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First Trust

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Monday Morning Outlook

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Paving the Road to France

It is hard to imagine that markets are not being affected by the potential for major changes in US tax policy. Senator Obama says he wants tax rates back where they were in 2000, while Senator McCain says he wants to keep income tax rates down to a maximum of 35%. With both the House and Senate in Democratic control, Mr. Obama will have an easier time following through on his plans than Mr. McCain.

Mr. Obama has also said he wants to push up tax rates on investment and does not agree that corporate tax rates should be cut. Senator Obama's proposals would not only harm the investment landscape, but they would also make the tax system substantially more "progressive." In particular, Mr. Obama wants to raise taxes on "the rich," but "cut" taxes for 95% of Americans. He does this by giving $500 to anyone who is in the workforce and earns between $8,000 and $75,000 per year. In addition, he would use tax credits to further subsidize daycare, college, and unwed (working) parents.

In many cases, these are not really tax cuts at all but spending programs dressed up as "tax cuts." The IRS will send out the check rather than some other government agency. This is a modern day version of the negative income tax, and it would make the burden of taxes fall even more heavily on those with higher incomes. This is hard to imagine.

In 2005, the most recent year available, the top 1% of households (by income) paid 39% of all income taxes. The top 40% of households paid 99% of income taxes.

These percentages surpass late 1970s levels when the top income tax rate was 70%. Some say that looking at just income taxes overstates the burden on the wealthy, but when Social Security, Medicare, corporate, and excise taxes are included, the top 40% of income earners still pay a whopping 86% of the overall federal tax burden.

Senator Obama apparently believes that this is not enough. His tax plan would make the system even more progressive and would push the US perilously close to the "tipping point," when more than 50% of Americans would pay no income taxes at all.

One implication is that, in any given year, most potential voters will have no direct stake in the federal government spending responsibly. Another is that the federal budget will depend even more on the strength of the economy. Periods of relatively fast economic growth will lead to soaring revenue, while slower growth (or recession) will cause sharper declines.

In the end, the kind of progressivity proposed by Mr. Obama is not sustainable over the long run. Policymakers, hungry for revenue to finance further expansions in government spending – like national health care, or just meeting the huge unfunded liabilities already built into Social Security and Medicare – will eventually find that upscale taxpayers are tapped out and that the only way to get more revenue is to tax the middle class.

After all, the government is so big that it cannot possibly fund itself on just the rich. For example, if the US government confiscated the total wealth of the Forbes 400 – a total of $1.6 trillion – it could only finance the US budget for about 6 months. And if it did that it would take away billions in charity money such as that pushed into the Gates Foundation by Bill Gates and Warren Buffet. So, the only way to generate more money is to tax the middle class.

One way to do that would be to introduce Western Europe's favorite tax: the Value Added Tax. This would actually tax the middle class even more than if marginal income taxes were raised, while making the tax code less progressive.

In the end, it is clear that financial markets have many things to fear. Income redistribution, like France and other social welfare states, leads the list.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-27 / 9:00 am	New Home Sales - Sep	0.450 Mil	**0.478 Mil**		0.460 Mil
10-28 / 9:00 am	Consumer Confidence – Oct	52.0	**48.6**		59.8
10-29 / 7:30 am	Durable Goods - Sep	-1.0%	**-0.2%**		-4.8%
7:30 am	Durable Goods (Ex-Trans) - Sep	-1.5%	**-1.7%**		-3.3%
10-30 / 7:30 am	Q3 GDP Advance	-0.5%	**-0.3%**		+2.8%
7:30 am	Q3 GDP Chain Price Index	+4.0%	**+3.8%**		+1.1%
7:30 am	Initial Claims - Oct 25	475K	**482K**		478K
10-31 / 7:30 am	Personal Income - Sep	0.1%	**+0.7%**		+0.7%
7:30 am	Personal Spending - Sep	-0.2%	**+0.1%**		+0.5%
9:00 am	Chicago PMI - Oct	48.0	**54.5**		56.7
8:45 am	U. Mich. Consumer Sentiment	57.5	**60.0**		57.5