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Markus Jaeger

Foreign Economic and Macro Policies after the US Presidential Election

KEY MESSAGES

- **Foreign trade and macroeconomic policies under a Harris administration would largely provide for continuity with the Biden administration, while policies under another Trump administration would have the potential to be highly disruptive**
- **Regardless of who becomes the next president, US national-security-focused trade and investment policies will continue to be tightened in the context of US-Chinese strategic competition**
- **Trump trade policies could prove hugely destabilizing to international trade, severely strain US-EU trade relations, and lead to a full-blown trade war with China**
- **Fiscal policy will remain loose under both a Harris and a Trump administration, but the latter would also seek to pressure the Federal Reserve to pursue loose monetary and weak dollar policies**
- **The EU should ready its new geoeconomic instruments to deter US discriminatory measures, while signaling openness to negotiations about how best to defuse transatlantic economic conflict**

The US presidential elections on November 5 could lead to dramatic change in US economic policies. National-security-driven trade and investment restrictions targeting China will continue to be tightened, regardless of who is elected president. But policies under a Trump administration could prove highly disruptive to international trade and the global economy. A number of other radical proposals, including the taxation of capital inflows and the abolition of income taxes in favor of import tariffs, would face significant domestic political obstacles. By comparison, a Democratic administration under Kamala Harris would provide for relative continuity, but trade policy would continue to drift towards moderately greater protectionism.



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PRESIDENTIAL POWERS AND ECONOMIC POLICY

The US Constitution grants Congress the power to regulate inter-

national trade. But Congress has delegated important trade- and investment-related authority to the president. The president can invoke various trade, national security and emergency acts to take wide-ranging trade- and investment-related measures.

The US executive has wide-ranging powers to impose import restrictions on cross-border trade and investment flows, whether in the case of substantial threat to US industry, other countries engaging in discriminatory trade policies or violating existing trade agreements, or on the grounds of national security. By invoking substantial threats to national security, foreign policy, or the economy, the president can take all kinds of discriminatory trade- and investment-related measures, not just import-related ones. Whether across-the-board, indiscriminatory tariffs on imports, introduced under presidential emergency powers, would hold up if challenged in domestic courts or by Congress, and for how long, would remain to be seen.

In terms of macroeconomic policy, the Federal Reserve is responsible for monetary policy, while the Treasury, legally speaking, is in charge of international economic policy, including policies related to the dollar. In practice, however, the dollar exchange rate is determined by the markets. Fiscal policy is the prerogative of Congress and presidential influence is highly dependent on whether the president's party holds majorities in Congress.

To what extent a second Trump administration would ride roughshod over laws, rules, and precedent is impossible to say. The analysis that follows assumes that institutional (laws) and political (Congress) constraints will continue to matter and act as constraints on radical policy change.

A HARRIS ADMINISTRATION WOULD PROVIDE FOR RELATIVE CONTINUITY

Trade policy under Biden (2021–2025) was far less disruptive than under Trump (2017–2021). Biden was keen to neutralize long-standing transatlantic trade disputes, including the Trump-era steel and aluminum tariffs, the long-running Airbus-Boeing subsidy dispute, and disagreement over digital taxes, without solving them permanently.

Meanwhile, a revival of industrial policy, which comprised discriminatory subsidies, caused transatlantic trade friction. In addition to withdrawing its support for free cross-border data flows, the Biden administration did nothing to revitalize the World

Trade Organization (WTO) and it refrained from negotiating any new free trade agreements. The gradual drift towards greater trade protectionism would likely continue under a Harris administration. Trade policy would certainly not take a more liberal turn, given the limited domestic political and electoral incentives to do so. For all practical purposes, Congress would need to grant the president trade promotion authority. But regardless of which party wins the congressional elections, this is highly unlikely to happen.

