First Trust
Monday Morning OUTLOOK

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Tax Cut Politics

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While some investors are freaking out about investigations, tweets, or the personality of President Trump, we are still watching policy. So far, some regulation has been rolled back and more is on tap, the Supreme Court has a more market friendly make-up, and there is a hiring freeze on many government agencies. These policies will help economic growth, but they are not enough to get it above 2.5% annually.

The latest political news is that the Justice Department appointed a former FBI Director, Robert Mueller, to look into the supposed ties between Russia and the Trump campaign. Some may fret that this is a negative for the market, but we believe it will reduce, to some extent, the bickering in Washington and allow more focus on major policy questions.

Mueller has already had a long career (apparently has very little craving for the limelight) and will conduct a thorough and clean investigation. Leaks will be few and the investigation will drag on for a long time.

This will allow the GOP to focus their efforts on health care and tax cuts. They believe the more legislative accomplishments they have to show their voters, the better off they'll be in 2018.

The politics of these policy changes is complicated. Republican leaders in the House of Representatives have proposed a "border-adjusted tax" which we think is a bad policy move (see our piece from February 13). One reason they did this is because they are trying to make the tax cut "revenue neutral" so that it fits in budget rules and might possibly get some Democrats on board.

The Trump Administration said no to the border adjustment and proposed sweeping tax cuts that Congressional budget experts say aren't revenue neutral. They "score" it as losing tax receipts because they use a "static scoring model" which does not account for revenue from more economic growth. For example, the Congressional Budget Office estimates that 1% more GDP growth over the next 10 years will bring in $3.0 trillion in additional revenue. If you don't score that revenue bump, tax cuts are almost impossible to accomplish.

So, to overcome this budget hurdle, the GOP must use the budget reconciliation process. This means a simple majority is all that is needed to pass the law and no filibuster by Democrats is allowed.

Using reconciliation (a legal maneuver) means that tax cuts that are scored to reduce revenue can't last beyond a 10-year budget window. That's why President Bush's tax cuts "sunset."

Some Republicans, who still want a border-adjusted tax, are digging in their heels and saying the tax cut should be "revenue neutral," and "permanent." These are code words that they want to use the budget rules to force higher taxes on some to pay for tax cuts on others. The "border adjustment" is one way. Others are pushing for a carbon tax

But the US economy doesn't need higher tax rates on anyone, it needs better incentives and that means lower tax rates.

For the past generation, many free-market economists have urged budget scorekeepers to do "dynamic" scoring, which considers the impact of tax cuts on broad economic growth. But the scorekeepers have resisted, which has biased the budget process in favor of higher taxes. With control of the House, Senate, and White House, the dynamic scorekeepers could have the upper hand. If so, Congress could pass actual tax cuts that won't automatically expire at the end of ten years without resorting to offsetting tax hikes on anyone.

But even if they do expire in 10 years, we consider that permanent by DC standards. Reagan cut taxes in 1981, raised them in 1982, and did tax reform in 1986. Bush raised taxes in 1991, Clinton in 1993 and then cut them in 1997. Bush cut taxes in 2001 and 2003, Obama raised tax rates.

The Trump Administration should ignore the budget rule games and find tax cuts that help the economy. It's the politics that is noisy and confusing, the policy is simple.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-23 / 9:00 am	New Home Sales – Apr	0.610 Mil	**0.599 Mil**		0.621 Mil
5-24 / 9:00 am	Existing Home Sales – Apr	5.650 Mil	**5.600 Mil**		5.710 Mil
5-25 / 7:30 am	Initial Claims May 20	238K	**238K**		232K
5-26 / 7:30 am	Q1 GDP Preliminary Report	0.9%	**0.8%**		0.7%
7:30 am	Q1 GDP Chain Price Index	2.3%	**2.3%**		2.3%
7:30 am	Durable Goods – Apr	-1.3%	**-0.8%**		+0.9%
7:30 am	Durable Goods (Ex-Trans) – Apr	+0.4%	**+0.1%**		0.0%
9:00 am	U. Mich Consumer Sentiment- May	97.5	**97.7**		97.7