

ElectionWatch

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Chief Investment Office GWM
Investment Research

Looking ahead to the 2020 US elections



2020 election
coverage online

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2020 US elections.



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Trade off

Many readers will be familiar with the maxim that politicians “campaign in poetry and govern in prose.” We may yet see some alluring verse from the Democratic challengers, but their speeches and debate performances to date have been decidedly mundane. The extraordinary number of candidates seeking the nomination may be one reason for the inability of a single candidate to set him- or herself apart from the larger group.

The underlying theme of these early debates is a fight for the heart and soul of the Democratic Party.

There is an increasingly noisy debate within the Democratic Party over what type of candidate would have the best chance to beat Donald Trump. Moderates favor a deliberate approach that focuses on economic opportunity, infrastructure investment, and incremental improvements to the social safety net. More progressive party activists argue that this approach beckons defeat at the polls next

year by alienating younger voters. They call for universal access to health care, a reduction in income inequality, and bold action on climate change.

While political pundits are apt to focus on who manages to deliver the best sound bite or get the biggest headline with a well-placed jibe, the underlying theme of these early debates is a fight for the heart and soul of the Democratic Party. Former Vice President Joe Biden is the standard bearer for the more pragmatic wing of the party, but he has been forced to tack left to protect his liberal flank from more progressive challengers.

Meanwhile, President Trump has adopted a dual strategy of motivating his political base to turn out at the polls in 2020 while sowing discord among his Democratic opponents. His ability to do the latter as we get closer to next year’s election will depend upon whether Democrats are able to nominate a candidate who can unify party regulars before exercising some poetic license on the campaign trail.

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Takeaways from the Democratic debates

Contenders for the Democratic nomination for president of the United States convened in Detroit this week for two lengthy debates on a wide array of subjects. The philosophical division within the party was immediately evident on both evenings. Candidates aligned with the progressive wing of the party unabashedly called for higher taxes on affluent Americans, universal single-payer healthcare in lieu of private insurance, and aggressive action on climate change. Others on stage opted to stake out more moderate positions, focusing instead on education, infrastructure investment, and job creation.

This week's debates exposed a deep fissure within the Democratic party, but it is worth noting that Americans are also divided on the subject of healthcare. In a recent survey conducted by the Pew Research Center, 53% of the respondents say it's the responsibility of the federal government to provide universal coverage. However, another 44% disagreed with the premise. And even among Democrats and those who lean Democratic, only 44% support a single-payer system. Another 34% prefer a

combination of public and private options.¹ So in that context, it's not that surprising that the party's potential nominees are not aligned on the subject.

The debate moderators relished the opportunity to highlight the candidates disparate policy prescriptions, often asking one individual to explain his or her criticism of another's signature proposal. The approach was arguably more effective on the second night, when the decorum exhibited on the first evening dissipated in the withering criticism leveled at Former Vice President Joe Biden by some of the challengers. Biden's performance in this week's debate was stronger than a month ago, but he may not have gained much ground on other candidates.

The next debates are scheduled for 12-13 September in Houston and the thresholds for participation will be higher. Candidates will have to collect 130,000 unique donations and receive at least 2% support in four qualifying polls. Eight candidates have already qualified but the number of participants will certainly be reduced.

Democratic presidential candidates who participated in the second debates

Candidates on stage on night one, 30 July (left); candidates on stage on night two, 31 July (right)



Note: Mike Gravel, Wayne Messam, Seth Moulton, Joe Sestak, and Tom Steyer did not meet the minimum criteria set forth by the Democratic National Committee for participation in the debates and therefore did not appear.
 Photos: John Shearer / Contributor, Getty Images (Bill de Blasio); Alexander Tamargo / Contributor, Getty Images (Pete Buttigieg); David Livingston / Contributor, Getty Images (Marianne Williamson); JOSHUA LOTT / Contributor, Getty Images (Andrew Yang); Wikipedia (all other candidates)

¹Amina Dunn, "Democrats differ over best way to provide health coverage for all Americans", Pew Research Center, 26 July 2019.

