



# Economic Insights

SEB ECONOMIC RESEARCH

2004-09-24

## Bush or Kerry?

### The economic impact

---

- The economic programmes of the main candidates for president are vague in terms of details but reflect major ideological differences.
- John Kerry has a more ambitious programme for shrinking the federal budget deficit, but it is far from certain that it will be implemented.
- His protectionist statements are more a matter of rhetoric than practical politics.
- A victory by George W Bush would benefit the stock market in the short term, while a Kerry victory would benefit the bond market more.
- The US dollar would benefit in the short term if fiscal policy were tightened by a Kerry administration.

The outcome of the election is uncertain, and the candidates' economic programmes are full of question marks. Furthermore, the election may influence the allocation of power between the president and Congress in a way that will create obstacles to implementing the proposed policies. Yet there are reasons to try to analyse the differences between the candidates and predict the economic impact of their respective policies.

#### Congressional elections too

Not only the White House is at stake. The House of Representatives (all 435 seats) and the Senate (about one third of 100 seats) will

also face the voters. Today the Republicans enjoy a majority in both houses of Congress. It is unlikely they would lose their majority in both. **A Kerry victory would thus lead to "gridlock" between president and Congress.** This implies that a Kerry victory would lead to horse-trading, with an uncertain outcome.

During Bill Clinton's presidency, gridlock between a Democratic president and a Republican Congress paradoxically ended up helping to strengthen the federal budget; Congress blocked the president's expenditure hikes and the White House blocked Congress's tax cut proposals.

Today the situation is different, however, and **gridlock risks having a budget-weakening impact.** This time, Congress may conceivably block White House proposals to raise taxes, while the president may veto congressional plans for cutbacks in the public sector.

Things need not end up this badly; new compromises are likely to emerge along the way. But one should be aware that Kerry's programme in particular is likely to be modified on its way through Congress.

#### Ideological dividing lines

One cornerstone of President Bush's economic programme is "the ownership

society". This implies far-reaching tax cuts and market price formation in previously regulated and publicly financed sectors.

- Bush has stated that he wants to restructure the **Social Security retirement system** (from a pay-as-you-go system to one that is fully funded). He also wants to boost the level of deductibles in the **health insurance system**. However, moving to funded pensions will cost enormous sums for the generation that will have to pay both for its own pensions and those of another generation. Such a process will thus extend over many years. The president's focus on **low, uniform tax rates** and even greater individual responsibility is clear, however.
- Kerry – in contrast – advocates a **comprehensive publicly operated health insurance programme** that would also include the more than 40 million Americans who lack health coverage today. He also wants to reduce deductions and plug various loopholes in **corporate taxation** as well as raise taxes on high-income earners.

On the whole, there are clear ideological dividing lines between the two candidates, along a traditional left-right scale.

### Protectionism?

President Bush has flirted with protectionist sentiments during his first term of office (steel tariffs). But the risk of protectionism would be greater with Kerry/ Edwards in power.

However, on this point Kerry's programme appears to be more a matter of rhetoric than practical politics. He has proposed that companies wishing to outsource jobs abroad should report their plans to unions and local authorities. Meanwhile he has

expressed a desire to make tougher use of bilateral trade agreements. How much of this will become reality after a Kerry election victory also remains to be seen. My interpretation is that his proposals may complicate life somewhat for companies, but that **they hardly amount to any major realignment of American trade policy**.

### Fiscal policy challenges

Both candidates have expressed the ambition to halve the federal budget deficit within five years. Clearly, however, they do not believe they can win votes by presenting as distinct and credible a programme as possible. **Bush's programme is especially diffuse**. It is impossible to see how he can succeed if he sticks to both restructuring social insurance systems and making his recently enacted tax cuts permanent.

Kerry has a far more specific programme, based on both expenditure cuts and tax increases, but his promises about expanded health insurance make the task more difficult. The net cost of this reform is estimated at more than 650 billion dollars over a ten year period. The funding would come from **targeted tax hikes** of nearly USD 900 billion on high income-earners during the same period. In addition, **tougher corporate taxation** would generate another USD 500 billion plus. However, a number of American economists maintain that these calculations are pie-in-the-sky estimates.

