HOW THE ECONOMY SHAPES THE ELECTION — AND HOW THE ELECTION SHAPES THE ECONOMY

OCTOBER 11, 2020

BY PHILIPP CARLSSON-SZLEZAK AND PAUL SWARTZ

U.S. elections are typically billed as "pivotal" or "existential" and 2020 particularly so. In the economic realm, common notions include that the economy decides the election and, in turn, that the election outcome shapes the economy. To assess these notions, we look at the numbers, historical precedent, and institutional dynamics of the U.S. political system.

While recessions are classically an electoral headwind for incumbents, it is worth noting the idiosyncrasies of the current one, including that Q3 GDP growth will likely be the fastest growth ever recorded and that the Covid recession is set to the be the shortest on record. Still, the state of the economy is so diminished as to potentially deliver a broader sweep of Washington – a critical scenario in a political system designed to prevent abrupt change.

Conversely, the impact of electoral change on the economy is typically overstated. The depth of power required to effect policy change varies significantly by policy area, which means that 'existential' or 'pivotal' discontinuities are difficult to engineer. Even in areas that are malleable with only executive power, such as trade, change would likely be more stylistic than substantive. Meanwhile, the broad constellation of macroeconomic regimes – the prevailing institutional, financial and real economy conditions – cannot be easily changed over the course of a presidency or even two.

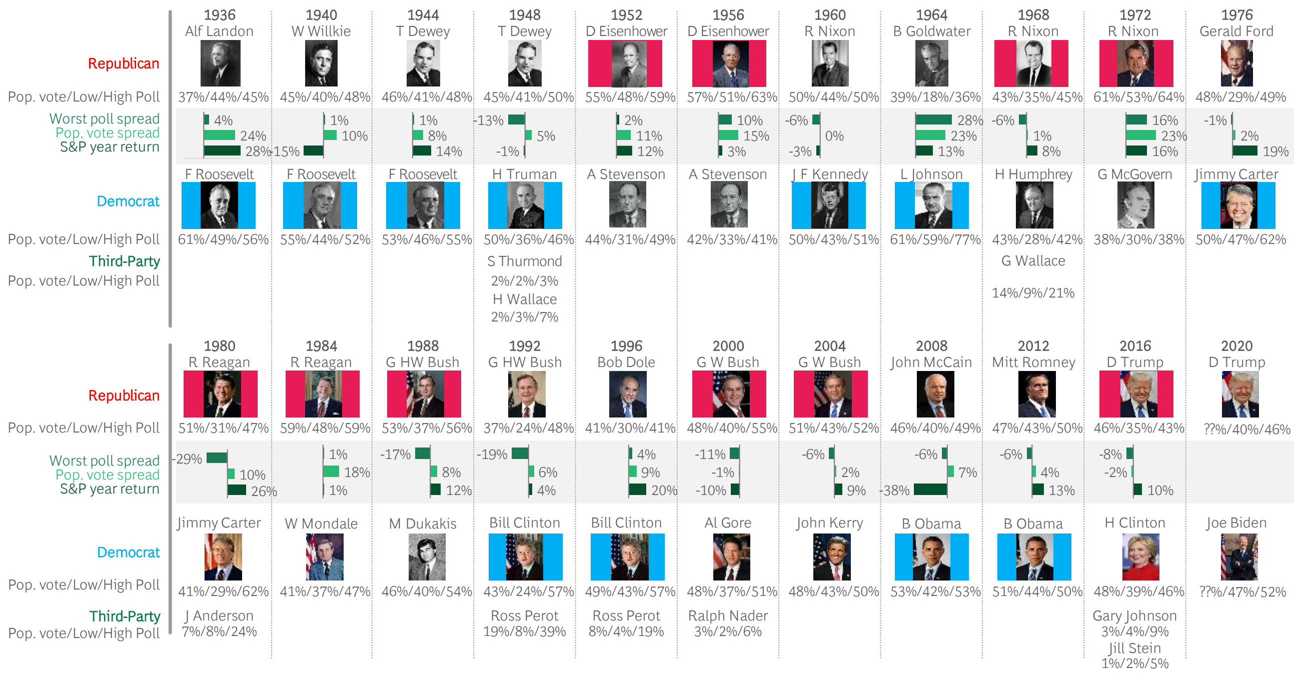
TOPICS IN THIS REPORT

KEY CHARTS

AN UNUSUAL RACE

Though the desire to see electoral patterns is strong, elections are ultimately idiosyncratic. As a reminder of the unique narratives in each, we start with a 1-chart history of modern U.S. elections (Exhibit 1). While they collectively point to some "eternal truths" – incumbency helps re-election; third-party candidates can spoil the race; the popular vote is not sufficient – each election contained (potential) turning points and idiosyncratic dynamics, often rooted in the economy, that make generalizations treacherous.