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The dog that didn't bark in the night

Gregory: "Is there any other point to which you would wish to draw my attention?"
Holmes: To the curious incident of the dog in the night-time.
Gregory: The dog did nothing in the night-time.
Holmes: That was the curious incident."

The Adventure of Silver Blaze, Sir Arthur Conan Doyle (1859-1930)

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The topics of international trade and commerce thus far have received remarkably little attention from the field of Democratic presidential candidates, despite their importance to the US economy and their geopolitical implications. While this week's debates touched on the topic, most candidates have refrained from advocating for policies that would promote free trade. There is a reason for that, but first let us set up our point with some crime fiction.

Sir Arthur Conan Doyle wrote more than 50 short stories featuring his protagonist, Sherlock Holmes. *The Adventure of Silver Blaze*, a mystery about a missing racehorse, was among his most popular. The detective identifies the culprit in the murder of the horse's trainer by observing that a dog in the stable never barked at the intruder.

Sometimes, as Conan Doyle's short story suggests, the absence of something can be just as revealing as its presence. So let's apply this Holmesian deduction to trade and this election season so far.

The absence of a more robust discussion on trade—at least thus far—is revealing and attributable to the fact that most of the Democratic field is more or less aligned with the general thrust of the current administration's trade policies.

Only three candidates discussed trade during the initial set of debates in June. The topic was given more airtime during the second set of debates, but most of the candidates appeared reluctant to categorically oppose the use of tariffs on imported goods from China, choosing instead to criticize the manner in which the Trump administration conducts its trade negotiations.

The absence of a more robust discussion on trade—at least thus far—is revealing and attributable to the fact that most of the Democratic field is more or less aligned with the general thrust of the current administration's trade policies. Former Vice President Joe Biden was instrumental in promoting the Trans-Pacific Partnership (TPP) but now promises to renegotiate the agreement. His reluctance to discuss trade on the campaign trail may stem from President Trump's success in criticizing the 2016 agreement. The president's overt antagonism to the North American Free Trade Agreement (NAFTA) and the TPP during the last campaign probably played a part in convincing some traditional Democratic voters in the Midwest to cross party lines on Election Day.

Senators Elizabeth Warren and Bernie Sanders also applauded President Trump's decision in 2017 to withdraw from the TPP, a sentiment that is largely shared throughout the Democratic field. When 23 Democratic candidates were asked earlier this year by *The Atlantic* magazine whether they would restart negotiations on a multilateral trade agreement, only former Rep. John Delaney affirmed his intention to do so.² And it's probably worth noting that Delaney's campaign has failed to gain any traction with the Democratic base.

Seven years ago, when Mitt Romney opposed Barack Obama for the presidency, his platform rested on a traditional GOP foundation built on conservative social values, fiscal restraint, and a muscular foreign policy. He never abandoned the concept of free trade during the campaign, opting instead to focus on China's purported currency manipulation. Mitt Romney lost the election. Donald Trump's subsequent campaign for the presidency upended Republican orthodoxy in more ways than one, but his opposition to multilateral trade agreements was among the most prominent. And he won.

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²Edward-Isaac Dovere, Madeline Carlisle, and Olivia Paschal, "Joe Biden Won't Say If He Backs the Trade Deal He Helped Sell", *The Atlantic*, 26 June 2019.

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Tariffs escalate

It didn't take long for the new administration to leverage the US position as the world's biggest consumer. The president approved tariffs on washing machines and solar panels in January 2018 under a statute that allows a president to impose tariffs when the US International Trade Commission (ITC) determines that increased imports are a "substantial cause of serious injury to domestic producers."³