Furthermore, Kerry would be forced to grapple with a Republican majority in Congress, which would try to block tax increases. In reality, Kerry's prospects for successfully restoring order to the federal budget are thus considerably weaker than on paper.

Despite all the vagueness and pie-in-the-sky estimates, it is still **likely that a certain tightening in budget policy will take place during 2005**. Historical experience

underscores this: All post-election years except 2001 (which was dominated by recession and terrorism) have resulted in greater fiscal policy austerity. According to IMF calculations, the average tightening in the year following an election has been equivalent to about 1 per cent of GDP.

Nevertheless, blockages related to both ideology and power politics – in Bush’s case the former, in Kerry’s the latter – will make the task more difficult this time. The conclusion is that the coming fiscal policy tightening will initially be modest, especially if Bush is re-elected.

#### **Consequences for financial markets**

Given all these uncertainties and caveats, some general conclusions emerge.

These are clearest at the sectoral level. The impact on business opportunities and share prices may be highly varied in different sectors, depending on the election outcome. A Bush victory will benefit the defence industry and the energy sector. A Kerry victory would benefit businesses engaged in environmental technology. One controversial issue is what Kerry’s health care programme would mean to the pharmaceutical industry; there is a high probability here that tougher price controls would lead to lower profit margins.

In more general terms, **a Bush victory would benefit the stock market in a short-term perspective, while a Kerry victory would be more advantageous to the fixed-income market.** This is because Kerry’s fiscal policy may lead to somewhat lower interest rates, while Bush’s free market programmes and tax cuts would benefit corporate sector profits to a larger extent. Should Kerry actually succeed in pushing through a major tax increase, this conclusion would become even clearer.

**In terms of economic growth, the conclusion is the same.** Bush may conceivably fuel economic expansion through low taxes - while Kerry’s tax hikes would presumably slow the economy. It is worth noting, however, that **the overall impact is also influenced by the Federal Reserve’s reaction.** A more expansive fiscal policy under Bush would probably trigger higher interest rates, all else being equal. A more contractive Kerry policy may cause the Fed to move more slowly in its rate hiking cycle. This would moderate the impact of fiscal policy.

It also makes the impact on the dollar more difficult to discern. At the margin, a degree of fiscal tightening should benefit the dollar. Thus, **a Kerry victory has the potential to strengthen the dollar** more than a Bush triumph.

But this is a partial analysis. We should also take into account two other factors mentioned above. Firstly, a victory for Kerry would also result in a political **tug-of-war with Congress** – which would create political risks. Secondly, if Kerry should nonetheless succeed in pushing through a tighter fiscal policy, this might lead to **lower interest rates.** Both these effects would **dampen the dollar-strengthening impact of tighter fiscal policy.**

Based on the current political situation and the existing election campaign programmes, it is difficult to foresee that the actual improvement in the federal budget could be so large as to solve American deficit problems (both in the budget and the current account) in a medium-term perspective. The pressure on the dollar will thus resume.

*Klas Eklund*  
[klas.eklund@seb.se](mailto:klas.eklund@seb.se)

**Economic Research:**

Klas Eklund, Chief Economist	+46 8 763 80 88	<a href="mailto:klas.eklund@seb.se">klas.eklund@seb.se</a>
Håkan Frisén, Head of Economic Research	80 67	<a href="mailto:hakan.frisen@seb.se">hakan.frisen@seb.se</a>
Bo Enegren, Economist	85 94	<a href="mailto:bo.enegren@seb.se">bo.enegren@seb.se</a>
Ann Enshagen Lavebrink, Research Assistant	80 77	<a href="mailto:ann.lavebrink@seb.se">ann.lavebrink@seb.se</a>
Ingela Georgii-Hemming, EU Coordinator	82 97	<a href="mailto:ingela.georgii-hemming@seb.se">ingela.georgii-hemming@seb.se</a>
Olle Holmgren, Economist	80 79	<a href="mailto:olle.holmgren@seb.se">olle.holmgren@seb.se</a>
Mikael Johansson, Economist	80 93	<a href="mailto:mikael.johansson@seb.se">mikael.johansson@seb.se</a>

The contents of this report have been based on information that the Bank deems reliable. However, the Bank provides no guarantee as to the completeness or accuracy of this information. Those who read the report are urged to base their investment decisions upon such investigations as they themselves deem necessary.