EXHIBIT 1 | A BRIEF HISTORY OF MODERN U.S. ELECTIONS



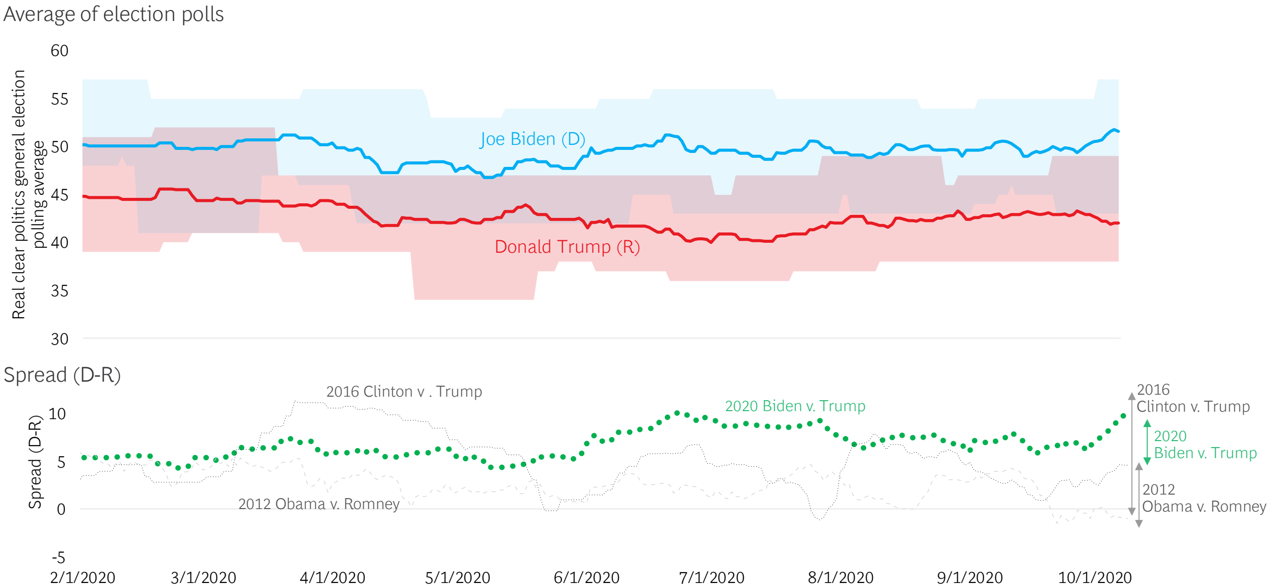
Note: Worst poll spread is from the winner's perspective

Source: Gallup, Bloomberg, RealClearPolitics, BCG Center for Macroeconomics (CME)

Still, even set against a backdrop of idiosyncrasy, the 2020 race stands out. Not just because it comes at the end of a controversial first term for President Donald Trump, and not merely because it takes place in the shadow of the deepest recession in generations and a national health crisis still not under control. There are at least two additional unique factors about this election.

First, the current state of the race stands out for the near **total lack of volatility**. Joe Biden enjoys not only a large polling spread over Donald Trump but has done so consistently throughout the year without any meaningful volatility. Exhibit 2 summarizes the polling history and also compares the polling spread to other recent Presidential races – none of which had either the level or the consistency of that spread.

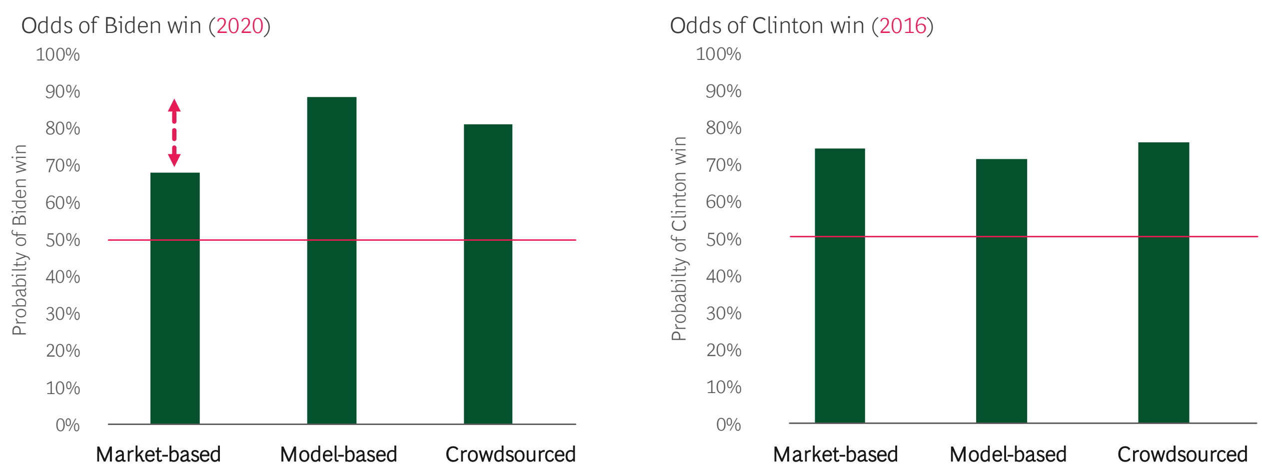
EXHIBIT 2 | POLLING SPREAD IS WIDE AND FAR LESS VOLATILE THAN IN PAST RECENT RACES



Source: Real Clear Politics, BCG Center for Macroeconomics analysis (CME)

This wide and stable spread is part of what has made some forecasters feel more strongly about Biden's chances for victory in comparison to Clinton in 2016. Market-based, model-based, and crowdsourced forecasts all currently give Biden a chance of winning far greater than 50% (Exhibit 3). Yet, one type of forecaster, the punter, is more reticent about pushing the odds of a Biden victory as high as they had for Clinton in 2016 (see "market-based" odds in the Exhibit), perhaps still smarting from their losses four years ago. And while national polls always miss the nuance of the electoral college, a sizable lead is also visible now in battleground states, such as Arizona and Pennsylvania, cementing Biden's position as the election's frontrunner.