With respect to trade policy vis-a-vis China, the Biden administration maintained the Trump tariffs and it imposed further, though more targeted, tariffs on less than USD 20 billion worth of Chinese steel and aluminum, electric vehicles, batteries, and semiconductor imports. In comparison, the Trump administration tariffs affected USD 380 billion worth of Chinese imports. Like his predecessor, Biden also tightened national-security-focused export control and inward investment restrictions targeting China and he introduced outbound investment controls, aimed at limiting China's access to US technology in the context of its "small yard, high fences" policy and US-Chinese strategic competition. These policies would continue under a Harris administration.

Under Biden, Congress passed a massive fiscal stimulus package (America Rescue Plan, 2021) worth almost USD 2 trillion to counter Covid-19. The administration also passed major investment programs, such as the Investment and Jobs Act, the CHIPS and Science Act, and the Inflation Reduction Act that helped support investment spending and economic growth. The major fiscal stimulus and continued large fiscal deficits, combined with post-pandemic supply side constraints, led to multi-decade high inflation and forced the Federal Reserve into significant monetary tightening. The combination of an expansionary fiscal and tight monetary policy translated into a strong dollar.

A Harris administration promises broad continuity in terms of macro policy. Harris has pledged to increase the corporate income tax from 21 percent to 28 percent and to provide financial support to homebuyers and families in the form of tax credits. More than a minor fiscal retrenchment would be unlikely, if any tightening is implemented at all, and fiscal deficits would remain high. Crucially, to what extent Democrats would be able to implement their agenda would depend on the outcome of the congressional elections, where the Democrats are likely to lose the Senate and may fail to recapture the House.

TRUMP 2.0 COULD PROVE HIGHLY DISRUPTIVE

As far as trade and investment restrictions related to national security and technology are concerned, the Trump and Harris administrations would be unlikely to differ much. A Trump administration may show less concern about getting allies on board (e.g., export

Table 1

Presidential Powers and Trade Policy

Legislation	President can:
Trade Expansion Act (1962) – Section 232	Impose tariffs based on a recommendation by the Department of Commerce if imports threaten or impair national security
Trade Act (1974) – Section 122	Impose quotas and tariffs for up to 150 days against countries that have large balance-of-payments surpluses with the US
Trade Act (1974) – Section 201	Impose temporary duties or other trade measures if the US International Trade Commission determines that imports cause threat or serious injury to US industry
Trade Act (1974) – Section 301	Impose trade sanctions if US rights under trade agreements are violated or if a country takes unreasonable, discriminatory action restricting US commerce
International Economic Emergency Powers Act (1977)	Block transactions and freeze or confiscate assets in case of threat to national security, foreign policy, or economy (among other things)
Foreign Investment Risk Review Modernization Act (2018)	Block foreign investment in US companies on national security grounds
Export Control Reform Act (2018)	Control exports, re-exports, and the transfer of items and restrict activities of US persons

Source: Author's compilation.

control policy). However, this difference would be more a difference in tone rather than substance, as the Biden administration nudged Dutch and Japanese companies to align with US export control policies targeting China, even if it did so somewhat politely and behind closed doors.

Harris and Trump policies are unlikely to differ much in terms of further restricting Chinese access to advanced, especially "emerging and foundational" technologies by leveraging, if necessary, the dependence of third countries on US technology (e.g., foreign direct product rule). US-Chinese strategic competition would largely shape the direction of both Harris and Trump geoeconomic policies, as it did under previous administrations.

RISK OF A HYPER-PROTECTIONIST TRADE POLICY

A Trump administration would risk being far more disruptive with regard to international trade. During his presidency, Trump imposed across-the-board tariffs on steel and aluminum, among other imports, and extensive tariffs on imports from China. His administration also used tariffs or the threat of tariffs to force allies to renegotiate trade agreements (NAFTA, KORUS) and it forced the EU to agree to start negotiations for a transatlantic trade agreement.

