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# US FISCAL UPDATE: TAXING TIMES

## NEW TAXES ON THE WEALTHY IN BIDEN'S 'AMERICAN FAMILIES PLAN'

Author

THOMAS COSTERG
tcosterg@pictet.com

### SUMMARY

› On 28 April, President Biden is expected to unveil his latest spending plan. Called the American Families Plan (AFP) and focused on childcare policies and education, it is reportedly worth USD1.5 trn.
› New tax increases will likely form part of the plan and will hit wealthier individuals via higher capital gains taxes and a higher marginal top income tax rate.
› These new taxes were part of the Biden manifesto during his election campaign. In theory, the Democrats could pass them on their own given their 51–50 majority in the Senate, although it is not certain whether they would win all 51 Democratic votes.
› Having to sift through a deluge of spending plans, Congress may need some time to go through the details of Biden's new proposals, so action looks unlikely before August. In our view, October / November is more realistic.
› The AFP spending package would be in addition to the USD 2.3 trn American Jobs Plan, focused on infrastructure, that was unveiled on 31 March and is to be partly financed by higher corporate taxes.
› While many tweaks are likely between Biden's initial plans and the final version likely to be passed by Congress, US taxes look like going up. Biden's push to curb wealth inequality (a crucial campaign motto of his in 2020) means that the wealthy and corporations will be the first in line to be affected by tax rises.

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### This time, the tax axe falls on the wealthy

President Biden continues to make spending announcements, bolstered by the successful passage of the USD 1.9 trn stimulus package (ARP) approved by Congress in March. That package was paid for through new debt issuance, and mostly aimed at boosting demand in the short term.

On top of that, on 31 March, President Biden announced an infrastructure-oriented fiscal package – the American Jobs Plan – worth USD 2.3 trn. This package is to be partly funded by higher taxes on corporates. Indeed, the most noteworthy measure is an increase of the statutory corporate tax rate from 21% to 28%, partly reversing the Trump tax cuts of December 2017.

On 28 April, President Biden is set to announce yet another plan, called the American Families Plan, focusing on childcare policies and education. According to media reports, it is set to include USD 225 bn for childcare (representing potentially an extra USD 300 per month in the pockets of parents with children), USD225 bn for paid family / medical leave, and USD200 bn to ensure all 3- and 4-year olds can benefit from free pre-kindergarten education. The proposal would also include free community college education.

The plan is to be partly financed by tax hikes, with the **axe falling this time on wealthy individuals**. According to media reports, capital gains tax would rise from 20% to 39.6%, matching the marginal rate on ordinary income. In a reversal of the December 2017 tax cuts, the top rate of tax on ordinary income could be raised back to 39.6%.

While the tax hike on capital gains would hit people earning more than USD 1mn per year, a higher marginal tax rate would apply to people earning more than USD400,000. Only 0.3% of taxpayers would be affected by higher capital gains as Brian Deese, the Biden cabinet's 'chief economist' confirmed on 26 April 2021, equivalent to only 500,000 individuals. Nonetheless, higher taxes on capital gains are indeed on the cards.

These tax-raising measures are much more about President Biden sending a signal about the seriousness of his intent to tackle income inequality rather than a way of balancing the books. Indeed, according to UPenn's Wharton Budget Model estimates of proposals made during Biden's presidential campaign, the increase in capital gains tax would only raise around USD180 bn and the increase in income tax around USD150 bn over the next 10 years.

### Biden's resolve for higher taxes is considerable

President Biden's plans are stacking up on the desks of members of Congress, who risk suffering indigestion in the coming months. **Each of Biden's spending proposals will require considerable scrutiny**. They are so wide-ranging (encompassing social policies, the green transition, traditional infrastructure, education etc…) that there is a risk of confusion and cacophony.