EXHIBIT 3 | MARKET-BASED FORECASTS APPEAR CHASTENED AFTER 2016 – THOUGH MODELERS HOLD FAST



Source: Market-based (Predictit, BetFair, RealClearPolitics); Model-based (Five Thirty Eight, The Economist); Crowdsourced (Good Judgement Project); BCG Center for Macroeconomics (CME)

Second, the 2020 race contains unprecedented **institutional uncertainty**, rooted in two factors. While the personal well-being of candidates is always a residual risk in elections, the current pandemic poses a realistic risk that either candidate, or both, could be incapacitated before, on, or after election day, potentially creating unprecedented practical and legal challenges around how the election is conducted and how the transition of power is managed. Meanwhile, the integrity of the election process itself has been called into question by one side. The refusal by the Republican candidate to acknowledge that he would accept the outcome, should he lose, has pushed institutional uncertainty to levels unknown in the modern era.

Against this backdrop of a unique race, we assess the relationship between the economy and elections from two perspectives: how the economy shapes the election and how the election shapes the economy.

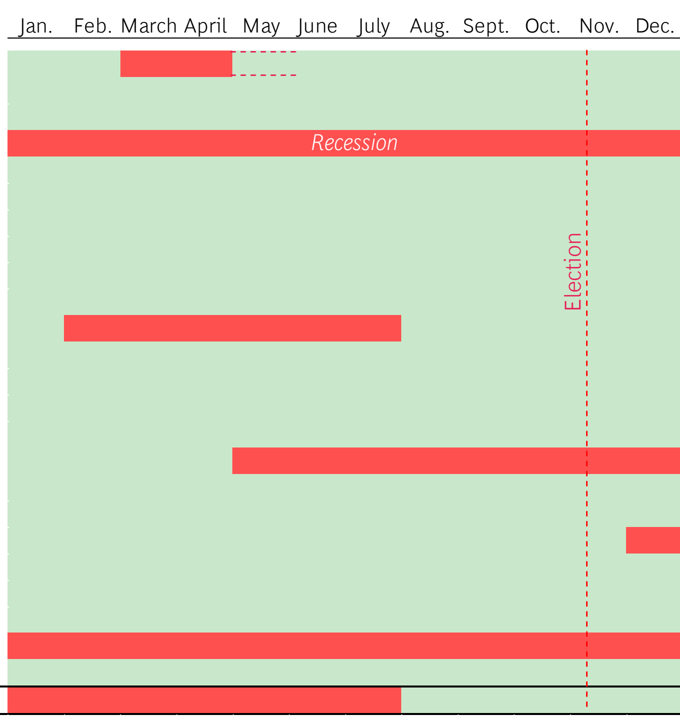
HOW THE ECONOMY SHAPES ELECTIONS

A political rule of thumb is that a strong economy helps re-election, and a recession does the opposite. While the Covid-19 recession is certain to be an electoral headwind to the incumbent in 2020, it is worth considering some of its idiosyncrasies to gauge the extent of that headwind. It is also worth considering if the recession supports the idea of a broader political sweep of Washington – a critical question in a political system designed to discourage rapid change.

Recessions hurt re-election, but a rebound is underway – with record 3Q growth

Much has been said about the headwind that the Covid-19 recession represents for incumbents in 2020 and Exhibit 4 demonstrates how history supports the notion. To find an incumbent party winning in a recessionary year we have to go back nearly 100 years to Coolidge's election in 1924. Since then, elections occurred in the shadow of recessions four more times and each time the incumbent party was voted out of power.

EXHIBIT **4** | RECESSION, RE-ELECTION, REJECTION – HOLDING ON TO POWER IN RECESSION IS ANOMALOUS



	Retain power?	President before	President after
2020*	???	**Trump (R)**	?
2016	NO	Obama (D)	Trump (R)
2012	YES	Obama (D)	Obama (D)
2008	NO	**W. Bush (R)**	**Obama (D)**
2004	YES	W. Bush (R)	W. Bush (R)
2000	NO	Clinton (D)	W. Bush (R)
1996	YES	Clinton (D)	Clinton (D)
1992	NO	H.W. Bush (R)	Clinton (D)
1988	YES	Reagan (R)	H.W. Bush (R)
1984	YES	Reagan (R)	Reagan (R)
1980	NO	**Carter (D)**	**Reagan (R)**
1976	NO	Ford (R)	Carter (D)
1972	YES	Nixon (R)	Nixon (R)
1968	NO	Johnson (D)	Nixon (R)
1964	YES	Johnson (D)	Johnson (D)
1960	NO	**Eisenhower (R)**	**Kennedy (D)**
1956	YES	Eisenhower (R)	Eisenhower (R)
1952	NO	Truman (D)	Eisenhower (R)
1948	YES	Truman (D)	Truman (D)
1944	YES	Roosevelt (D)	Roosevelt (D)
1940	YES	Roosevelt (D)	Roosevelt (D)
1936	YES	Roosevelt (D)	Roosevelt (D)
1932	NO	**Hoover (R)**	**Roosevelt (D)**
1928	YES	Coolidge (R)	Hoover (R)
1924	YES	**Coolidge (R)**	**Coolidge (R)**

