First Trust
Monday Morning OUTLOOK
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Can We Afford a Tax Cut?

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Congress took a big step last week toward enacting some sort of tax cuts and tax reform.

That big step was the US Senate passing a budget resolution creating the room for ten years of tax cuts totaling $1.5 trillion with a simple majority vote. This procedure means there is no need to break a filibuster by getting to 60 votes.

So right about now is when self-styled "deficit hawks" will start to squawk. They will claim the federal government simply can't afford to boost the federal debt, which already exceeds $20 trillion, with no end in sight.

Let's put aside the issue that between 2009-12 many of these deficit hawks were supporting new spending, when annual federal deficits were $1 trillion plus. Let's just take them at their word that they don't think any policy that increases the deficit can be good for the economy.

One problem with their argument is that the $1.5 trillion is an increase in *projected* deficits over a span of ten years, not a definite increase in the debt. If tax reform focuses on cutting marginal tax rates, particularly on overtaxed corporate capital and personal incomes, and can thereby generate faster economic growth, the actual loss of revenue could be substantially less than $1.5 trillion or maybe nothing at all.

The estimate of a $1.5 trillion revenue loss is based on "static" scoring, which means the budget scorekeepers on Capitol Hill make the ridiculous assumption that changes in tax policy can't affect the growth rate of the overall economy. Just a 1 percentage point increase in the average economic growth rate over the next ten years would reduce the deficit by $2.7 trillion, easily offsetting the supposed cost of the tax cut.

Another problem for the deficit hawks is that despite a record high federal debt, the servicing cost of the debt is still low relative to both the size of the economy and federal revenue.

Late last week, we got final numbers for Fiscal Year 2017 and net interest on the national debt was $263 billion – that's just 1.4% of fiscal year GDP. To put that in perspective, that's lower than it ever was from 1974 to 2002. The peak during that era was 3.2% of GDP in 1991. The lowest point since 1974 was 1.2% in 2015, not far from where we are today.

The same is true for interest relative to federal revenue, which was 7.9% in Fiscal Year 2017, lower than any year from 1974 to 2013. The high point during that era was 18.4% in 1991 and the recent low was 6.9% in 2015. Again, we're still pretty close to the recent low.

Yes, interest rates should move up in the years to come, but it will take several years to rollover the debt at higher interest-rate levels. Even if interest rates went to 4% across the entire yield curve, the interest burden would remain below historical peak levels relative to GDP and tax revenue.

The US certainly has serious long-term fiscal challenges. The US government has over-promised future generations of retirees and should ratchet back these spending promises to encourage work, saving, and investment. Meanwhile, we need the US Treasury Department to issue longer-dated maturities like 50-year and 100-year debt to lock-in low interest rates for longer.

However, the absence of these changes should not be an obstacle to boosting economic growth by cutting tax rates and reforming the tax code. Plow Horse economic growth is certainly better than no growth at all, but turning the economy into a thoroughbred would make it easier to handle our long-term budget challenges, not harder.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-25 / 7:30 am	Durable Goods – Sep	+1.0%	**+0.7%**		+2.0%
7:30 am	Durable Goods (Ex-Trans) – Sep	+0.5%	**+0.7%**		+0.5%
9:00 am	New Home Sales – Sep	0.555 Mil	**0.567 Mil**		0.560 Mil
10-26 / 7:30 am	Initial Claims – Oct 21	235K	**238K**		222K
10-27 / 7:30 am	Q3 GDP Advance Report	2.5%	**2.8%**		3.1%
7:30 am	Q3 GDP Chain Price Index	1.7%	**1.6%**		1.0%
9:00 am	U. Mich Consumer Sentiment- Oct	100.7	**101.1**		101.1

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.