ECONOMIC VIEWPOINT

Biden vs. Trump: A US Fiscal Policy Preview

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With the US presidential election not until November 5, Donald Trump and Joe Biden still have lots of time to lay out their vision for a second term. But the proposed budget that President Biden recently released for fiscal year (FY) 2025 does shed some light on his second-term priorities. It shows public finances improving somewhat, especially compared with some baseline scenarios. Trump's policy agenda is less clear right now, but he would likely want to make the 2017 tax cuts permanent. Meanwhile congressional Republicans have put forth their own proposal that would slash government spending and supposedly balance the budget.

Budget season is drawing to a close here in Canada, with the federal government set to present its plan on April 16. Stateside, on March 11 the Biden administration unveiled its proposed budget for fiscal year 2025, which begins in October. As we saw last year, however, the president's budget proposal is rarely enacted as written. That's because the US Constitution gives Congress the power of the purse. To take effect, the budget has to pass both the House and Senate and be signed into law by the president. Budget talks are therefore almost always fraught, especially when the two houses of Congress are controlled by different parties. So instead of enacting long-term budgets, Congress often passes stop-gap measures that maintain spending at current levels for a few weeks or months. This is how it narrowly averted another government shutdown just two weeks ago.

But the president's proposed budget does shed light on the state of public finances by outlining the administration's priorities. It gives us a better idea of how the president's proposed budget measures would affect federal public finances. This is especially instructive in a presidential election year like the current one. The budget President Biden just released lays out what his agenda would be if he wins re-election. That means we can compare his priorities with the proposals put forward by his opponents. Let's take a closer look at the potential fiscal implications of the Biden–Trump rematch.

The Current State of US Public Finances

Before we can make any comparisons, we need a sense of where the US federal government's finances stand and the outlook for the next few years. The federal government ended fiscal year 2023 on September 30 with a deficit of US$1.695 trillion (6.3% of GDP) and debt held by the public of US$26.240 trillion (97.3% of GDP). February data from the U.S. Treasury show that over the previous 12 months, the government ran a deficit of US$1.801 trillion and the debt rose to US$27.380 trillion.

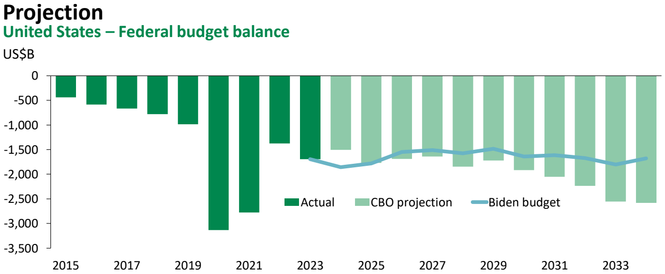
According to the latest Budget and Economic Outlook released by the Congressional Budget Office (CBO) in February, which takes into account only legislation that has been enacted, the deficit will shrink in FY2024, then grow in most years thereafter. The total budget shortfall for the 10-year period from 2025 to 2034 is expected to be US$20.016 trillion. Debt held by the public is projected to hit US$48.300 trillion (116.0% of GDP) by the end of fiscal 2034.

Biden's Budget

The Biden administration's budget proposal contains a somewhat rosier outlook for US public finances over the 2025–2034 period than the CBO does. According to Biden's budget, the deficit would clock in at US$1.781 trillion in 2025, a smidge higher than the US$1.772 trillion projected by the CBO. But the two forecasts diverge appreciably from that point on (graph 1 on page 2). Biden's budget predicts that the deficit over 10 years will total US$16.297 trillion, US$3.719 trillion less than the CBO projection based on laws currently on the books. And public debt would be 105.6% of GDP in 2034 instead of 116.0% (graph 2 on page 2).

How does Biden do it? He isn't proposing an austerity budget, that's for sure. Government spending would increase from US$6.941 trillion (24.6% of GDP) in 2024 to US$10.316 trillion (24.2% of GDP) in 2034. Over that period, spending would climb an average of 4.0%—in line with projections for nominal GDP growth (+4.2%). But revenue would grow much faster (+5.4%), improving the fiscal picture somewhat (graph 3 on page 2).