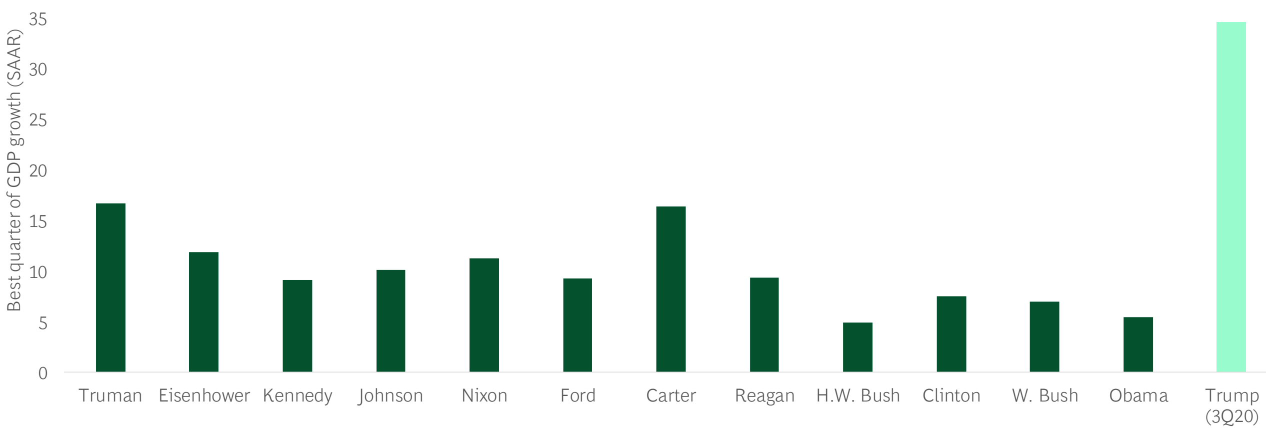
*2020 recession has not been fully dated as NBER has not called its end, but its end is likely to coincide with the fall in the unemployment rate (shown)
Source: NBER, BCG Center for Macroeconomics (CME)

Yet, while it's reasonable to expect economic hardship to weigh on voters' desire for change, the picture is more complex.

The 2020 Covid-19 recession was initially an exogenous shock, i.e. largely beyond the control of those in power – though the policy response was not, so interpretation by voters may be more flexible than might be expected. Further, though the recession has been historically deep and fast, it is also true that the rebound is historically steep and fast. In fact, 3Q GDP figures will be released just a few days before election day and will show the strongest quarterly GDP growth in history – likely to be somewhere around 35% (seasonally adjusted annualized rate). In Exhibit 5 we line up the strongest quarter by presidency, and while it would be wrong to insinuate that 3Q 2020 growth describes the *level* of economic output, it will be technically correct to claim that the *change* (growth) is the fastest ever. And even though economic hardship continues, the return of growth and falling unemployment mean that Covid is set to be the shortest recession – ever.[1] Additionally, the enormous fiscal response to the crisis has – astonishingly – led to real personal income growth during the recession.

Despite the above factors, it is a sound assumption that the state of the economy will be a net-negative for the incumbent. Yet, *how much* all this weighs on voter perception gives the state of the economy more uncertainty of impact than might ordinarily be expected in a downturn.

EXHIBIT 5 | A FEW DAYS BEFORE ELECTION DAY, 3Q GDP FIGURES WILL SHOW FASTEST QUARTERLY GROWTH – EVER



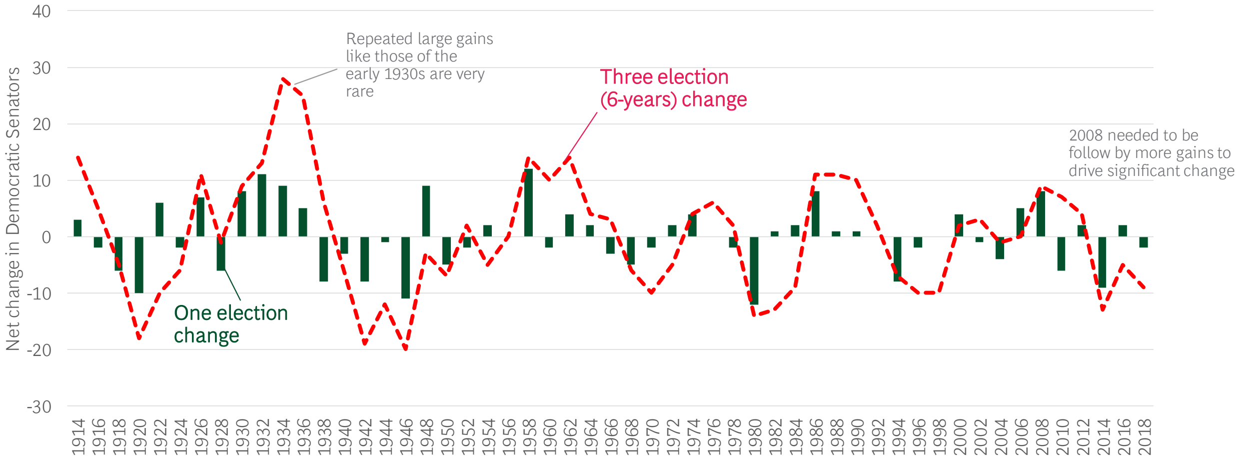
Note: 3Q20 using FRB of Atlanta GDPNOW
Source: Federal Reserve Bank of Atlanta, BEA, BCG Center for Macroeconomics analysis (CME)

