

GEOPOLITICAL RISK COMMENTARY: U.S. Elections Debrief

DECEMBER 2020

Author: Erik Brown, *Research Analyst, Global Risk Institute*



INTRODUCTION

At first glance, the 2020 United States election seems to offer a mixed bag of signals to Canadian financial institutions. Yet one can make some coherent observations about the result. U.S. President-elect Biden's solid margin of victory marks a clear rejection of President Donald Trump, while the prospect of a divided Congress threatens legislative gridlock, and highlights the Democrats' failure to resonate with voters further down the ballot. This commentary offers some initial thoughts on the election returns and their consequences for political uncertainty. It then reflects on the specific implications of the "Biden Minus Blue Wave" scenario for Canadian financial institutions, as manifest in American domestic policy, U.S.-Canada relations, U.S.-China relations, and the larger U.S. global role.

OBSERVATIONS ON THE ELECTION RESULT

With the tabulation of mail-in and absentee ballots, President-elect Joe Biden managed to win clear majorities in both the popular and electoral college votes. Biden's victory does mark a repudiation of President Trump and heralds a return to more political convention in the White House. Yet the prevailing narrative emphasizes that Trump, and the Republican Party down-ballot, overperformed relative to pre-election forecasts. The incumbent proved highly competitive in states where the polls had given Biden significant leads. Preliminary evidence shows that Trump even gained support among minority voters.¹ For many observers, this unexpected turnout for the Republican Party demonstrates how the allure of populist nationalism will linger beyond the current administration. It also suggests that many underestimated Trump's cross-demographic

appeal. For financial institutions, the surprisingly close results underscore the limits of pre-election analysis as a predictive measure.

Inversely, the results on Capitol Hill do provide some clarity given that bipartisan (and intraparty) divisions may well preclude Biden's bolder election proposals. The Democratic Party underperformed expectations of a "Blue Wave" in the Congress. Its margin of seats shrank in the House of Representatives, and thus far, it has failed to win a majority in the Senate. The Democrats' lacklustre performance at both levels has accentuated internal divides. In the House, centrists are now blaming progressives for alienating voters in key swing districts.² This ideological tension shows little sign of abating and may act as a political constraint on Democrats in the new session.

In the Senate, governing control remains contested at the time of publication. Republicans have secured 50 seats to the Democrats' 48, but there are still two run-off elections scheduled for early January to determine the winners in Georgia. As per analysis from *The Cook Political Report*, the Democrats have a narrow path to secure 50 total seats, and the thinnest of Senate majorities,* if they can overcome the likely Republican advantage to win both of the Georgia run-offs.³ Yet even a Republican minority could use the filibuster to gridlock progressive bills, and the Democrats could lack the internal party support to amend the Senate's procedural rules and avert this obstructionism.⁴ Thus, regardless of which party clinches the upper house, the bandwidth for major legislation will be limited.

* As Vice-President of the United States and President of the Senate, Kamala Harris will cast the tie-breaking vote in the case of a 50-50 split.

BIDEN MINUS BLUE WAVE: IMPLICATIONS FOR CANADIAN FINANCIAL INSTITUTIONS

A Biden Administration, constrained by a divided Congress, poses risks and opportunities for Canada and Canadian financial institutions. Partisan divides are likely to mire significant legislative reforms, while issues of Democratic and Republican alignment on China and economic protectionism could put pressure on Canadian policymakers and businesses. Yet Biden's style and outlook as a politician bode well for cooperation on shared geopolitical challenges and for the mediation of bilateral disputes.

U.S. Domestic Policy

As other commentators have observed, a Republican-controlled Senate could significantly curtail legislative action in the first two years of the Biden Administration. The President-elect's ambitious plans for income, corporate and capital gains tax increases, climate policy, green infrastructure, and healthcare reform, among others, will all face stiff opposition from a slim Republican majority. Senate Republicans might block the appointment of any cabinet nominees from the progressive wing of the Democratic Party. And a divided Congress could delay and/or restrict the scale of further economic stimulus.⁵ Even in the case that Democrats eke out marginal control of the Senate, their freedom to maneuver could remain heavily constrained. As noted previously, a sizable Republican minority may use its filibuster power to stall procedure on contentious bills and Democrats would be hard pressed to overcome it. Biden could wield executive powers to push through various changes without Congress, including to financial regulation and oversight.⁶ Yet significant economic reforms that materially affect business conditions are less likely in the immediate future, a point of some certainty for Canadian financial institutions.⁷