Graph 1
Biden's Budget Predicts Smaller Deficits than the CBO's Baseline Projection



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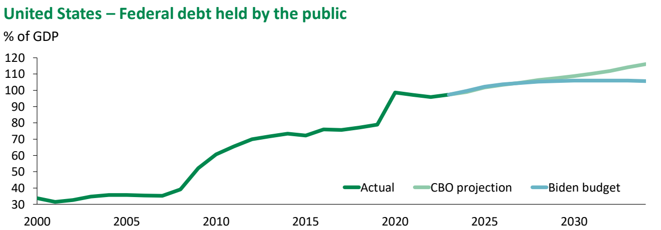
Graph 2
Public Debt Is Projected to Be Smaller under Biden's Budget



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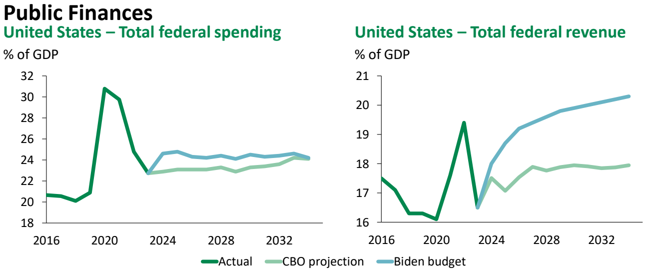
Graph 3
The Projected Revenue Increase in Biden's Budget Would Improve Public Finances



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So what does Biden's budget include? Some of the biggest new spending items in the administration's proposed budget are measures to reduce childcare costs and expand access to free preschool (price tag: US$600B over 10 years). Biden also wants to expand Obamacare (US$470B) and create a family and medical leave program (US$325B). He wants to reinstate the pandemic-era tax credit for workers (US$163B) and expand and make permanent the refundable tax credit for families (US$310B). The budget also proposes new measures to improve publicly funded health care (US$402B) and make post-secondary education (US$290B), housing and home ownership (US$183B), and home health care (US$154B) more affordable. Of course, it contains many other smaller-ticket items as well. While many of the Biden administration's signature plans have been criticized as inflationary, the White House says it's focused on cutting costs for families, especially the poor and the middle class. The budget contains most of the social programs that Biden ran on in 2020 but has been unable to enact as part of the legislation he's signed into law since the pandemic, including the American Rescue Plan Act of 2021, the bipartisan infrastructure law of 2021 and the Inflation Reduction Act of 2022.

The proposed budget also includes measures to reduce government spending, especially on health care and prescription drugs. But the overall increase in spending is partially offset by higher revenues. Again, the budget contains some measures that President Biden proposed before but never got through Congress, including raising the corporate tax rate from 21% to 28% ($1.350 trillion in savings). The budget would also increase the minimum corporate tax (US$137B) and stock buyback tax (US$166B) and change some international tax rules (US$374B). It would reinstate the 39.6% top marginal income tax rate for individuals (US$246B), introduce a 25% minimum tax rate for billionaires (US$503B), overhaul the capital gains tax (US$289B) and raise the Medicare tax on the rich (US$797B). It contains a number of smaller measures to boost tax revenue as well.

Overall, the Biden administration's 2025 budget is heavy on social program spending. The biggest new expenses are in health care, education and support for families and workers. Most of the increase in overall spending would go to fund social programs and to service the debt, while discretionary spending would be relatively stable (and lower as a share of GDP). New spending would be partially offset by higher taxes on corporations and the wealthy (defined as those making US$400,000 or more). Biden's opponents will surely continue painting him as a tax-and-spend liberal, a familiar Republican attack on Democrats.

The 2017 Tax Cut Dilemma

There's one big item that President Biden has promised that's missing from his proposed budget: an extension of the 2017 Trump tax cuts. The Tax Cuts and Jobs Act of 2017 (TCJA) introduced several tax cuts that took effect in 2018 and are set to expire at the end of 2025. That means in 2026, households and businesses could see their tax bills go up.