Trump has floated radical trade policy plans, including a 10 percent surcharge on all US imports. (This proposal is reminiscent of President Nixon's 1971 decision to force other countries to renegotiate their exchange rates following the closing of the gold window.) Trump also threatened to impose tariffs of 60 percent on all imports from China and wants to prohibit certain types of imports from China altogether (e.g., certain healthcare products).

If implemented, such restrictions would risk a major destabilization of the international trade regime. Restrictions might lead to tit-for-tat retaliation, and potentially trigger a full-blown trade war. It might also force countries to raise their tariffs on the world's largest exporter, China, as 60 percent US tariffs would lead Chinese exports to be diverted to third countries. In addition, transatlantic trade relations would come under renewed strain over long-standing trade disputes that were put on ice by the Biden administration (e.g., Airbus-Boeing, digital taxes, steel and aluminum tariffs and quotas) and over new disputes that are likely to arise over other issues (e.g., EU Carbon Border Adjustment Mechanism).

It is difficult to predict with much confidence what a second Trump administration would do, as it is unclear what the actual goal of US trade policy would be. Are tariffs meant to reduce US trade deficits, shelter selected sectors from foreign competition, force other countries to make asymmetrical trade concessions, reduce trade-related national security risks, or simply create political theater that appeals to the electoral base?

These objectives are of course not mutually exclusive. But understanding what the ultimate objective is would help predict how US trade policy might evolve after initial protectionist measures are imposed. Regardless, the immediate effect of implementing major tariffs would be an escalation of international trade conflict, lead to trade diversion, and weigh on economic growth and investor confidence. It would also prove inflationary and lead to relatively higher US and international interest rates, or at least keep them elevated for longer with negative implications for global growth, especially in capital-importing emerging and debt-challenged developing economies.

TAX ON CAPITAL INFLOWS IS UNLIKELY TO BE REALIZED

Among other radical proposals floating around the Trump orbit is a tax on foreign purchases of US assets. The rationale seems to be that such a tax would reduce foreign capital inflows, weaken the dollar, and

hence reduce the trade deficit. This logic is questionable, not least because the US trade deficit is largely a function of the economy's savings-investment imbalance. It is far from straightforward how much of an impact a weaker currency in what is effectively a very closed US economy would have on savings and investment and hence the trade and current account deficit, not least because other macroeconomic parameters would also be affected by a capital inflows tax. All other things equal, such a tax should make domestic investment more expensive. Whether it would actually lead to a narrowing of the savings-investment gap and an improvement in the current account balance would depend on how other economic parameters will change in response to such a measure. In the past, a weaker dollar has not necessarily led to a falling trade deficit, in part due to offsetting, loose domestic financial conditions. If the tax does lead to a decline in US investment, US economic growth will be negatively impacted. In addition to proving highly disruptive to the global economy. It might also weaken the dominant international role of the dollar. A proposal like this is unlikely to get approved by Congress, once US financial institutions and companies start mobilizing against it.

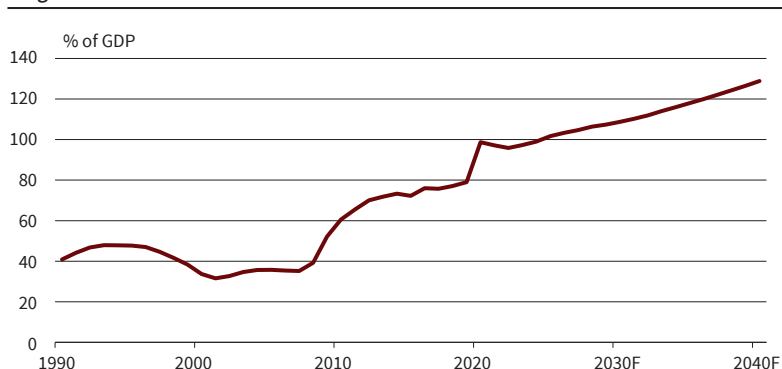
Under Biden, the US cooperated closely and largely smoothly with the EU on Russian sanctions policies. By comparison, the president's ability to ratchet up sanctions is very considerable, as it may seek to pressure Ukraine to negotiate an end to the war, while threatening to escalate support for Ukraine if Russia fails to come to the negotiating table. Although the bulk of Russia-related sanctions has been implemented via executive orders, which means that the president can simply revoke them, Congress has also passed sanctions legislation that makes it more difficult and even impossible for the president to abolish specific sanctions without congressional action. By contrast, the ability to ratchet up sanctions is considerable due to the International Emergency Economic Powers Act and the National Emergencies Act. With respect to US sanctions policy vis-à-vis Russia, a Trump victory would increase uncertainty.