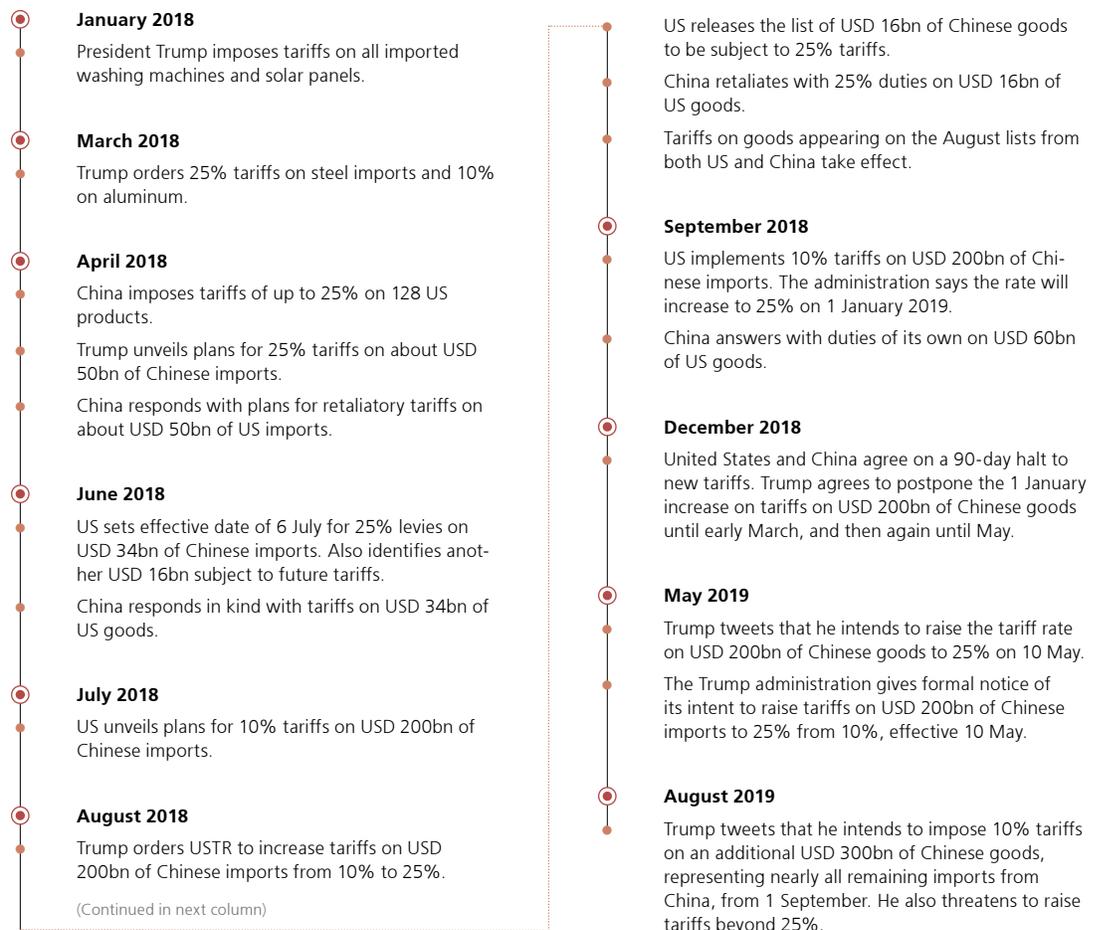
The administration's use of protectionist trade policies as a core component of foreign policy was another new development, or at least one that

harkened back to the Cold War. The president announced the imposition of a 25% tariff on steel imports and a 10% tariff on aluminum imports in March 2018, citing national security concerns.

The tariff trifecta was completed a month later when the US Trade Representative published a proposed list of products imported from the Peoples Republic of China (PRC) that would be subject to additional tariffs.⁴ Subsequent negotiations with China collapsed, leading to an escalation in the dispute and broad tariffs on both sides.

Tariff timeline

Major trade actions under the Trump administration



³Executive Office of the President, "Section 201 Cases: Imported Large Residential Washing Machines and Imported Solar Cells and Modules", 22 January 2018.

⁴Office of the United States Trade Representative, "USTR Releases Proposed Tariff List on Chinese Products", 3 April 2018.