U.S. political system is designed to prevent rapid change

The extent of the electoral impact from recession matters since it could give the Democrats a political sweep of Washington, i.e. control of the Senate (and House) in addition to the executive – a critical scenario in a political system designed to prevent abrupt political change. This can be seen in the electoral design of the U.S. Senate with its staggered 6-year terms of senators. With only about 1/3 of the senate up in any election (2-year cycles), it would take three election cycles (6-years) to turn over the entire senate. For a party out of power it typically takes several cycles to accumulate enough power in the Senate to make sweeping change. Exhibit 6 highlights the difficulty of power accumulation (see the dotted line depicting the 3-election change since 1914). The last time that happened in a significant way was in the 1930s when FDR was president.

1 The NBER's Business Cycle Dating Committee has not yet dated the end of the recession but when it does it is very likely to be < 6 months, which currently the shortest recession on record (1980)

EXHIBIT 6 | ELECTORAL SYSTEM IS BIASED AGAINST ABRUPT CHANGE – ACCUMULATION OF POWER IN SENATE OCCURS OVER SEVERAL CYCLES AND IS HARD TO DO



Source: BCG Center for Macroeconomics analysis (CME)

Yet history suggests that if the Democrats can win the White House they are also likely to sweep the legislature – new presidents have more often than not (and exclusively over the last 30 years) come to power with unified control of Washington (Exhibit 7). While this is by no means a foregone conclusion, an increasingly partisan political environment has driven more party-line voting which is a powerful explanation for why a new presidency can pull the legislature in its direction.

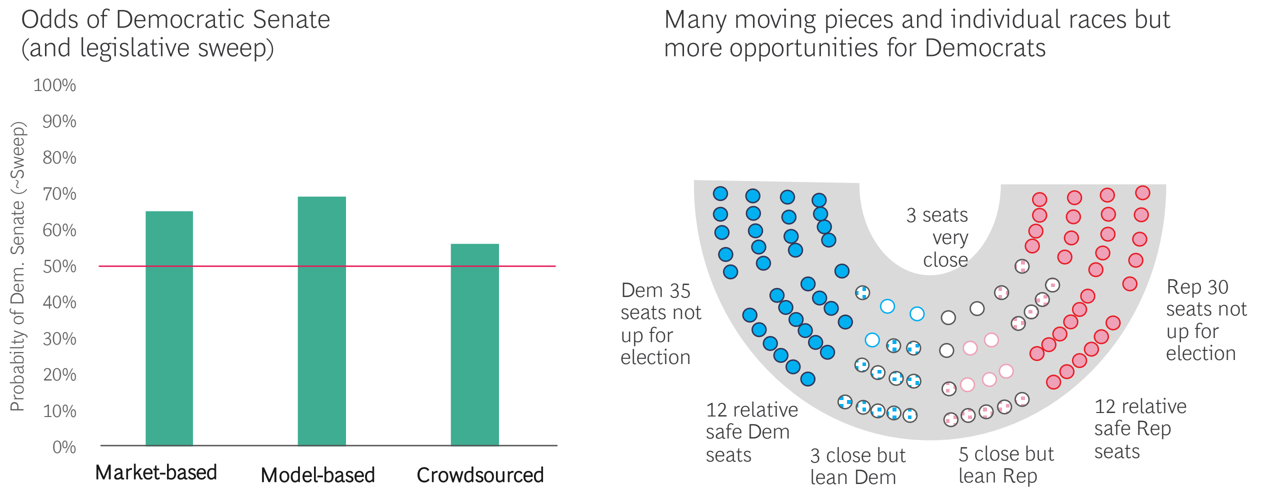
EXHIBIT 7 | BUT TODAY A SWEEP IS MORE LIKELY GIVEN MORE PARTISAN PARTY-LINE VOTING

	Eisenhower 1952	Kennedy 1960	Nixon 1968	Carter 1976	Reagan 1980	H.W. Bush 1988	Clinton 1992	W. Bush 2000	Obama 2008	Trump 2016
New president										
House	Republican majority 221-213-1	Democratic majority 264-173	Democratic majority 243-192	Democratic majority 292-143	Democratic majority 243-192	Democratic majority 260-175	Democratic majority 258-176-1	Republican majority 220–213-2	Democratic majority 257-178	Trump 2016 241-194
Senate	Republican majority 48-47-1	Democratic majority 64-36	Democratic majority 57-43	Democratic majority 61-38-1	Republican majority 53-46-1	Democratic majority 55-45	Democratic majority 57-43	Republican majority 50-50	Democratic majority 57-41-2	Republican majority 52-46-2
Unified Control?	✓	✓	✗	✓	✗	✗	✓	✓	✓	✓

Source: U.S. Senate, U.S. House of Representatives, BCG Center for Macroeconomics analysis (CME)

A closer look at the U.S. Senate shows that a (simple) Democratic majority is in play, though not the 60-vote majority that would confer deeper power on the party. All types of forecasters (Exhibit 8) see the odds of a Democratic Senate as greater than 50%.