Congress tends to have more appetite for spending than for higher taxes, and some **centrist Democrats could oppose the range and scope of Biden's proposed new taxes**. But there seems to be implicit support for *moderate* tax increases among Democrats as long as they do not fall on the middle class (respecting Biden's campaign promise in this

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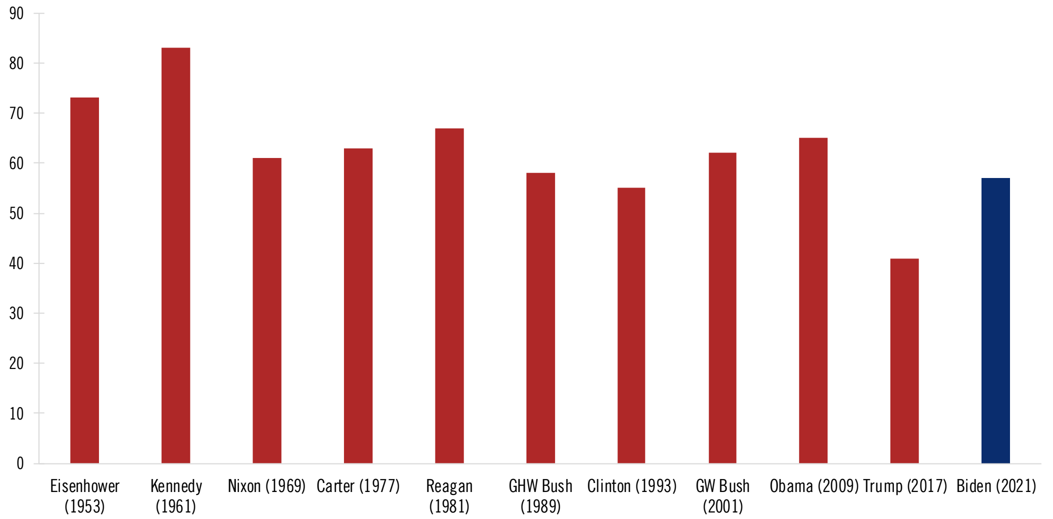
regard). The window for passing legislation remains relatively narrow as from early next year, mid-term election campaigns for November 2022 will already be starting.

**Congress is unlikely to vote on Biden's numerous spending plans before August**, with October/November more likely. Between the initial plans and actual legislation, we predict there will be some dilution in both the spending and taxation plans. That being said, **President Biden's resolve to impose higher taxes on companies and the wealthy should not be underestimated**, and some tax hikes could well materialise later this year.

Biden's strategy to have his spending (and tax hikes) plans through Congress remains uncertain at this stage but it looks like he will depend on the **Democratic party alone** for support rather than seek consensus. Some Republicans have shown that they are willing to compromise on infrastructure spending, putting on the table an alternative USD570 bn plan that avoid higher corporate taxes (the Democrats' reaction has been mixed). Biden's scheduled meetings with Republican leaders to discuss spending plans in the coming days have probably more to do with politeness than any real intention to work with them (and compromise), however. At the end of the day, the March 2021 rescue package was approved without any support from Senate Republicans.

CHART 1: PRESIDENT BIDEN'S JOB APPROVAL RATING AFTER FIRST 100 DAYS, ACCORDING TO GALLUP




*Source: PWM - AA&MR, Gallup (April 2021)*

From a pure macro perspective, we believe that Biden's spending plans should provide a net boost to economic growth (despite tax hikes), although this boost is likely to be moderate given that the **spending is to be spread over several years and is more supply-side oriented**. The biggest bang for the buck is undoubtedly provided by the American Rescue Plan voted in March, which aims to provide a direct boost to 2021 activity via federal cheques and increased unemployment benefits. The ARP partly explains our solid growth forecast for 2021: we expect the **US economy to grow by 6.5% this year**, with GDP growth likely to be particularly strong in Q2, when we expect a 10.0% quarter-on-quarter seasonally adjusted annual rate.

We expect GDP growth to moderate in 2022 (to about 3%) due to the evaporation of fiscal support and lingering cautiousness among consumers about spending their crisis-era savings. **US consumers' savings and spending behaviour is more crucial for 2022 growth than Biden's spending plans on infrastructure and education, in our view**.

