Market Strategy
by STRATEGAS A BAIRD COMPANY

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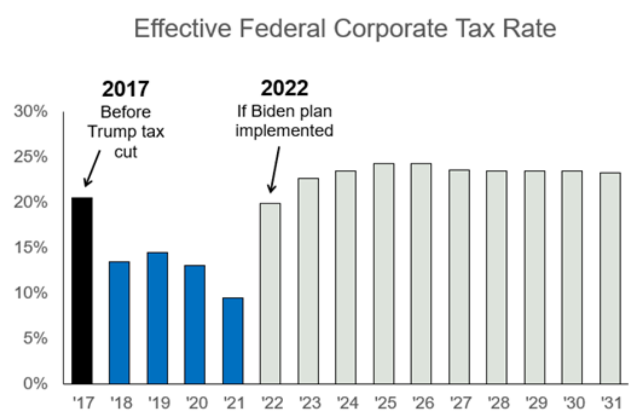
CANDY (SPENDING) AND SPINACH (TAXES) BOTH ON THE MENU

As quickly as the ink was dry on the $1.9 trillion American Rescue Plan, focus began shifting to passage of a new infrastructure bill. President Biden plans to break his infrastructure plan into two parts, with the first part consisting of physical infrastructure investments paid for with corporate tax rate increases. In the coming weeks we expect a second proposal that will focus on “social infrastructure” that will be paid for with tax increases on high net worth individuals and limits on drug prices. Altogether the plan should increase spending $4 trillion over the next eight years and raise an almost equal amount of taxes over 10 years. If the tax increases are enacted as proposed, this would mark the largest tax increase since 1968.

On March 31, President Biden proposed the first part of his two-part infrastructure plan consisting of $2.25 trillion of new spending on physical infrastructure. Biden’s plan focuses spending on both traditional infrastructure (highways, roads, bridges, rails, electrical grid, broadband, water) and non-traditional infrastructure such as home health care and alternative energy. Notably the Biden proposal spends more money on electric vehicles, $174 billion, than highways ($110bn), a sign of this administration’s commitment to climate change. The proposal also notably increases spending on water projects to avoid future instances of water contamination like what happened in Flint, Michigan.

With the US holding a $4 trillion budget deficit currently and COVID-19 economic fallout winding down, new spending will likely be paid for. President Biden proposed his first set of tax increases with higher taxes on US companies. Our calculations suggest the Biden plan, if implemented, would raise the effective corporate tax rate by 6.8 percentage points in 2022 (about the size of the Trump administration’s 2017 tax cut). The proposal calls for raising the corporate tax rate to 28%, instituting a 15% minimum tax, and more than doubling the tax rate on international income. Biden’s proposal moves the US towards a structure that taxes companies’ earnings on a worldwide basis that we believe puts US companies at a competitive disadvantage globally.



We are at the beginning of the legislative debate over this new infrastructure package and we anticipate that Congress will have more influence in modifying the details than was the case with the COVID-19 package passed earlier this year. This could create a volatile legislative process. Our sense is that Republicans are unlikely to raise taxes and Democrats will again use budget reconciliation to pass the legislation with just 51 votes in the Senate. The Senate Parliamentarian’s recent ruling that Democrats can use an already passed budget resolution for another reconciliation bill was important as it would save Democrats about one month in getting the package done. Reconciliation is still an arduous process though. New authorizations of spending are tough to get through (e.g. climate spending) and specific infrastructure projects were thrown out of the COVID package. There are ways around some of these restrictions, but for others, Democrats may get frustrated, which could lead to Democrats overruling the Parliamentarian, firing her, or getting rid of the filibuster.

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