United States' prosperity and security, but also, given its continuing global economic and political power, to the prosperity and security of countries across the world.

The months before and after the elections will witness an enormous number of analyses and reports by US institutions and media on the future of foreign and domestic policy, targeted principally at US public and policy-making audiences. Using Chatham House's international reputation for informed and independent analysis, the US and the Americas Programme will assess the likely trajectories of US international policy after the 2016 presidential election. Looking at US foreign policy from an external perspective, the Election Note papers will analyse the implications for other countries and help them to understand how a new president and his or her policies will affect them.

In the run-up to the elections, Chatham House is producing a series of Election Notes on major foreign policy issues, explaining the background, the relative positions of the main contenders for the White House, and the international implications of each. These Election Notes do not just provide independent analysis of what the candidates say, but draw upon an understanding of their record in public life, if relevant, and their domestic and foreign policy teams to offer a deeper and more rounded assessment of their likely approach to major foreign policy issues. They are intended to inform and be relevant to governments, businesses, NGOs, foundations and the broader public.

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