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Expected impact

The Trump administration has transformed the narrow and exceptional remedies found in federal statutes into an oft-used tool to protect domestic industry and execute foreign policy.⁵ The results have been mixed. While the threat of new tariffs may have convinced the Mexican government to strengthen its southern border, the PRC has only recently returned to the negotiating table. The Chinese leadership's willingness to negotiate will be tested by the president's decision yesterday to impose a new 10% tariff on an additional USD 300bn of goods produced in the PRC.

The imposition of tariffs has raised household operating costs, wreaked havoc on global supply chains, and reduced the pace of US economic growth, even without considering the impact of retaliatory tariffs on US exports. The economic impact was estimated in a recent paper published jointly by the New York Federal Reserve Bank and the National Bureau of Economic Research. The authors concluded that the cost of the tariffs imposed in 2018 was passed through to US consumers in the form of higher prices. The New York Fed estimates the cost to the average US household at USD 419.⁶ US manufacturers have taken advantage of the tariffs, which protect them from foreign competition, to raise prices.⁷

These results are not altogether surprising as mainstream macroeconomics has consistently concluded that tariffs are a tax on consumption. While a combination of tax cuts and government spending boosted growth in 2018, the fiscal stimulus has begun to fade. As we have discussed in recent reports, the rate of US economic growth is slowing toward 2%, and business investment has been relatively soft amid the uncertainty created by the trade disputes.⁸ Fed Chair Jay Powell's recent assertion that the US central bank would "act as appropriate to sustain the expansion" in the face of global uncertainties may have been prompted by concern over weakening global growth rates.⁹

The US seeks greater access to Chinese markets as well as detailed and unambiguous written commitments from China to protect intellectual property. The administration is wagering that the economic pressure exerted on the PRC as a result of its greater reliance on external trade will force

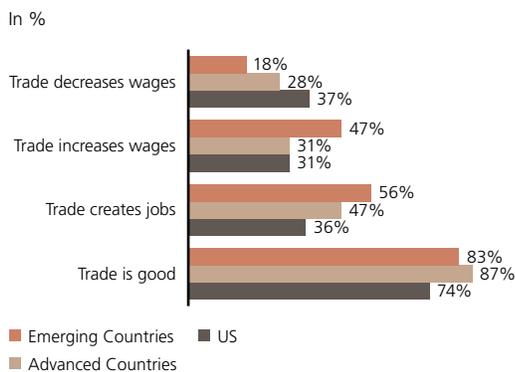
the Chinese leadership to strike a deal before the next US election. President Xi's inclination to do so is unclear at the moment, as is the willingness of other Chinese political institutions to make concessions. In the meantime, China has reduced its duties on imports from US competitors, including Germany, Japan, and Canada.¹⁰

Looking ahead

There is a striking paradox in the way that citizens of advanced economies view global trade. On the one hand, they generally agree that international trade is good for their respective countries. According to a recent study by the Pew Research Center, 74% of Americans (and 87% of citizens from across a variety of advanced economies) agree with that sentiment. However, when asked whether trade creates jobs, only 36% of US respondents agreed with the premise. And even fewer, just 31%, believe that trade increases wages.¹¹

President Trump's use of tariffs to restrict access to the US market poses a challenge to faster US economic growth. But here again, he appears to have tapped into a deep well of skepticism among voters regarding the impact of free trade on their own well-being. While tariffs may have already increased the cost to US households, voters may not react as negatively to their imposition as one might expect.

Globally, citizens back trade in principle, but many question its benefits



Source: Pew Research Center, UBS, as of 23 July 2019

⁵Simon Lester and Huan Zhu, "Closing Pandora's Box", Cato Institute, No 874, 25 June 2019.

⁶Mary Amiti, Stephen J. Redding, and David E. Weinstein, "New China Tariffs Increase Costs to US Households", 23 May 2019.

⁷Mary Amiti, Stephen J. Redding, and David E. Weinstein, "New China Tariffs Increase Costs to US Households", 23 May 2019.

⁸Brian Rose, Bull Market Monitor, UBS, 19 July 2019.

⁹James Politi, "Jay Powell links Federal Reserve's dovish tilt to global factors", *Financial Times*, 16 July 2019.

