American Jobs Plan – “Stripping Away Objections”
April 1, 2021

Now that the Biden administration has finally rolled out its long-awaited American Jobs Plan which seeks to spend ~$2.25T on highways, the electric grid, broadband, housing and US manufacturing, we’re spending a lot of our time talking with investors about the process from here and how this broad proposal will work its way through the Committees and become law. In this report we work through some of the most frequently asked questions we’ve received from clients this week and provide our latest expectations for 2021 from here.

The Aircover Stage

Yesterday was the opening salvo for President Biden’s second major legislative agenda item. Earlier this year we heard from Democrats that they were waiting for “air cover” from the administration before speculating about what was in and what was out on the next legislative push as “Build Back Better” could mean anything to anyone before the White House put parameters around it. Slowly but surely over the last few weeks, the White House has whittled down expectations for this bill, first by splitting it into two, then further by keeping any offsets strictly to the corporate side of the tax code and now we have a pretty clear message from the White House that lawmakers will take with them as they translate the broad proposals into legislative text.

The President’s Chief of Staff, Ron Klain, spoke to a forum hosted by Politico this morning and used a phrase we found deeply informative: when explaining the rationale for raising the corporate tax rate to 28% and taxing intangible earnings offshore to offset the $2.25T cost of the package, Klain asserted that the White House was trying to kick off this process by “stripping away objections” to the infrastructure investment plan inside the Beltway. Interpreting the infrastructure bill from that lens is a consistent message we’ve picked up from the administration, and it essentially means that everything on the table now is open to negotiation.

There are three big objections that the White House has already negotiated against itself on and ended up preemptively stripping out from the broader Democratic coalition asks for $4-6T in spending this year:

1. **Slashing the Size of the Bill:** This bill includes none of the social safety net issues of universal Pre-K or eliminating student loan debt or permanently extending the Child Tax Credit the Progressive wing of the party has called for. These and other initiatives would’ve added another $2-3T to the infrastructure spending price tag and more problematically, don’t have the votes to pass in the Senate. To preemptively provide air cover for this bill and “strip away objections” then, the White House preemptively stripped out half of the bill before even publishing it. This spending will
be rolled out separately next month and those pieces will very likely will not become law during Biden’s first term.

2. **Don’t Tax Families & Individuals:** This bill proposes no hikes to the individual side of the code. All tax provisions in this bill will come from corporations and the perennial boogeyman of international earnings and tax avoidance, aka the GILTI tax, inversions, and offshoring. In the wake of a devastating global pandemic, Democrats decided to preemptively take any hikes that would affect individuals and families directly off the table. As a result, there will be no hike to capital gains taxes this year, in line with expectations. Similarly, there will be no hike to marginal tax rates, a wealth tax or the estate tax. We are further lowering our odds on those accounts which we’ll elaborate on below.

3. **Find the Path of Least Resistance on Messaging:** Finally, the President has determined at this stage of the legislative process, that increasing the deficit would be more problematic for the public messaging campaign stage of this bill than proposing ways to raise revenues to offset the cost (so long as those revenues do not touch individuals). “Stripping away objections” though is a far cry from having a core belief that this bill needs to be offset or that corporate tax rates must rise. Nonetheless, the administration is providing air cover for corporate and international tax hikes which we are factoring into our odds this morning and slightly raising our expectations on those fronts as well, more on that below.

**Process Drives Policy – Waiting for Reconciliation Instructions**

Most importantly, what this strategy implies to us is that the process will be prioritized over policy. The White House wants to see an infrastructure bill pass this year, likely knowing it will be the last major piece of legislation the administration signs before the mid-terms, if not for the remainder of Biden’s term. **Policy purity is not the priority, passing a major infrastructure spending initiative is.** Because the White House is so amenable to change and malleable on the scale and scope of this bill, we remain confident, with 75% odds, up from 70% previously, that this bill will become law. Likely between July-October 2021.

We’ve heard from various White House officials in the last 72 hours that the President does not require policy purity for this bill – the spending can move around and offsets are merely proposals designed to avert charges that the bill would increase the deficit beyond politically palatable levels, not because the corporate tax hike must rise from a policy perspective or that deficit increases are nonstarters.

