First Trust
Monday Morning OUTLOOK

630-517-7756 • www.ftportfolios.com | August 27, 2018

US Stops Subsidizing Global Growth

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For decades the United States has, directly and indirectly, subsidized global growth. For example, after World War II, the U.S. provided direct economic aid to Western Europe with the Marshall Plan, while also helping to rebuild Japan. And since then, we have provided never-ending direct aid to foreign countries, which has been a constant political football.

But in the economic scheme of things, the biggest subsidies of all have been indirect. For decades the U.S. has held trade tariffs below those of most foreign countries. And until recently, the U.S. has maintained a corporate tax rate significantly above the world average. At the same time, the U.S. hindered, through regulation, its production of energy.

According to the World Trade Organization, before the Trump tariffs were put in place, the U.S. had an average tariff of 3.4%. Canada had an average tariff of 4.0%, the EU 5.1%, Mexico 6.9%, China 9.8%, and South Korea 13.7% - all higher than the U.S., which means the playing field was tilted in favor of foreign countries. The U.S. was subsidizing them.

In 1993, America lifted its federal corporate tax rate to 35%, from 34%. When combined with state and local corporate taxes, the average rate was 38.9% and held there until the Trump tax cut in 2017. In 1993, the average worldwide corporate tax rate was roughly 33% (about 6 percentage points below the U.S.) and by 2017, the average had fallen to 23% (about 16 points below the U.S.). In other words, at the margin, businesses looking to invest globally had an incentive to invest outside of America.

The slowing of energy production in America became a direct subsidy to those who produce energy. Russia, Saudi Arabia and the Middle East, Venezuela and Mexico all benefited as the U.S. bought most of its crude oil from overseas.

But things have changed – in a huge way. The geopolitical implications of this are coursing through the world right now. In some places, like Venezuela, it's an economic crisis. In others, like China, it's reflected in slowing economic growth. And if anyone doesn't understand the relationship between fracking and the fact that women in Saudi Arabia will be allowed to drive, they aren't thinking hard enough.

But, more to the point, cutting the U.S. corporate tax rate to 21% and boosting tariffs on select countries and products is removing a huge subsidy to growth for the rest of the world. The U.S. is the dominant economy in the world and when it stops subsidizing foreign countries, who have not followed free market principles, economic pain spreads.

The U.S. has become not only the largest producer of petroleum products in the world, but a net exporter to some regions. And output keeps going up. This is altering the balance of world power in a huge way.

The impact of all this is to put pressure on other countries to come back to the table and talk about more equal trade. It also forces countries that previously were able to have high income tax rates, huge government budgets, and lots of red tape to rethink their fiscal policies. The global establishment have never been under attack like they are today. The world order is changing for the better.

This means the U.S. economy and its stock markets are in better shape relative to others. However, if these pressures really do lead to more freedom and less political interference in economic activity, the world could end up seeing a boom like it did in the 1980s, when Reagan's tax cuts led other countries to follow suit.

While news shifts rapidly, the pressures we outlined above already seems to have pushed Europe, Mexico, Canada, and China to negotiate on trade. We think this will eventually lead to lower tariffs, not a full-blown trade war. After all, because the U.S. is removing a subsidy to these countries, their growth will suffer relatively more. They have an incentive to follow better policies.

No one knows exactly how this will turn out, or whether the establishment will fight back and find a way to resist change. But, for now, the U.S. is benefiting from an increase in investment and growth due to better policies.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-29 / 7:30 am	Q2 GDP Preliminary Report	4.0%	**4.1%**		4.1%
7:30 am	Q2 GDP Chain Price Index	3.0%	**3.0%**		3.0%
8-30 / 7:30 am	Initial Claims – Aug 25	213K	**213K**		210K
7:30 am	Personal Income – Jul	+0.4%	**+0.4%**		+0.4%
7:30 am	Personal Spending – Jul	+0.4%	**+0.4%**		+0.4%
8-31 / 8:45 am	Chicago PMI	63.0	**64.8**		65.5
9:00 am	U. Mich Consumer Sentiment- Aug	95.5	**95.3**		95.3