Meanwhile, the 31 July debt ceiling deadline looms. Some Republicans have indicated interest in leveraging this deadline to extract concessions on other legislation. Democrats may wish to wait until after the deadline to pass the more controversial aspects of their spending plans, including the reversal of the December 2017 tax cuts. **The question in the longer run is whether such legislative ping-pong between Republican and Democratic administrations is hurting US business and consumer confidence by contributing to uncertainty over tax rates.**

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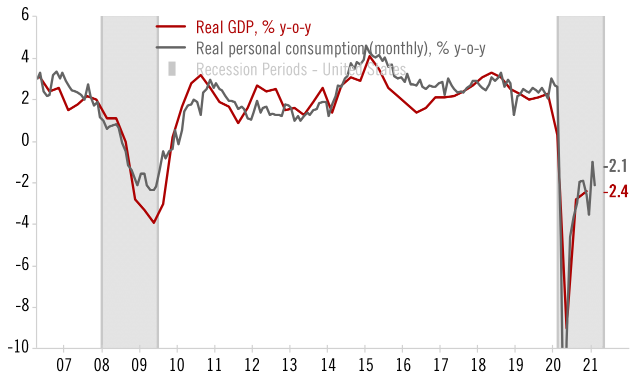
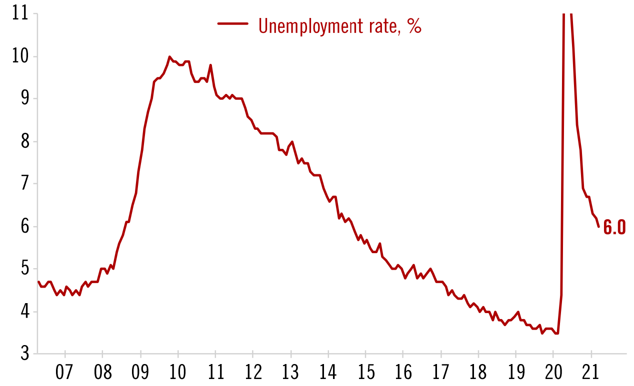
### REAL GDP AND PRIVATE CONSUMPTION GROWTH, % Y-O-Y



