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Wall Street, Financial Experts Call for Major Stimulus Package Despite Concerns Over Tax Increases

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There are theories but no tablets of stone to guide economists as the nation struggles to emerge from the COVID-19 shutdown. Republicans urge tax cuts and limited stimulus while Democrats push for trillions in additional government spending.

The opposing views underscore a continuing debate between the parties: Do higher taxes needed to fund the stimulus packages inhibit economic growth or does government spending boost the economy?

President Donald Trump and the Republicans argue that increasing taxes now would slow the recovery by taking money out of the private sector. Challenger Joe Biden and the Democrats believe higher tax revenue would be used to build a stronger economy by spending on infrastructure improvements and shifting to green energy from fossil fuels.

So far, Wall Street heavyweights believe Democrats have a stronger argument.

Investment bank Goldman Sachs said the boost to the economy from the fiscal stimulus advocated by Biden would "outweigh the negative effects of tax increases, particularly in light of the fact that the increased tax revenue would go to funding new spending."

Goldman Sachs said a Democratic sweep of the House, Senate and White House would "likely result in substantially more fiscal support" including a "stimulus package in (the first quarter), followed by infrastructure and climate legislation."

Under Biden's plan, new spending, including housing, education and infrastructure, would be partially offset by increased taxes on incomes greater than $400,000 and a rollback of the 2017 corporate tax cut.

S&P Global Ratings didn't take sides but said that immediate action is needed to boost the economy.

"Given that the U.S. economy is mired in a weak recovery, we believe the single most important task of the next president will be to create jobs, given the unemployment rate is still high at 7.9 percent – above or equal to the peak of eight of the past 11 recessions," the Wall Street firm said in a research report.

The next president should first "throw a lifeline to those in need," S&P said, and issued warnings that "premature fiscal austerity could result in another slump," and that the economy faces a 30-35 percent chance of falling back in recession.

Even with the passage of a $500-billion stimulus package before the end of the year, S&P doesn't foresee the economy returning to its fourth quarter 2019 level until late next year.

Moody's Analytics, a Wall Street research firm, concluded that the gross domestic product—the value of all goods and services produced in a year — would expand more quickly and go higher under Biden's plan in the next four years, because the boost from the challenger's additional spending plans would outweigh the dampening effect of tax increases.

But economists at the Hoover Institution, a conservative think tank at Stanford University, said Biden's plan to raise personal income and payroll taxes would increase the rate many small businesses pay to above 50% from its current level at less than 40%. The higher federal rates would be on top of state taxes, and the additional tax burden therefore would reduce hiring and future growth, the economists said.

Small businesses, or those with fewer than 500 workers, employ nearly 60 million people, or about 47.5% of the nation's workforce. The 30.2 million small businesses represent 99.9% of the nation's enterprises, government statistics show.

"My view is that we are in a Keynesian demand-side economy through 2021 and at least the first half of 2022," Gary Hufbauer, a nonresident senior fellow at the Washington-based Peterson Institute for International Economics, told *Newsweek*. "For that period, I credit Moody's with the better forecast. After the middle of 2022, I expect the US economy to bump against supply-side constraints—labor shortages and productivity issues. Going forward, the Hoover Institution has the better forecast, in my view."

Trump has called for Congress to "Go big or go home!!!" with a next stimulus bill close to the $2.2 trillion package proposed by House Speaker Nancy Pelosi, a California Democrat. But Senate Majority Leader Mitch McConnell, a Kentucky Republican, said he can't sell such a bill to his members, and called for a package of about $500 billion.

Biden said he would return the top income tax rate to 39.6% from 37% and raise the top corporate tax rate from 21% to 28%. If elected, Biden also would extend Social Security taxes to earnings in excess of $400,000, and tax capital gains and dividends at ordinary rates for those with annual income higher than $1 million.

Last week in a speech from the White House, Trump said the economy was strong prior to the coronavirus pandemic, and promised a robust rebound if re-elected.

"The policies of the Left would unleash an economic disaster of epic proportions," Trump said.

Unemployment was close to a 50-year low prior to the pandemic. The US economy has recovered about half the jobs lost during the economic shutdown, and consumer spending is strong.