¹⁰Chad Bown, Euijin Jung, Eva Zhang, "Trump has Gotten China to Lower Its Tariffs, Just Toward Everyone Else", Peterson Institute for International Economics, 12 June 2019.

¹¹Bruce Stokes, "Americans, Like Many in Other Advanced Economies, Not Convinced of Trade's Benefits", Pew Research Center, 26 September 2018.

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Political calculus

The Democratic candidates are keenly aware of the mixed feelings that global trade generates in the American heartland and in particular among voters in pivotal Midwestern states. We are inclined to believe that the challengers will continue to focus on the abrupt manner in which the president has imposed the tariffs, rather than the substance of the policy. We expect some of the Democratic contenders to criticize the president's preference for unilateral action on trade, often through tweets, in lieu of any overt support for free trade. Of course, that approach could change if the US economy slows appreciably in the months ahead. But for now, this is an area that the Democratic field has largely ceded to the incumbent. The absence of a robust discussion of trade and tariffs thus far in the campaign may well be, to quote Holmes, "the dog that didn't bark in the night."

Absent an economic incentive stemming from a slowing economy, the politics of the moment suggest that the president's hard stance on trade is still resonating with voters and posing a conundrum for his Democratic opponents.

America's two political parties are now more aligned on the issue of global trade than is widely appreciated. President Trump often focuses on fairness and a preference for bilateral negotiations. His Democratic opponents, meanwhile, are apt to emphasize the importance of demanding higher wages and improved working conditions overseas. Senator Elizabeth Warren released a draft of her own proposed trade policy on Monday, 29 July. Entitled "Trade—on our terms", she favors the imposition of stringent new criteria on America's trading partners prior to the execution of any new trade agreement. We believe the plan, however well intentioned, would make the execution of new trade agreements more challenging. Both parties are now more skeptical of treaties that might jeopardize American jobs. The dynamic is relatively new, which suggests that our trading partners may not find themselves in a better position even if there were a change in control of the White House in 2020.

We believe President Trump would welcome the opportunity to execute a trade pact prior to the next election. A US delegation left for Shanghai earlier this week for face-to-face meetings with their Chinese counterparts. While this suggests that a comprehensive settlement remains possible, the current administration is sending mixed signals regarding the significance of the trip. Absent an economic incentive stemming from a slowing economy, the politics of the moment suggest that the president's hard stance on trade is still resonating with voters and posing a conundrum for his Democratic opponents.

Impact of further tariffs on China

Probability	It appears highly likely that tariffs will be placed on an additional USD 300bn of Chinese goods, representing nearly all remaining imports from China, from 1 September.
Macroeconomic	The goods chosen for previous tariffs were selected to minimize the economic impact. Further escalation could take 1% off of US GDP growth and raise recession risks.
Markets and investments	Additional tariffs would have a negative impact on corporate profits and global equity markets, while government bonds could benefit.
Taxes and wealth management	Tariff revenue has increased markedly but this has a relatively minor impact on the overall budget deficit.
Business owners, executives, and entrepreneurs	Trade disputes add uncertainty, making it more difficult for business owners to commit to new investment projects.
Private citizens/consumers	Another round of tariffs would hit mostly consumer goods, and price increases would be more noticeable when consumers go shopping.

Source: UBS

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Timeline of key events

2019

26-27 June	First Democratic debates (Miami)	TBD October	Fourth Democratic debates
30-31 July	Second Democratic debates (Detroit)	TBD November	Fifth Democratic debates
12-13 September	Third Democratic debates (Houston)	TBD December	Sixth Democratic debates