We stressed earlier in this process that Democratic lawmakers feel strongly that they need political air cover from the White House to advance this bill because they have no margin for error and an ideologically diverse caucus. The White House is giving them that with this bill,
but the real meat and potatoes of writing the legislation falls to the House and Senate Budget Committees, the tax writing committees, and the infrastructure committees. That means to us that while the President’s proposal is informative, it is definitely not the most important document we will see in these early stages of debate. Here’s what we’re watching for and why:

This bill will not receive 10 Republican votes. Full stop, no question – this bill is going to be partisan, whether it is paid for or not. Without 10 Republican votes, Democrats must generate reconciliation instructions that will allow the bill to pass with only 51 votes in the Senate if they even want it to come to the floor for a vote. There are two ways to achieve that theoretically right now:

1. **Pass a FY2022 Budget.** This is going to be a doozy. Democrats marched in lockstep to pass a FY2021 Budget in February, unlocking reconciliation and with it, the authority to spend $1.8T without offsets and without any Republican votes for COVID relief.

   - They need to do that again. Contrary to popular opinion, Congress does not need to wait until FY2022 to pass this FY2022 Budget. The fiscal year begins on October 1, 2021 but technically the budget for FY2022 is due in April 2021. This budget can pass at any time and can authorize reconciliation instructions at any time now. There is no requirement that the budget needs to wait until October 1, 2021 to pass – a common misperception on the Street.
   - Debate over a FY2022 Budget will take at least a few weeks between the President rolling out his top line numbers, the House and Senate Budget Committees’ crafting their resolutions, and the full House and Senate voting for the budget on the floor.
   - This process could be completed by late April/early May at the earliest and could be stalled until May or June if Democrats continue to avoid formally casting the infrastructure bill as purely partisan, even though eventually that’s how it will proceed. This is a process decision that will be made by leadership and the White House.

2. **Get the Parliamentarian to agree to reopen the FY2021 Budget.** Because passing a budget is so politically difficult, Majority Leader Schumer (D-NY) is trying a novel workaround through Section 304 of the Congressional Budget Act. This would effectively reopen the FY2021 Budget that passed in February and necessitate only votes on another reconciliation bill, not an entirely new budget for FY2022.

   - There has not been a ruling on this yet from the Parliamentarian, but that Schumer is trying at all underscores just how hard it will be for Democrats to push through another partisan budget, take votes on everything from abortion rights to the minimum wage and tax hikes (again), and keep their caucus unified over the next 3-6 months.
   - Procedurally, a revised budget reconciliation process would be shorter than option 1 listed above. Under revised budget rules, a budget would get 15 hours
of debate in the Senate and an additional 10 hours of debate for any conference report that reconciles the bills between the House and Senate.

- This strategy would require that the infrastructure bill be signed into law prior to the end of FY2021, or by September 30, 2021. That is already our base case, but using FY2022 Budget authority would give Democrats through at least 1Q2022 to pass the next infrastructure bill if they needed more time.

Democrats must make use of one of those two options: either passing a FY2022 Budget or theoretically through re-opening the FY2021 Budget. Most likely, with 70% or higher odds, we think Democrats will need to pass a new FY2022 Budget. While President Biden was supposed to provide a "preview" of the FY2022 Budget to set top line spending numbers for appropriators today, we understand that effort has been delayed slightly and a release is now expected either tomorrow or next week. Nothing better than a Good Friday news dump for another $1.5T in spending just after rolling out a $2.25T infrastructure spending package...

We continue to expect this “preview” budget will not include reconciliation instructions which are still the single most important data point for investors anticipating the scale of tax increases associated with this infrastructure bill.

Because the process is going to require reconciliation authority, Democrats will have to, at some point, show their hand when it comes to their deficit appetite. We are constantly trying to assess where the deficit appetite is on Capitol Hill because at the end of the day, this number included in the reconciliation instructions, will tell investors how much spending and taxing will really be included in this infrastructure bill. When we talk about fading the bill from here, it’s because we believe the deficit appetite in the Democratic caucus is substantially below $2.25T – closer to $1-$1.5T based on our ongoing conversations with lawmakers of all political stripes in the conference.

If we’re off on that number, either on the high end or the low end, then we will commensurately be off base in our estimate for the size of this spending package, or the tax revenue needed to pay for it. If the next reconciliation package authorizes $500B in deficit increases, that will be an immediate indicator that tax revenue will be greater than we are currently anticipating. If the deficit appetite is much larger, that will imply that even fewer tax changes will be needed to offset the cost of this bill. Democrats continue to delay on releasing a FY2022 Budget and its likely we won’t know this critical number until mid-April.