Service jobs, including retail, restaurants and leisure, are likely to recover quickly if the public accepts coronavirus vaccines now being tested as safe and millions receive shots. The Federal Reserve has said it plans to keep interest rates low for the immediate future to encourage business investment and consumer spending, which represents about two-thirds of the U.S. economy.

Democrats argue that another large stimulus package is needed to help the unemployed meet routine living expenses.

The Tax Policy Center, a joint venture between the liberal Urban Institute and the Brookings Institution in Washington, estimated that Biden's plan would boost tax revenue by as much as $4 trillion by 2030. It calculated taxpayers in the top 20% of households would pay about 93% of the tax increase and the top 1% would shoulder about 75% of the hike.

But economists at the Hoover Institution concluded that Biden's tax plan would mean 4.9 million fewer jobs, reduce median household income by $6,500, trim $2.6 trillion from the GDP by 2030 and reduce consumption by as much as $1.5 trillion in that year alone.

"While these effects may seem large, they are actually conservative estimates of the negative impact of the full Biden agenda," the Hoover Institution economists said in a report.

The Hoover Institution pegged the cost of increased regulation under Biden's policies at $279 billion a year, which they argue will create additional drag on the economy.

Many economists have noted that the coronavirus pandemic has pummeled workers at the lower end of the economic scale while leaving those at the higher levels generally untouched.

That disparity, Andrew Karolyi, a professor of finance and the Harold Bierman Jr. Distinguished Professor of Management at Cornell University, said calls for action – even if it means taking on additional debt.

"Context matters to understand the debate over the consequences of Biden's proposed tax policy for future economic growth," Karolyi told *Newsweek*. "And the relevant context now is that we are in the middle of a global pandemic that has thrust us here in the U.S. and around the world into a deep recession, and one that is unevenly felt across the population."

Karolyi argued that an effective stimulus is an essential element of economic recovery.

"We are slowly climbing out, but major stimulus programs are critical," he said. "It is important to focus on what most analysts agree on – which is that funding long-overdue infrastructure improvements and investments are needed to give us a boost, whether supported from raising corporate taxes or accepting some additional debt."

Asked last week by ABC News at a Town Hall event if it's smart to increase taxes on high earners and companies as the economy struggles to recover from the coronavirus pandemic, Biden said, "Absolutely."

The Cato Institute, a Libertarian think tank in Washington, said Biden's tax proposal should be considered as part of the entire tax structure.

"The interaction of tax bases in the three levels of government is an underappreciated factor in public policy," a report from the Institute said. "Federal, state, and local governments compete as they tax capital gains, individual income, and corporate income."

The Institute said that the effect of interaction of taxes at all levels should be taken into consideration when evaluating federal tax policy.

"Higher tax rates at one government level shrink the tax bases and revenues at the other levels," the report said. "Biden's proposals to raise capital gains taxes, individual income taxes, and corporate income taxes would shrink state and local tax bases and revenues. Federal and state tax rates pile on top of each other, and it is the combined marginal rate that affects taxpayer behavior."

Gabriel Mathy, an assistant professor at American University, said the conservative arguments that higher taxes and regulation slow growth and lower employment and wages have not withstood the test of time, but that the positive economic impact of stimulus spending has.

"From what I can tell, these predictions have never panned out," Mathy told *Newsweek*. "On the other hand, we have seen a very deep recession, and with unprecedented fiscal stimulus that was distributed very quickly, we saw that the economy bounced back sharply."

He said that without a new stimulus package, the next downward turn is likely to be twice as significant.

"However, since a new package has not been passed, we have seen the recovery slow, and we may face a double-dip where the economy returns to contraction," Mathy said.

He argued that deficit spending is a must while the economy is in contraction.

It's important for the federal government to continue to run deficits until the economy has fully recovered," Mathy said. "Once recovery is complete, then spending can return to more normal levels."

He said the effects of tax increases will be negligible in the big picture.

I expect Republicans will continue to allege that any tax increase Biden proposes will have large negative effects," Mathy said. "And, yet again, the effect will be hard to notice at all."