A LOOSE FISCAL POLICY AND LARGE DEFICITS

The US has been running large deficits in recent years. Annual deficits are projected to average more than 6 percent of GDP for the 2024–2028 period. The International Monetary Fund (IMF) has called on the US to “urgently” address its large budget deficits. The Congressional Budget Office (CBO) projects federal debt to reach 122 percent of GDP in 2034, up from 97 percent of GDP last year.

Against this backdrop, Trump has promised to make permanent the tax reductions contained in the 2017 Tax Cuts and Jobs Act when the legislation expires in 2025. The CBO puts the additional costs of extending the 2017 tax cuts at USD 4–5 trillion over

Figure 1
Large Fiscal Deficits Will Lead to Further Increase of Federal Government Debt



Note: F = Forecast.
Source: Congressional Budget Office.

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the next decade, or around 10 percent of 2034 GDP. To what extent Trump will be able to make the tax cuts permanent will depend on whether Republicans end up controlling Congress. If they do not, Trump would be forced into negotiations with Democrats. Democrats would demand higher spending in exchange for agreeing to make some tax cuts permanent. Either way, the effect would be a larger budget deficit.

A significant deficit reduction is unlikely, regardless of the election outcome. Democrats dislike cutting expenditure and Republicans dislike increasing taxes. And even if the Republicans control Congress under a Republican president, it would remain to be seen how keen they would be to slash spending once they are in office. Discretionary non-defense spending accounts for only 3–4 percent of GDP and it will be difficult to reduce it substantially, while a reform of mandatory spending, mainly social security, will not find support in either party. US fiscal policies will remain relatively loose and the debt-to-GDP ratio will continue to increase.

One of the wonkier macro proposals floated by Trump concerns replacing federal income taxes with additional revenue raised from tariffs. Individual and corporate income taxes raised about USD 2.6 trillion in revenue last year, compared to the roughly USD 3 trillion raised on US imports of goods. To be deficit-neutral, such a measure would need to levy tariffs worth significantly more than 90 percent on imports, as higher tariffs would lead to a sharp fall in imports. The consequences for the US economy and the international trade regime would be severe. Like the equally wonky capital inflow tax proposal, this proposal is highly unlikely to get approved by Congress, even if the Republicans were to hold majorities in both houses.

RISKS TO INDEPENDENCE OF THE FEDERAL RESERVE

Radical ideas have also been floated in the Trump orbit regarding monetary and exchange-rate policy. Trump has raised the idea of reducing the Fed's independence presumably to allow for an easier monetary policy and a weaker dollar, possibly to offset likely dollar appreciation following the imposition of higher tariffs. This would lead to higher inflation and increased financial uncertainty.