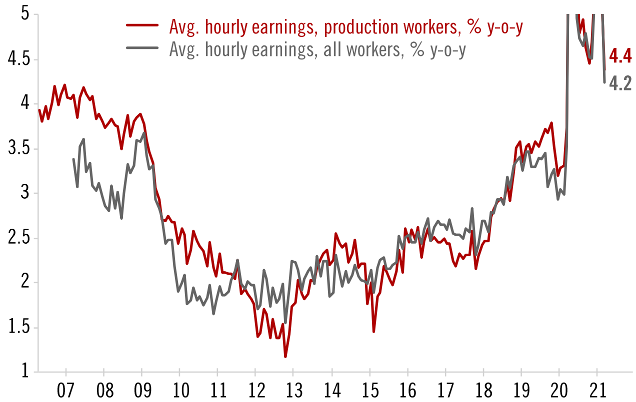

*Source: Pictet WM – AA&MR, Factset*

### UNEMPLOYMENT RATE, %



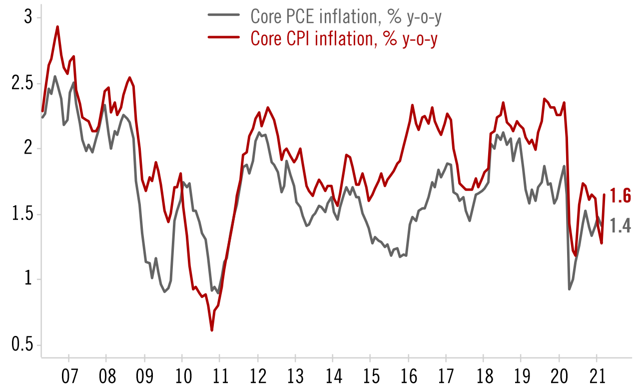

*Source: Pictet WM – AA&MR, Factset*

### AVERAGE HOURLY EARNINGS (WAGE GROWTH), % Y-O-Y



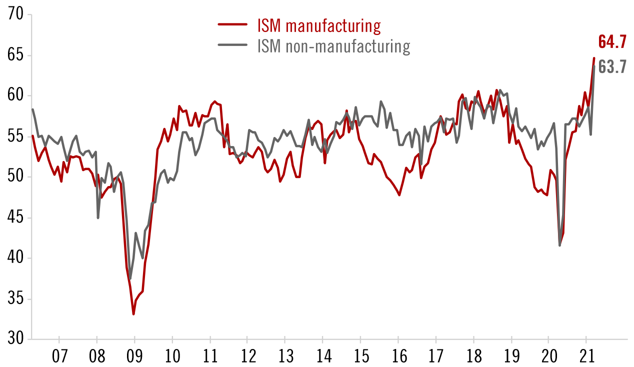

*Source: Pictet WM – AA&MR, Factset*

### CORE INFLATION (PCE AND CPI), % Y-O-Y



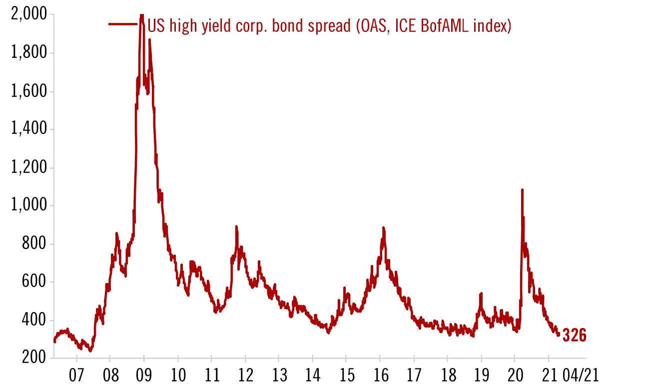

*Source: Pictet WM – AA&MR, Factset*

### ISM BUSINESS SURVEYS




*Source: Pictet WM – AA&MR, Factset*

### HIGH-YIELD CORPORATE BOND SPREAD, BASIS POINTS




*Source: Pictet WM – AA&MR, Factset (last close)*

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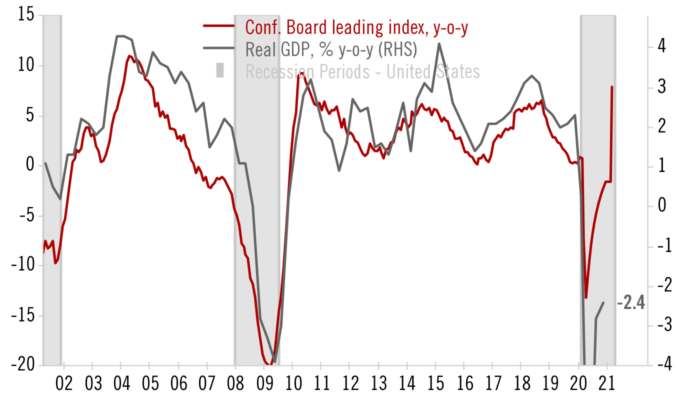
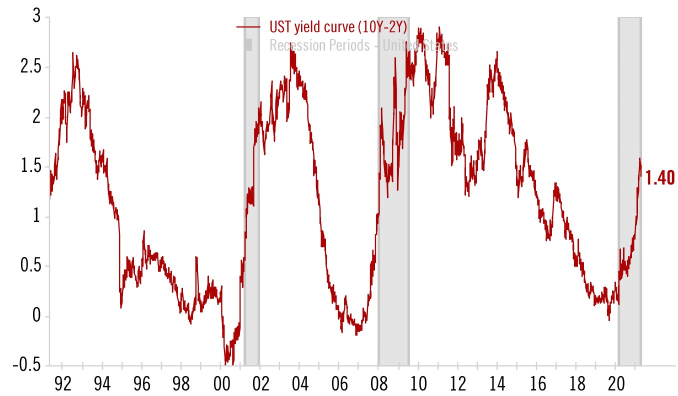
### CONF. BOARD LEADING INDEX, % Y-O-Y VS GDP GROWTH, % Y-O-Y