EXHIBIT 8 | A DEMOCRATIC "SWEEP" LOOKS PLAUSIBLE OR EVEN LIKELY NOW



Source: Predictit, BetFair, FiveThirtyEight, The Economist, Good Judgement Project, BCG Center for Macroeconomics (CME)

HOW THE ELECTION CAN (AND CANNOT) SHAPE THE ECONOMY

While the economy is quite certain to impact the election, perhaps profoundly, then what about the election outcome impacting the economy? This direction of causality has far less certainty in this case. For all the notion of an "existential" and "pivotal" election, the idea of significant discontinuities in the macroeconomy is mostly overstated. As we remind readers here, the depth of political power required to change policy varies significantly by policy area, and the ability of a single administration to materially change the macroeconomic regime is very limited.

The depth of political power

There is no uniform answer to the question how electoral success translates into the ability to move economic policy. Ultimately, it is an intersection of the depth of power, illustrated on the vertical axis in Exhibit 9, and the policy area in question (examples shown across). As the depth of power grows, more degrees of freedom emerge. In some areas even a government limited to executive power has significant opportunity to shape policy, while in others a government in full control of laws can struggle to make economic change. In the following we walk through four economic topics – spending, trade, anti-trust, and the broader economic regime – to highlight some of these dynamics.

EXHIBIT 9 | DEPTH OF ELECTORAL SUCCESS MATTERS DIFFERENTLY ACROSS POLICY AREAS

Cumulative source of power	Instruments of power	Current modeling probability	Spending	Trade	Anti-trust	Economic regime
White House	**Control of exec. orders & appointments**	*~85% - Biden ~15% - Trump*	Limited	Significant direct authority (e.g. Section 232/302)	Ability to set tone and direct priorities	Limited impact, particularly in short run
Senate <60 Not house	**Easier path to appointments**	*~66%*	Limited	Easier path to USTR and other appointments	Ability to easily confirm heads of departments	
Senate <60 And House	**Control of budgetary bills**	*~66% - Dem sweep*	Full party control over budget through reconciliation*	Easier path to USTR and other appointments	Provide money via budget for stricter enforcement	
Senate >60 And House	**Control of ordinary law**	*Very low*	Full party control over legislation – new programs possible	Can pass laws implementing trade agreements	Can create new law related to anti-trust	

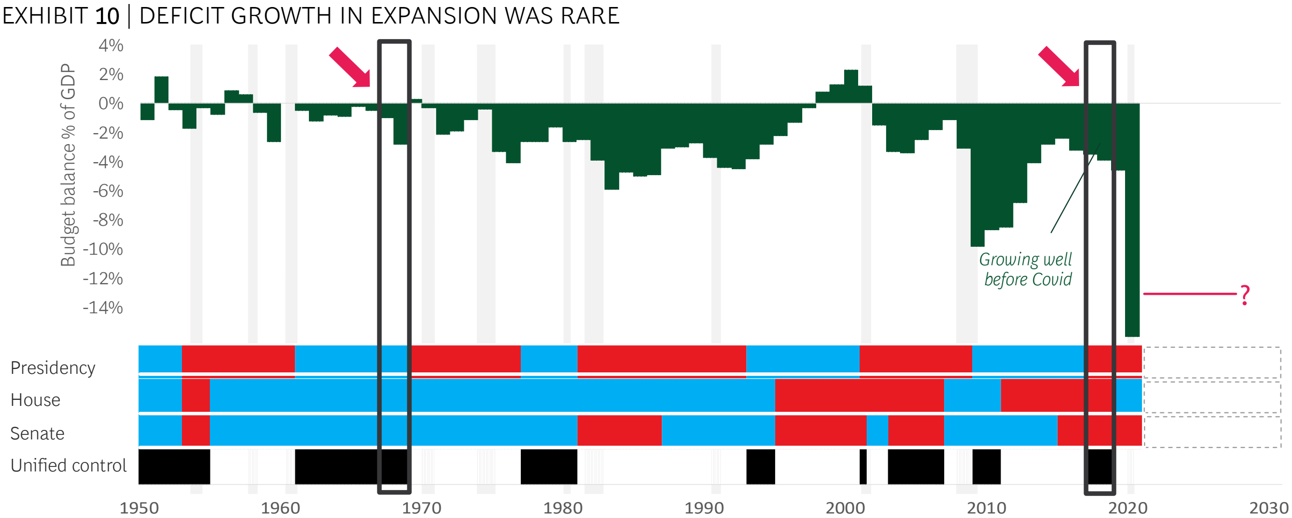
Note: Various assumption are made – including the maintenance of legislative rules (i.e. filibuster); * Limited by Byrd rule (deficit neutral past 10-year horizon)
Source: BCG Center for Macroeconomics (CME)

Control of fiscal policy/budgetary bills requires unified control of Washington

As seen above, the current baseline forecasts is for a Democratic sweep of the White House and the legislature – this would present the Democrats with the opportunity to make budgetary changes on a purely partisan basis. While in the past the aspiration for a president may have been higher – new ordinary laws addressing key areas of concern – the need to rely on bi-partisan support in a hyper partisan world may encourage the Democrats to move quickly to work on areas that they can change with ease.

If this translates into bigger spending it could present itself as a fiscal expansion even after the Covid recession is well in the rear-view mirror – this would be a historical anomaly as deficit growth is typically cyclical. Yet there are two clear historical precedents of deficit growth during expansion (See Exhibit 10) – first under LBJ in the 1960s (think Great Society and Vietnam War) and second under DJT (2018 tax cut) – it's not hard to imagine JRB (Joe Robinette Biden) doing the same to push green infrastructure for example.