2020

TBD January/February	Seventh, eighth, ninth, and tenth Democratic debates	4 April	Alaska, Hawaii, and Louisiana primaries (Democratic)
3 February	Iowa caucuses (Democratic and Republican)	7 April	Wisconsin primaries (Democratic and Republican)
11 February	New Hampshire primaries (Democratic and Republican)	28 April	Connecticut, Delaware, Maryland, New York, Pennsylvania, and Rhode Island primaries (Democratic and Republican)
22 February	Nevada caucus (Democratic)	2 May	Kansas primary (Democratic)
29 February	South Carolina primary (Democratic)	5 May	Indiana primaries (Democratic and Republican)
TBD March	Eleventh Democratic debates	12 May	Nebraska and West Virginia primaries (Democratic and Republican)
TBD March	Wyoming caucus (Democratic); Colorado caucus (Republican)	19 May	Kentucky and Oregon primaries (Democratic and Republican)
3 March	Super Tuesday (Alabama, Arkansas, California, Colorado, Maine, Massachusetts, Minnesota, North Carolina, Oklahoma, Tennessee, Texas, Utah, Vermont, and Virginia primaries [Democratic and Republican]; Democrats Abroad preference vote through 10 March)	2 June	Montana, New Jersey, New Mexico, and South Dakota primaries (Democratic and Republican)
8 March	Puerto Rico primary (Republican)	7 June	Puerto Rico primary (Democratic)
10 March	Hawaii caucus (Republican); Idaho, Michigan, Mississippi, Missouri, Ohio, and Washington primaries (Democratic and Republican); North Dakota firehouse caucus/primary (Democratic)	16 June	District of Columbia primary (Democratic)
17 March	Arizona, Florida, and Illinois primaries (Democratic and Republican)	13-16 July	2020 Democratic National Convention (Milwaukee, Wisconsin)
24 March	Georgia primaries (Democratic and Republican)	24-27 August	2020 Republican National Convention (Charlotte, North Carolina)
TBD April	Twelfth and final Democratic debates	TBD September	Presidential debates
		TBD October	Presidential debates
		3 November	Election Day

2021

5 January	Electoral votes formally counted before a joint session of Congress; the President of the Senate formally announces the electoral result	20 January	Inauguration Day
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Source: UBS

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A brief history of tariffs in the US

A tariff, also called a customs duty or an import duty, is a variable tax levied by a government on the value of an imported product. Tariffs increase the cost of imported items for consumers, thereby making them more expensive and less competitive with domestically produced goods. The Tariff Act of 1789 was among the first acts of Congress of the newly reconstituted federal government. Alexander Hamilton, America's first Treasury Secretary, was among the Act's prominent proponents. Hamilton believed that import duties were a necessary bulwark to protect domestic manufacturers from foreign competition.¹²

Today, tariffs generate less than 3% of US federal revenue.

The application of tariffs was an important source of federal revenue for most of the nineteenth century. The rate was adjusted regularly to protect nascent domestic industries and to generate revenue for the federal government. For the period 1820 through 1862, customs duties generated more than 85% of aggregate federal government revenue.¹³ The imposition of tariffs also often led to significant regional animosity. For example, the Tariff of 1828 was enacted to protect Northern

and Western agricultural products from foreign competition. Unfortunately, it also raised the cost of living for residents of Southern states, who were more reliant on imported goods from abroad. Critics, including Senator John C. Calhoun of South Carolina, dubbed it the Tariff of Abominations.

Customs duties remained relatively high through the first three decades of the twentieth century and may have contributed to the severity of the Great Depression as retaliatory tariffs imposed by other governments led to an abrupt decline in global trade. The use of tariffs declined precipitously after World War II, as reconstruction of a war-ravaged Europe took precedence over the protection of domestic industry. Equally important, the federal income tax had already supplanted tariffs as a much more important source of federal revenue.

Today, tariffs generate less than 3% of US federal revenue. The importer of record (who may be the buyer, an importer, or a licensed broker) must pay the duty on items subject to the tax before they can be removed from the US port of entry. Civil, and sometimes criminal, penalties are assessed for violations. US Customs and Border Protection enforces the law.

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¹²Tyler Halloran, "A Brief History of Tariffs in the United States and the Dangers of their Use Today", Fordham Journal of Corporate Finance and Law, 17 March 2019.

¹³Congressional Research Service, US Federal Government Revenues: 1790-Present, 25 September 2006.

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