The TCJA lowered most individual income tax rates. It increased the basic deduction significantly and doubled (and made partially refundable) the child tax credit. It doubled the estate tax threshold as well. It also cut corporate taxes, especially the corporate tax rate, with the top rate slashed from 39% to 21% and the alternative minimum tax eliminated altogether. But some tax credits and exemptions for businesses and individuals were reduced or eliminated, including the state and local tax deduction and the mortgage interest deduction.

Reverting to 2017 tax rates on January 1, 2026, would send the US off a fiscal cliff that could hurt households and businesses and jeopardize economic growth. The US faced a similar threat when the 2001 and 2003 Bush tax cuts expired at the end of 2012.

Joe Biden has been clear that he won't raise taxes on anyone making less than $400,000. That means he has to avoid a messy end to the TCJA. As we saw in the fine print of Biden's proposed budget, he wants to raise several tax rates to pre-2018 levels. But the White House has been mum on the cost of holding other rates steady beyond 2025, discussing only the cost of increasing the child tax credit. According to some sources, extending most of the 2017 tax cuts for those making less than $400,000 would cost about US$160B per year. Over ten years, that's almost half the savings in Biden's budget. Keeping all the tax cuts, including those for corporations and the wealthy, would cost about US$3.8 trillion factoring in the additional cost of debt service. Once the election's over, the fate of Trump's tax cuts is likely to be a hot topic next year. Will they be extended or not? In part or in full? The last time tax cuts were set to expire, they were extended just after the deadline in the early morning of January 1, 2013.

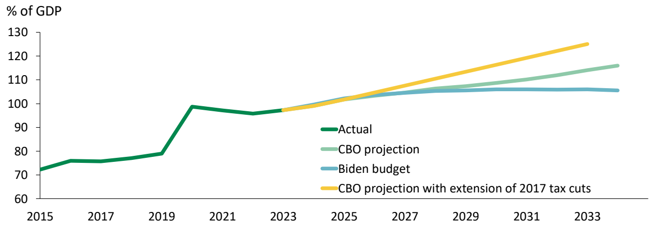
Proposals by Trump and Congressional Republicans

So far this election cycle, Donald Trump has proposed very few new measures when it comes to taxes and the economy. Instead, he's been playing up his administration's economic record and claiming Biden's economic policies have destroyed "the greatest economy in the history of the world."

Right now, Trump seems to be running on three economic policies: boosting energy production, eliminating regulation and repealing the Biden tax hikes. (The Inflation Reduction Act of 2022 raised some corporate taxes and increased funding for the Internal Revenue Service). If Trump wins a second term, he will undoubtedly try to make permanent the Republican tax cuts passed in late 2017 that are set to expire at the end of 2025. As we've discussed, this would come with a hefty price tag of around US$3.8 trillion over 10 years and could send public debt soaring to over 125% of GDP in 2033 (graph 4).

Graph 4
US Public Debt Would Be Even Higher If the 2017 Tax Cuts Were Extended

United States – Federal debt held by the public



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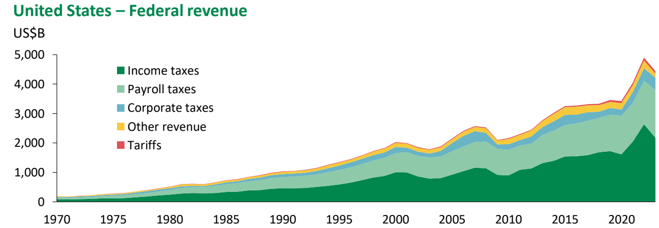
Increased protectionism was a mainstay of Trump's first-term economic agenda. And while Biden hasn't reversed many of those measures, Trump could step up the protectionism and slap on additional tariffs. According to his official campaign website, Trump wants to impose the same tariffs that other countries place on imports from the United States. "Matching the tariff practices of our foreign rivals will help protect American jobs, end our reliance on foreign competitors, and generate hundreds of billions of dollars in government revenue from foreign companies." But don't expect new tariffs to move the needle much on public finances. In FY2023, tariffs generated just US$82.6B in revenue—a mere 1.7% of the total federal tax take (graph 5). That figure would need to be exponentially higher to offset even a portion of the proposed tax cut extension, not to mention the economic impact these tariffs would have. Some of Trump's other official policy stances could also hurt the economy, like stronger border enforcement or a mass deportation of undocumented workers. But it's less clear what impact such policies would have on public finances despite Trump's claim that "[t]he onslaught of illegal aliens invading our wide-open borders threatens public safety, drains the treasury, undermines U.S. workers and burdens schools and hospitals."