If the gulf between the Biden Administration and Senate Republicans constrains the fiscal response to the pandemic, it could put more pressure on monetary policymakers to cover the shortfall.⁸ Since the crisis began, the Federal Reserve has cut rates to the lower bound and launched

a massive Quantitative Easing program. Without new fiscal stimulus, the central bank could find itself resorting to even more severe alternatives like equity purchases or negative interest rates. Mohamed El-Erian suggests that the benefits of these new unconventional monetary policies are unlikely to outweigh their costs, including to financial stability.⁹ Their distributional consequences might also serve to unduly politicize the Fed at the expense of its operational independence. Both of these outcomes could pose market and systemic risks to Canadian investors.

U.S.-Canada Relations

Relations between the United States and Canada centred on trade policy in President Trump's first term. The Canada-United States-Mexico Agreement (CUSMA) lowered economic uncertainty in both countries, and its ratification by the Democrat-controlled House of Representatives signaled a measure of bipartisan consensus around the new trade equilibrium in North America. Yet by no means did the agreement settle all U.S. grievances or prevent future reprisals.

President-elect Joe Biden's hardening views on globalization may not bode well for bilateral trade under his presidency. In a pre-election essay for *Foreign Affairs*, Biden echoed Trumpian themes, arguing that "Economic security is national security."¹⁰ His platform stated that "The goal of every decision about trade must be to build the American middle class, create jobs, raise wages, and strengthen communities."¹¹ It also proposed "Buy America" provisions that would prioritize domestic sources in government procurement, and strategic reshoring of critical production in response to vulnerabilities exposed by COVID-19. Republicans across the aisle share in this conviction, with prominent senators like Marco Rubio and Josh Hawley voicing their support for greater economic protectionism post-pandemic.¹² The Biden platform does favour more cooperation with allies to reduce their dependence on China and build mutual supply chain resiliency. Nevertheless, the former ambassador to Washington, David MacNaughton, reportedly foresees little change for Canada between the trade policies of the outgoing and incoming administrations.¹³

Bilateral tensions over other issues like climate change might even increase with Biden in the White House. During the campaign, the President-elect pledged to cancel the Keystone XL pipeline project, and his platform proposed an “adjustment fee” to be levied on carbon-intensive imports from countries that fall short of “their climate and environmental obligations.”¹⁴ Opposition from Senate Republicans on climate policy would not prevent the White House from taking action in both these cases. The pipeline approval can be repealed through executive order, while the President-elect could impose carbon levies unilaterally on national security grounds¹⁵ (the Biden platform framed climate change in these terms).

Personal diplomacy may help to moderate frictions over policy. Biden has offered, at least rhetorically, a more positive assessment of Canada than his opponent. During an official visit to Ottawa in 2016, the then Vice-President described the bilateral relationship “more like family, even than allies,” and hinted at his affection for and confidence in Prime Minister Trudeau.¹⁶ If at a minimum, these sentiments reflected in the *tactics* of a Biden Administration, they could mitigate political uncertainty. Policy differences between the two governments might not change substantively, but the bandwidth for negotiation and compromise could sufficiently improve to preclude unilateral trade actions, benefitting financial institutions on both sides of the border.

U.S.-China Relations

China was a defining issue for the Trump Administration. Over the past four years, the U.S. has adjusted to an era of “strategic competition” with Beijing. Bilateral tensions will likely continue under the Biden Administration. In *Foreign Affairs*, the President-elect identified China as a “special challenge” for the United States, and called on the U.S. to lead a coalition of democracies that can confront Beijing and shape global rules in line with their shared values and interests. Yet Biden also recognized that the U.S. and its partners must cooperate with China on shared problems like climate change and global health.¹⁷ He has condemned Trump’s punitive tariffs on Chinese imports, although domestic political pressures could preclude their repeal for some time after his inauguration.¹⁸

In the legislature, Democrats and Republicans largely agree on a more assertive U.S. response to Beijing.¹⁹ Differences between the two parties increasingly centre on questions of execution rather than intent, with Democrats preferring a multilateralist approach to Trump’s unilateralism.²⁰ This directional alignment could still yield a consistently hardline posture in a divided Congress.