EXHIBIT 10 | DEFICIT GROWTH IN EXPANSION WAS RARE



Source: OMB, CBO, NBER, U.S. Senate, U.S. House of Representatives and BCG Center for Macroeconomics (CME) analysis

Trade policy can be shaped by executive action, but change would likely be more stylistic than substantive

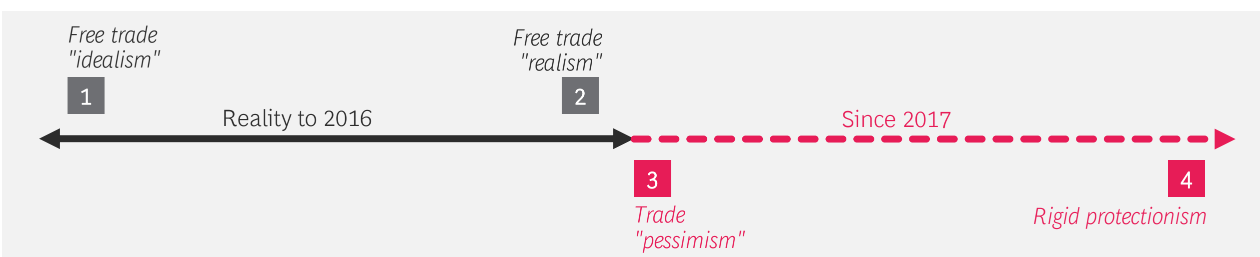
A Democratic presidency and Republican Senate remain a plausible outcome – in that case the president is likely to focus on the tools at their disposal. The first of which is executive action – something that is wide-ranging and occasionally powerful, if often lacking permanence (given the next White House occupant can reverse the action). A clear example of where this method of action has impact is that of trade, as demonstrated by the Trump presidency.

Yet, trade policy presents an interesting case study in how policy may not – even with a change in power – shift dramatically. Stylistically trade policy would almost certainly change under a President Biden (trade policy by tweet is less likely), but substantively the scope of the debate around trade has changed in a way that is unlikely to reverse under Biden. As shown in Exhibit 11, the old spectrum of debate, between “free trade idealism” and “free trade realism” is effectively over. Donald Trump has successfully shifted the debate onto a new spectrum, where “trade pessimism” describes the more cooperative end (striking aggressive trade deals) while “rigid protectionism” marks the other end (those who would like to see the dismantling of multilateral trade institutions). Despite his anti-trade reputation, Trump appears to be closer to the “trade pessimism” side than “rigid protectionism.” Meanwhile, Biden is unlikely to steer the debate back toward the old spectrum where trade was viewed as a positive – rather trade would continue to live in negative light where difficult negotiations are oriented towards serving domestic interests first.

EXHIBIT **11** | IN TRADE POLICY, EXECUTIVE ACTION GOES A LONG WAY – AND TRADE TENSION IS LIKELY TO REMAIN

1 ⟷ 2

"Reality to 2016" of the trade debate was about arranging mutually beneficial trade deals. At one end of the debate were those who believed free trade was inherently good and needed little control or regulation and on the other of the debate were those who believe it was beneficial but needed to be managed with respect to its downsides.



"Since 2017" has rearranged the debate around trade. On one side are those who are willing to engage in trade but feel that deals must be struck aggressively to prevent 'losing' – where on the other side of the debate view less trade as better and would like to dismantle the existing set of trade institutions.

3 ⟷ 4

Source: BCG Center for Macroeconomics analysis (CME)

Anti-trust policy can be shaped via executive appointments, but realistically requires popular support

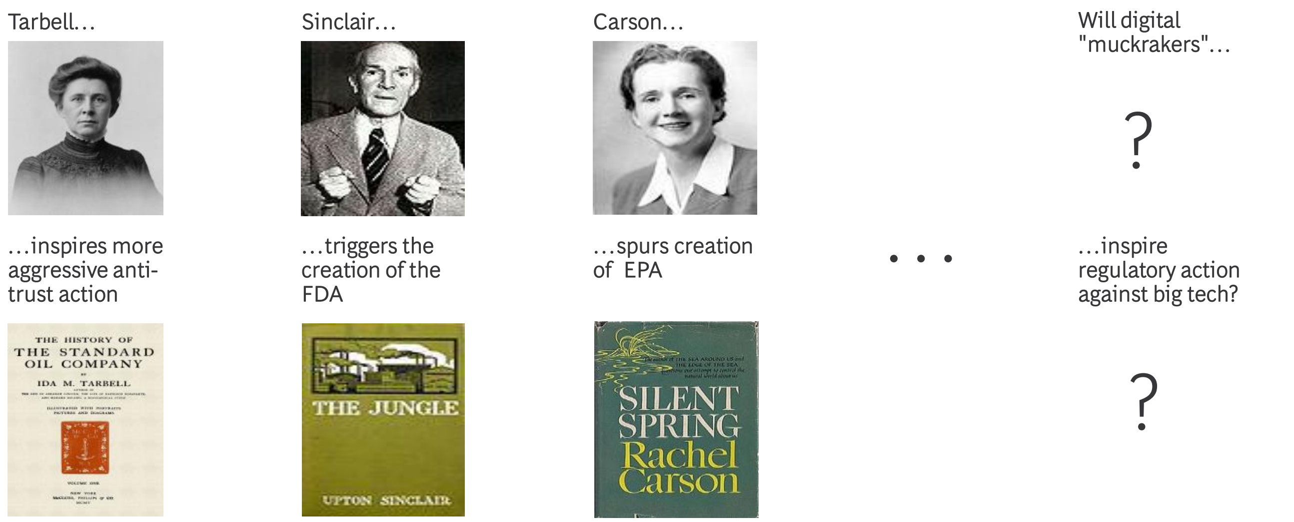
Certain policy areas, such as anti-trust, can effectively be influenced by appointments rather than attempts at legislation or other instruments of power. While an incredible number of appointments require senate confirmation, presidents are typically, if not universally, able to appoint leaders of their choosing even without the senate majority.