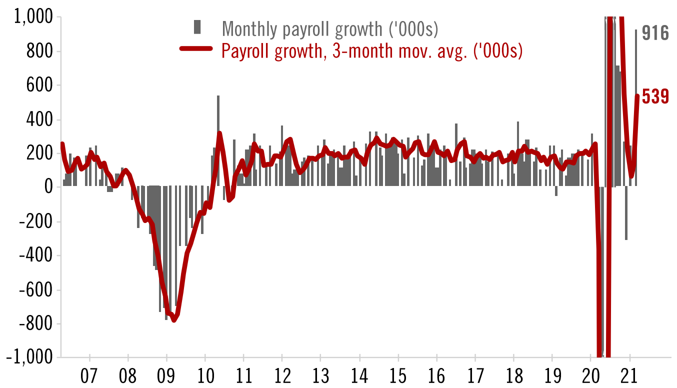

*Source: PWM - AA&MR, Factset*

### US YIELD CURVE SPREAD (10-YEAR YIELD MINUS 2-YEAR YIELD)



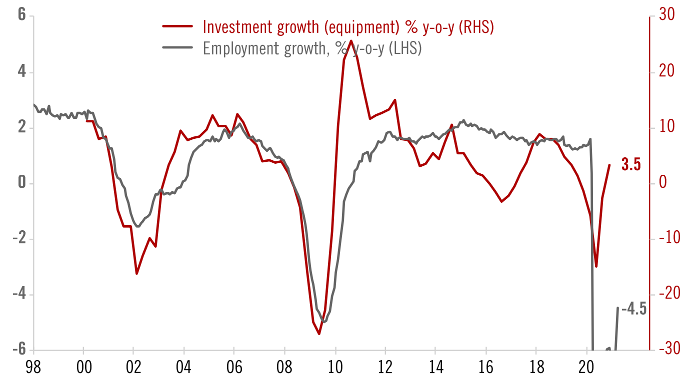

*Source: PWM - AA&MR, Factset (last close)*

### EMPLOYMENT GROWTH, IN THOUSANDS



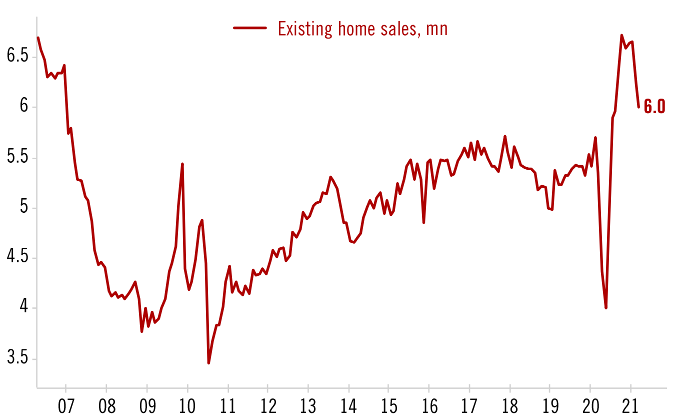

*Source: PWM - AA&MR, Factset*

### US INVESTMENT (EQUIPMENT) VS EMPLOYMENT GROWTH, % Y-O-Y



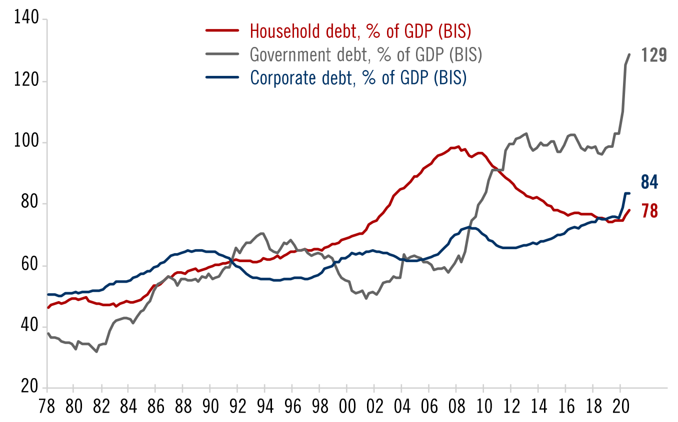

*Source: PWM - AA&MR, Factset*

### EXISTING HOME SALES, MILLION UNITS (ANNUALISED)




*Source: PWM - AA&MR, Factset*

### DEBT RATIOS (HOUSEHOLD, CORPORATE, GOVERNMENT), % OF GDP




*Source: PWM - AA&MR, Factset*

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