Thus, the election result may not substantially reduce the collateral damage that Canada faces in the shadow of the U.S-China rivalry. Compared to Trump’s “go-it-alone” approach, however, Biden’s appeal to allies could provide Canada with a window to seek more active U.S. support in resolving its own diplomatic tensions with Beijing. Furthermore, if the U.S., Canada, the European Union, Japan and other countries find greater alignment on their shared grievances, they could encourage more substantial economic reforms in China that benefit foreign investors.

U.S. Role in the World

The executive branch retains significant autonomy over international relations, and so the new administration could take meaningful steps to reaffirm a larger U.S. global role in spite of Republican opposition. President-elect Joe Biden has an extensive record on foreign policy, both as Vice-President and a former Chair of the Senate Foreign Relations Committee. In both spirit and substance, he maintains a firm commitment to multilateral cooperation. Biden promised to “take immediate steps to renew U.S. democracy and alliances, protect the United States’ economic future, and once more have America lead the world.” His resolve could help to improve collective responses to borderless risks. The President-elect also vowed to re-enter the Paris Climate Agreement and the Iranian Nuclear Deal, subject to Tehran’s compliance.²¹ But if his more protectionist take on trade policy offers any indication, Biden is not poised to simply accept the old status quo without exception. Furthermore, the United States does not have the capacity or the opportunity to regain the kind of leadership role it once held as the “indispensable nation.” And Trump’s sizable share of the popular vote hints that a large proportion of Americans remain wary of overseas commitments and are favourable to a more self-interested foreign policy approach.

Given Biden’s reputation, he may re-introduce a degree of consistency and predictability in Washington that helps to moderate geopolitical risks, and in turn, limit related market volatility.

© 2020 Global Risk Institute in Financial Services (GRI). This “Geopolitical Risk Commentary: U.S. Elections Debrief” is a publication of GRI and is available at www.globalriskinstitute.org. Permission is hereby granted to reprint the “Geopolitical Risk Commentary: U.S. Elections Debrief” on the following conditions: the content is not altered or edited in any way and proper attribution of the author(s) and GRI is displayed in any reproduction. **All other rights reserved.**

ENDNOTES

1. Zachary Evans, “Trump Won One-Quarter of Non-White Voters, Improving On 2016 Numbers: Exit Poll,” *National Review*, November 4, 2020, <https://www.nationalreview.com/news/trump-won-one-quarter-of-non-white-voters-improving-on-2016-numbers-exit-poll/>.
2. Heather Caygle and Sarah Ferris, “Dem Leaders Warn Liberal Rhetoric Could Blow Georgia Races,” *Politico*, last modified November 5, 2020, accessed December 9, 2020, <https://www.politico.com/news/2020/11/05/house-democrats-warn-caucus-left-434428>.
3. Jessica Taylor, “Democrats Must Go Down To Georgia To Save Disappearing Hopes of A Senate Majority,” *The Cook Political Report*, November 6, 2020, <https://cookpolitical.com/analysis/senate/senate-overview/democrats-must-go-down-georgia-save-disappearing-hopes-senate>.
4. Jordain Carney, “Manchin Shoots Down Chance That Senate Democrats Nix Filibuster, Expand Court,” *The Hill*, November 9, 2020, <https://thehill.com/homenews/senate/525236-manchin-shoot-down-chance-that-senate-democrats-nix-filibuster-expand-court>.
5. Paul Waldman, “Mitch McConnell’s Senate Might Be Where The Biden Presidency Goes to Die,” *The Washington Post*, November 4, 2020, <https://www.washingtonpost.com/opinions/2020/11/04/mitch-mcconnells-senate-will-be-where-biden-presidency-goes-die/>.
6. Alan Rappeport, Jeanna Smialek, Ana Swanson and Jim Tankersley, “In A Divided Washington, Biden Could Still Exert Economic Power,” *The New York Times*, November 8, 2020, <https://www.nytimes.com/2020/11/08/us/politics/biden-economy.html>.
7. Mark Rendell, James Bradshaw and Andrew Willis, “Canadian Businesses See Benefits In Divided U.S. Government As They Prepare To Navigate Political Gridlock,” *The Globe and Mail*, November 4, 2020, <https://www.theglobeandmail.com/business/article-canadian-businesses-see-benefits-in-divided-us-government/>.
8. Alan McGugan, “Gridlock: U.S. Election Puts More Strain On Federal Reserve To Manage Economic Recovery,” *The Globe and Mail*, November 4, 2020, <https://www.theglobeandmail.com/business/article-gridlock-us-election-puts-more-strain-on-federal-reserve-to-manage/>.
9. Mohamed El-Erian, “A Divided Electorate Spells Trouble For The US Economy,” *Financial Times*, November 4, 2020, <https://www.ft.com/content/bad0c75d-24dc-4d3a-9f19-6cecfef4fb50>.
10. Joseph R. Biden, Jr., “Why America Must Lead Again: Rescuing U.S. Foreign Policy After Trump,” *Foreign Affairs*, March/April 2020, <https://www.foreignaffairs.com/articles/united-states/2020-01-23/why-america-must-lead-again>.
11. “The Biden Plan To Ensure The Future Is ‘Made In All Of America’ By All Of America’s Workers,” *Joe Biden*, accessed December 9, 2020, <https://joebiden.com/made-in-america/>.