Yet a new president won’t be able to immediately transform the realm of anti-trust enforcement, if he so desired. While they would appoint a new attorney general who will influence the priority of anti-trust prosecutions, they won’t be able to touch (at least initially) other independent agencies which pursue anti-trust cases, such as the FTC. Nor will they be able to change easily the makeup of the court system that hears anti-trust cases.

This sometimes convoluted and lengthy process of anti-trust action is one reason why meaningful pushback against corporate power is rare. It is generally not enough to have an administration that wishes to push back, but requires a public backlash against corporate power, something specific that inspires outrage and moves the abuse to the top of the political agenda.

Historically, these groundswells of backlash have come from works of journalism and literature that spur action. Key examples are the abuses detailed in Tarbell's *History of Standard Oil*, which forced the political hand to break up the monopoly; the disgusting practices of the meat packing industry revealed in Sinclair's *The Jungle,* which gave us the FDA; or the dystopian world painted in Carson's *Silent Spring,* which helped spur the creation of the EPA. In other words, pushback often requires something more than just the wheels and instruments of power – making change more difficult. Today, the popular backlash against the tech giants is (still) modest.

EXHIBIT 12 | ANTI-TRUST ACTION HISTORICALLY DRIVEN BY POPULAR BACKLASH FORCING THE HAND OF POLITICIANS



Source: Wikimedia Commons, BCG Center for Macroeconomics analysis (CME) analysis

Economic operating system ("macro regime") difficult to change

What if the electoral win is bigger than what currently seems possible? What if a supermajority grew that enables significant legislative change? Undoubtedly this would create the potential for accelerated change, yet the economic operating system (i.e. constellation of economic regimes) is difficult to transform even with substantial legal powers.

We have written in the past about this constellation making up a "Good Macro" world – the real, financial, and institutional conditions that make up the business environment. Many of these dimensions are simply not a direct function of law and policy. Consider the inflation regime which is low, stable, well-anchored and a cornerstone of the macro ecosystem. This is difficult to dislodge and not only because it is protected by what is technically an independent agency (i.e. Federal Reserve). It is difficult to dislodge because doing so would generally require sustained and significant cyclical tightness that would put inflationary pressure into the economy. Expansionary fiscal policy could certainly contribute to tightness in the next cycle and if fiscal growth continued at that point it would contribute to inflationary pressures. Yet that scenario is a process playing out over years, not an event or single decision and is not strictly a function of the election outcome.

Exhibit 13 offers a summary of the real, financial, and institutional regimes that make up the current macroeconomic operating system. Not much of that is easily or dramatically changeable by policy in the short run. For a more in-depth treatment of the constellation of the macroeconomic operating system see: *Coronavirus and the "Good Macro" Regime: Will the U.S. Economy be truly different post-Covid?*

EXHIBIT **13** | ELECTION WON'T EASILY UNDERMINE ECONOMIC REGIMES

Structural macro "regimes"		Description	Why it is hard for election to change it
Real	Potential (trend) growth regime Global Value Chains Real volatility (risk profile)	Real regimes underpin economic potential (supply side – labor, capital, productivity) as well as the value chains and structural nature of cyclical risk.	Regardless of the election outcome the supply side factors, or the structural backdrop of cyclical risk is not going to change.
Financial	Inflation regime Global monetary order Sov. debt regime ("r-minus-g") Volatility regime	Financial regimes are built around low and stable inflation and are complimented by the US dollar centric monetary order and significant sov. debt capacity – as well as "modern volatility" (more high and more low volatility)	Regardless of the election outcome breaking the inflation regime (the cornerstone financial regime) would be very unlikely in the near term – however sustained policy pressure and cyclical pressure could do so over the longer run.
Institutional	Stimulus effectiveness & culture Trade/technology order Global political order Mindsets and expectations	Institutional regimes compose the arrangement which help the economy transact, backed-up by the soft infrastructure of cultural arrangements	Here the election is most able to impact the regime – but the stress in the global political order is driven by fundamentals, not just personalities, and thus any change is more stylistic than substantive.

Source: BCG Center for Macroeconomics analysis (CME)

AUTHORS

Philipp Carlsson-Szlezak, Ph.D. is a managing director and partner in BCG's New York office and chief economist of BCG. He can be reached at carlsson-szlezak.philipp@bcg.com

Paul Swartz is a director in BCG's New York office and a senior economist at the BCG Henderson institute. He can be reached at swartz.paul@bcg.com