

Revolution

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One word that could describe Donald Trump’s unexpected ascendancy to the presidency is – “revolt.” Revolt against the “establishment.” Revolt against the “status quo.”

After all, status quo bureaucracies, tax rates, institutions, regulations, and narratives promised prosperity, yet the economy was mired in slow growth and many felt it was hard to get ahead. Reliably blue states tilted red, and the pendulum swung the other way.

Since 1993, the top federal tax rate on US corporations has been 35%, one of the highest in the world. This has forced US companies to expand overseas. Both sides of the political spectrum knew it was a problem, yet nothing was ever done.

Now the rate is 21%, and full expensing of business investment for tax purposes is law. These changes will boost the incentive to invest and operate in the US, leading to more demand for labor, which means lower unemployment and faster wage growth, as well. From an economic perspective, this is a revolution.

But there’s more. We’re referring to the new limit for state and local tax deductions. That change, combined with a larger standard deduction, will launch an overdue revolution in the policy choices of high tax states as well as the geographical distribution of business activity.

California’s top marginal income tax rate is 13.3%. Under the old tax system, tax payers who itemize could deduct their state income taxes from their taxable federal income. So for the highest earners, the effective marginal rate was 8.0%, not 13.3%. [Deducting 39.6% of 13.3% saved them 5.3%. 13.3% minus 5.3% is 8.0%.]

Politicians in California could raise state income tax rates, and up to 39.6% of the cost would be carried by taxpayers in other states. The same goes for New York City residents, where the top income tax rate is roughly 12.7%.

Now taxpayers are limited to \$10,000 in state and local tax deductions (with a 37% top federal tax rate). The financial pain of living in high tax states is now exposed. California and New York City - and many other high tax jurisdictions - look a lot less attractive than states like Texas, Florida, and Nevada.

This change may limit the measured income and wealth gap in the US between the rich and poor. California and New York don’t just have high taxes, they also have a high cost of living. So, if some high earners in these places leave to take lower pay in places with lower taxes and a lower cost of living, the income and wealth gap would narrow.

But incentives work on all institutions, and policymakers in high-tax states have massive pressure to cut tax rates.

Meanwhile, the Supreme Court is set to rule on Janus vs. American Federation of State, County, and Municipal Employees. Based on a similar case from a few years ago, it’s likely the Court will rule that all government workers (state, local and federal) will have a choice to pay union dues, or not. We know from experience that, when given a choice, many workers stop supporting the political activities of unions. This would be another force significantly altering the balance of power.

Whether you agree with these developments or not, the U.S. hasn’t seen economic policy changes like this in a long time. The forces that support markets and entrepreneurship over government control are reasserting themselves.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-3 / 9:00 am	ISM Index – Dec	58.2	58.1		58.2
9:00 am	Construction Spending – Nov	+0.5%	+0.7%		+1.4%
afternoon	Total Car/Truck Sales – Nov	17.5 Mil	17.6 Mil		17.4 Mil
afternoon	Domestic Car/Truck Sales – Nov	13.3 Mil	13.6 Mil		13.5 Mil
1-4 / 7:30 am	Initial Claims – Dec 30	245K	239K		245K
1-6 / 7:30 am	Non-Farm Payrolls – Dec	189K	187K		228K
7:30 am	Private Payrolls – Dec	185K	183K		221K
7:30 am	Manufacturing Payrolls – Dec	20K	27K		31K
7:30 am	Unemployment Rate – Dec	4.1%	4.0%		4.1%
7:30 am	Average Hourly Earnings – Dec	+0.3%	+0.2%		+0.2%
7:30 am	Average Weekly Hours – Dec	34.5	34.5		34.5
7:30 am	Int’l Trade Balance – Nov	-\$48.7 Bil	-\$50.1 Bil		-\$48.7 Bil
9:00 am	ISM Non Mfg Index – Dec	57.5	57.6		57.4
9:00 am	Factory Orders – Nov	+1.3%	+1.4%		-0.1%