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The Romney Tax Plan

The US federal budget is a mess. Spending has soared, which has hurt economic growth and undermined tax revenues. The result is four consecutive years of trillion dollar deficits.

Politicians are always tempted to hike taxes to fix deficits, but the US has reached the point where this is not possible. To fix this mess, spending must be reduced. The US has never balanced its budget when spending was more than 19.5% of GDP. Big government undermines economic growth.

But, the fiscal cliff is looming and our tax code is a morass of deductions, one-year fixes, and temporary rate structures. It is clear that President Obama wants to lift taxes on the wealthy and the only question is what that may look like.

Governor Romney wants to make some big changes to the US tax code: extending all the tax cuts that go back to 2001/03, ending the alternative minimum tax, getting rid of the extra income taxes in Obamacare, and then cutting regular income tax rates an additional 20%. Tax rates on regular income that now go from 10% up to 35% would range from 8% up to 28%.

The Romney campaign says his tax cuts are “revenue neutral” if we limit deductions (broaden the tax base) and count the positive effect on revenue of some extra economic growth due to better incentives. But, candidate Romney has been silent on what deductions he will choose to eliminate.

Using 2009 data, we can estimate that in 2015 taxpayers would have about \$1.7 trillion in itemized deductions. In 2015, we estimate that the big deductions would be; Medical (\$170 billion), State and Local taxes (\$333 bil), Real Estate tax deduction (\$237 bil), Mortgage Interest deduction (\$592 bil), and Charitable Contributions (\$223 bil).

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Applying an average tax rate of 25% to the total of these deductions suggests getting rid of all of them would generate an additional \$425 billion – approximately 30% of all income tax revenue. If we include traditional (and cautious) models of positive revenue feedback effects, revenues would likely be boosted by another \$120 billion from better economic growth.

The total increase in revenues from excluding all deductions and a positive revenue feedback loop would be \$545 billion, more than offsetting the cut in tax rates and allowing the code to maintain some popular middle class deductions.

Lobbyists in Washington have a long-standing opposition to ending any deductions and many politicians on both sides stand ready to defend all of them. But these deductions distort the economy by redirecting resources toward areas in a way that does not accurately reflect the most optimum allocation of resources. We hope that the election provides a mandate for this type of reform, it would be very positive.

There is one other major political and budgetary hurdle. The scorekeepers in Washington will not accept the current tax code as the baseline. Instead, they will assume that the Bush tax cuts expire in 2013 and all Obamacare taxes become effective. Any plan that does not include these huge tax hikes will be “scored” as a major reduction in tax revenues.

As a result, the only way to get Romney’s tax cuts passed is to get 60 votes in the Senate. But that’s highly unlikely. Instead, if elected, Romney would have to make his plan temporary using the same special budget process Bush used back in 2001/03, so he could pass them with only 50 Senators.

Bottom line, we like the plan, but don’t expect full passage on a permanent basis. Compromises will have to be made.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-15 / 7:30 am	Empire State Mfg Index – Oct	-4.0	-6.5	-6.2	-10.4
7:30 am	Retail Sales – Sep	+0.8%	+1.0%	+1.1%	+0.9%
7:30 am	Retail Sales Ex-Auto - Sep	+0.6%	+0.8%	+1.1%	+0.8%
9:00 am	Business Inventories – Aug	+0.5%	+0.5%	+0.6%	+0.8%
10-16 / 7:30 am	CPI – Sep	+0.5%	+0.5%		+0.6%
7:30 am	“Core” CPI – Sep	+0.2%	+0.2%		+0.1%
8:15 am	Industrial Production – Sep	+0.2%	+0.2%		-1.2%
8:15 am	Capacity Utilization – Sep	78.3%	78.3%		78.2%
10-17 / 7:30 am	Housing Starts – Sep	0.770 Mil	0.760 Mil		0.750 Mil
10-18 / 7:30 am	Initial Claims – Oct 13	365K	385K		339K
9:00 am	Leading Indicators – Sep	+0.2%	+0.1%		-0.1%
9:00 am	Philly Fed Survey – Oct	0.2	1.0		-1.9
10-19 / 9:00 am	Existing Home Sales – Sep	4.750 Mil	4.650 Mil		4.820 Mil