However, a Trump administration would find it difficult to gain control of the Fed's interest rate policy. Legally and politically, it would be difficult to curtail the Fed's independence. While the president may be able to replace Jerome Powell as the chair of the Board of Governors, it would be next to impossible to remove him (and others) as members of the Board and hence as voting members of the Federal Open Market Committee (FOMC), which sets the Fed funds rate before their respective terms end. Moreover, the FOMC takes decisions by majority, and

besides the seven members of the Board of Governors and the New York Fed president, it consists of the eleven regional Reserve Bank presidents (four of which are FOMC voting members at any one time). The regional Reserve Bank presidents are not appointed by the president, though subject to approval by the Board of Governors. So, Trump would need to purge all or at least most of the members of the Board of Governors and replace them with loyalists. But, as happened during the first Trump administration, the Senate would balk at confirming highly economically unorthodox Fed appointees that would weaken the Fed's commitment to monetary stability. Finally, only two Board members will see their terms expire before the end of 2028, further limiting the degree to which Trump would be able to stack the FOMC with loyalists and doves during the next presidential term. For the Fed to lose its independence, Congress would need to pass legislation, which is highly unlikely, not least because even if Republicans were supportive of such reform, they would need to overcome a Democratic filibuster in the Senate.

Verbal attacks on the Federal Reserve to pursue an expansionary monetary policy and a weaker currency are likely but would not fundamentally put at risk the Fed's independence and commitment to price stability. A possible legal wild card might be whether the Trump administration could exploit the fact that legally speaking, the Treasury is in charge of international economic policy, including policies related to the dollar. But without the Treasury also gaining control of interest rates, its ability to set exchange-rate targets would be practically irrelevant.

POLICY CONCLUSION: EU SHOULD PREPARE FOR POST-ELECTION UNCERTAINTY

The election of Kamala Harris would lead to relative continuity of economic policy. The US would continue to become more protectionist and impose further trade and financial restrictions targeting China. Fiscal deficits would remain high, but the Fed would be left to get on with its job of maintaining low inflation.

Fiscal policy will remain loose under both Harris and Trump, though the latter's tax-cutting plans would translate into an even looser policy, not least because the Republicans, assuming they end up in control of Congress, will not be keen to substantially reduce federal spending, their rhetoric when a Democrat occupies the White House notwithstanding. Democrats, should they unexpectedly end up controlling Congress, would be amenable to raising taxes on corporations and high-income earners, but would also increase spending. Budget deficits will remain high in virtually all scenarios. All other things being equal, inflation and interest rates would be higher under Trump due to a looser fiscal policy and higher tariffs as well as lower immigration – and perhaps even “net negative” immigration, should Trump be able to make

good on promises not to just curtail immigration but also to deport illegal immigrants.

The trade policy envisioned by Trump would be very disruptive to international trade. In addition to direct, potentially tit-for-tat retaliation in response to 10 percent US import surcharges, a 60 percent across-the-board tariff on American imports from China would lead Chinese exports to be diverted to third countries, which would then have little choice but to impose tariffs on Chinese goods. China would not take this lying down and would feel compelled to retaliate, which would likely lead to at least US counter-retaliation. The risk of a broader trade war would then become a distinct possibility.

Given the uncertainty about what the Trump administration actually wants to achieve with its trade policy, it is difficult to predict how trade conflict would play out after an initial round of tit-for-tat retaliation. Increasing US protectionism would prove hugely disruptive and would add to the increasing trade and investment restrictions and geoeconomic fragmentation that have characterized the global economy in the past few years against the backdrop of intensifying geopolitical competition.

The EU should prepare for a worst-case scenario by readying its geoeconomic toolbox, including its anti-coercion instrument. It should also engage with likely appointees, senior advisors, and members of Congress on either side of the aisle to signal the EU's ability and willingness to deter and, if necessary, retaliate against discriminatory US policies and spell out the potential economic costs of a broader transatlantic trade conflict. But it should also attempt to understand what the ultimate goal of US trade policy is – especially under a Trump administration – so as to evaluate where there may be room for compromise. In the meantime, the EU should urgently accelerate efforts to enhance its economic security through export diversification, the reduction of import-related vulnerabilities, the promotion of the international role of the euro and, last but not least, efforts to increase euro area macroeconomic stability to be able to deal with policy-induced increasing international economic and financial instability and uncertainty. Enhancing economic security is highly desirable, regardless of who wins the US elections.

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