Graph 5
Import Tariffs Account for Only a Tiny Fraction of Federal Revenue

United States – Federal revenue



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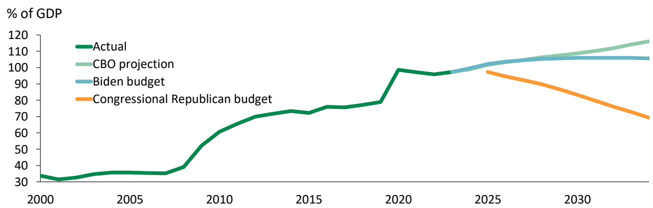
To get a better sense of what fiscal policy would look like under a second Trump administration, we can look at what congressional Republicans have proposed. After all, the 2017 tax cuts were largely the brainchild of the Republican majorities in the House and Senate, not the White House.

The Republican Study Committee, a group of congressional conservatives that includes House Republican leaders, recently published its own budget proposal. And while the plan is chock-full of proposed measures, it lacks the detailed figures the White House and CBO documents contain. This makes comparisons difficult, especially since it appears to include drastic spending cuts in fiscal 2025 that would slash the deficit over 10 years but seem unlikely to make it into law. The plan would balance the budget by 2031, however. Debt held by the public would plummet from 97.3% of GDP in 2025 to 69.3%

in 2034 (graph 6). Federal finances would improve even though the budget would "cut taxes by nearly $4.2 trillion over the next 10 years." The proposed budget would make the tax cuts in the Tax Cuts and Jobs Act permanent, completely eliminate the estate tax and reduce the capital gains tax. To offset the drop in revenue, overall spending would be cut to 26% below CBO projections in 2034 and 41% below for non-defense discretionary spending. Non-defense discretionary spending was 3.4% of GDP at the end of FY2023, but under the congressional Republican budget it would fall to 1.8% in 2025 and 1.4% in 2031. Since 1962, it's never dipped below 3.1% of GDP (graph 7). Even during the Trump administration, non-defense discretionary spending increased by 10.1% between 2016 and 2019. In short, the draconian cuts proposed by congressional Republicans would require major changes to the way the federal government operates.

Graph 6
Despite Cutting Taxes, the Budget Proposed by Some Congressional Republicans Would Reduce the Federal Debt
United States – Federal debt held by the public



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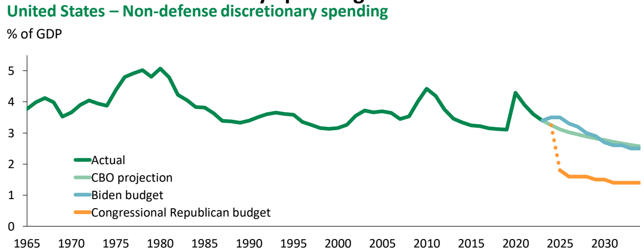
Graph 7
Under the Budget Proposed by Some Congressional Republicans, Non-defense Discretionary Spending Would Plummet
United States – Non-defense discretionary spending



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Fiscal Agendas: A Work in Progress

It may seem like the campaign has already been going on forever, but it's really just started. November 5 is still over 7 months away, leaving the candidates lots of time to lay out their vision for a second term. We should have a better sense of the candidates' platforms by the Republican convention in July and the Democratic convention in August. In the meantime, Biden's budget and the measures proposed by Trump and congressional Republicans give us a hint of what each side would do. The contrast between the two parties is already quite stark. Both are looking to build on their first-term accomplishments. Biden and the Democrats would support a strong federal government funded by higher taxes on corporations and the wealthy. The other side would dole out tax breaks and reduce the role of the federal government by slashing regulation (Trump) or drastically but unrealistically cutting federal spending (congressional Republicans). Either way, it's clear that public finances will continue to be a huge challenge for the US.