12. Marco Rubio, "We Need A More Resilient American Economy," *The New York Times*, April 20, 2020, <https://www.nytimes.com/2020/04/20/opinion/marco-rubio-coronavirus-economy.html>.; Josh Hawley, "The W.T.O. Should Be Abolished," *The New York Times*, May 5, 2020, <https://www.nytimes.com/2020/05/05/opinion/hawley-abolish-wto-china.html?searchResultPosition=1>.
13. Lawrence Martin, "Biden's New Nationalism Could Leave Canada Behind," *The Globe and Mail*, July 15, 2020, <https://www.theglobeandmail.com/opinion/article-bidens-new-nationalism-could-leave-canada-behind> .
14. Matt Viser and Dino Grandoni, "Biden Says He Would Revoke Permit For Keystone Pipeline," *The Washington Post*, May 18, 2020, https://www.washingtonpost.com/politics/biden-says-he-would-revoke-permit-for-keystone-pipeline/2020/05/18/93ba6fd4-9960-11ea-ac72-3841fcc9b35f_story.html; "The Biden Plan For A Clean Energy Revolution And Environmental Justice," *Joe Biden*, accessed December 9, 2020, <https://joebiden.com/climate-plan/>.
15. Janet French and Tony Seskus, "Jason Kenney Says Biden Would Have Hard Time Explaining Keystone XL Position To Americans," *CBC News*, May 19, 2020, <https://www.cbc.ca/news/canada/edmonton/jason-kenney-says-biden-would-have-hard-time-explaining-keystone-xl-position-to-americans-1.5575693>; and Timothy Meyer and Todd N. Tucker, "Trump's Trade Strategy Points The Way To A U.S. Carbon Tariff," *Lawfare*, August 24, 2020, <https://www.lawfareblog.com/trumps-trade-strategy-points-way-us-carbon-tariff>.
16. Joe Biden, "My Speech To Prime Minister Trudeau And The People of Canada:" *Medium*, December 9, 2016, <https://medium.com/@VPOTUS44/my-speech-to-prime-minister-trudeau-and-the-people-of-canada-ef28e37afd46#.bkutr0syy>.
17. Joseph R. Biden, Jr., "Why America Must Lead Again: Rescuing U.S. Foreign Policy After Trump," *Foreign Affairs*, March/April 2020, <https://www.foreignaffairs.com/articles/united-states/2020-01-23/why-america-must-lead-again>.
18. David Lawder and Trevor Hunnicutt, "Pulled In Many Directions, Biden May Keep Trump's China Tariffs In Place," *Reuters*, September 8, 2020, <https://www.reuters.com/article/us-usa-election-biden-trade-analysis/pulled-in-many-directions-biden-may-keep-trumps-china-tariffs-in-place-idUKKBN25Z1VH>.
19. Julien E. Barnes, "House Reports Push For More Focus on China By Intelligence Agencies," *The New York Times*, September 30, 2020, <https://www.nytimes.com/2020/09/30/us/politics/house-intelligence-china.html>.
20. Chris Coons, "A Bipartisan Foreign Policy Is Still Possible," *Foreign Affairs*, October 7, 2020, <https://www.foreignaffairs.com/articles/united-states/2020-10-07/bipartisan-foreign-policy-still-possible>.
21. Joseph R. Biden, Jr., "Why America Must Lead Again: Rescuing U.S. Foreign Policy After Trump," *Foreign Affairs*, March/April 2020, <https://www.foreignaffairs.com/articles/united-states/2020-01-23/why-america-must-lead-again>.