**Veda Expectations**

While we wait for this reconciliation instruction, which will likely not come until mid-April at the earliest, we want to reiterate and slightly revise our expectations on the tax and spending front.
• We are lowering our odds today that capital gains tax rates or estate tax rates will rise this year. As discussed above, the White House provided air cover for corporate tax, not individual tax hikes. Without air cover from the White House, Democrats aren’t going to keep their caucus united, as a result, our already low expectations for any reforms to the individual side of the tax code are dropping further today.

  o Our odds of a capital gains tax hike are dropping from 15% to 5%.
  o Our odds of an estate tax reversion to 2009 levels is dropping from 25% to 5%.
  o While Democrats will roll out a second bill proposing another ~$2T in spending on healthcare, education and childcare later this month, we have very low expectations that this bill will become law (30%) and therefore do not anticipate that the individual side of the tax code will change in 2021 (or 2022).

• While the President has proposed a 28% corporate tax rate, which would generate an estimated $1.08T/10 years, we do not believe there are sufficient votes in either the House or Senate to raise the US corporate rate above the OECD average of 23.59 percent. Our odds will remain unchanged at their low 5% rate that the 28% corporate tax rate will be implemented in 2021 or 2022.

• We are however raising our odds that the corporate tax rate will rise to 25% from 10% to 30%. We will potentially shift those odds again when we see reconciliation instructions and the deficit authorization associated with this infrastructure bill. Again, a $1.5T deficit appetite would eliminate the need to raise the corporate tax rate and would keep Congress trained on international earnings and taxation instead of on the broader domestic corporate rate in our estimation. A lower $500B or so deficit appetite in the next reconciliation instruction would indicate that Congress does need more revenue, potentially the full $397B a 25% corporate tax rate would generate over 10 years. A $1.5T deficit appetite would likely keep the focus trained on easier lifts like taxing international assets and earnings.

• The GILTI tax and other international tax changes have been the most likely to rise in our forecast and that remains the case, particularly as we know the Senate Finance Committee leadership will be rolling a bill out shortly to reform and increase rates there and the President prioritized the revenue basket in yesterday’s proposal. Our odds of a GILTI tax hike therefore have risen further to 40% from 20% and this remains the most likely tax to rise in 2021 and 2022.

Figure 1. Veda’s Macro Odds Tracker
Timing & Sequencing from Here

**Early April:** President Biden’s team will continue briefing Democratic and Republican lawmakers and staff inside and outside the Beltway. Lawmakers are out for the Spring Recess at the moment and staff is doing the legwork of translating White House ideas into legislative policy.

- Tomorrow or early next week President Biden is expected to release his **FY2022 Preview budget.** This will set top line spending levels for 12 appropriations bills which combined will likely spend ~$1.8T in FY2022 vs $1.4T in FY2021. These bills need to be written and passed with 60 votes to avoid a government shutdown on October 1, 2021. The urgency of a government shutdown creates an annual legislative rush, and the infrastructure bill could easily be teed up for final votes in conjunction with these bills.

- The **Surface Transportation Act**, a 5-year package of traditional highway and surface transportation provisions that will spend at least ~$300B on infrastructure also
needs to pass by September 30, 2021. It is not clear that Democrats will lump the entirety of the STA into this infrastructure package, but it is a helpful timeline marker to keep in mind for final votes on the infrastructure bill.

- House and Senate Infrastructure and Tax Committees are already in the process of writing their portions of this infrastructure package. There will be more hearings and details of their proposals, not to mention an explosive lobbying spree around infrastructure spending, tax revenue and earmarks from all corners of the corporate and political world between now and passage of this bill.

**Mid- to -Late April:** President Biden is expected to provide details around the reconciliation request for a FY2022 Budget. This remains the most important number investors can watch for to deduce whether tax revenue will be needed to offset the cost of this bill, and if so, how much.

- Because there will not be 60 votes for this infrastructure bill, if it is to pass Democrats are going to have to go through the politically painful process of voting for more reconciliation instructions.

- At some point in April or May the House and Senate Budget Committees will have to publish either a revision to the FY2021 Budget or a new FY2022 Budget to give Democrats the reconciliation instructions they need to pass this bill. We will follow that process closely.

- President Biden is expected to make a speech to a joint session of Congress in late April – this will be the President’s first year iteration of a State of the Union Address.

**Late May:**

- The committees of jurisdiction should be done with their individual bills by this time. The goal of the infrastructure committees is already to have their bills completed and voted out of committee by Memorial Day which begins May 24, 2021.

**June/July:**

- Speaker Pelosi (D-CA) has indicated that she would like the infrastructure bill completed by the 4th of July which ostensibly means June 30, 2021, the last day of votes in the House before the holiday.

- There are only two weeks of session scheduled for the House in July, from the 19-30th, after which Congress will not be back in session until September 20. This bill then realistically has two main timeframes for passage: June/July or late September. Our base case is late September, but June/July is also a possibility.
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