First Trust Portfolios Canada®
Monday Morning OUTLOOK

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Budget Rule Shenanigans

The Tax Cut and Jobs Act (TCJA) was passed in 2017, otherwise known as the Trump Tax Cuts. Because of arcane budget rules, the TCJA will "sunset" or expire at the end of 2025 in the absence of a brand-new tax law. The potentially expiring tax cuts include those on regular income as well as estates and qualified small businesses.

In turn, a key legislative problem throughout the process will be biased budget rules. You'd think that just keeping the tax code the same as it was this past year wouldn't take any special political effort at all, but that's not how it works.

Tax legislation must be "scored" by the Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO), in order to estimate the impact on revenues in future years. If the JCT and CBO compare current tax rates to the rates that existed before the TCJA, they call it a tax cut all over again. This scores as a cut in revenue (therefore a boost in the deficit from its current path), and 60 votes in the US Senate are necessary to make the new law permanent.

The other option is to find "pay fors" – offsetting tax hikes or spending cuts – that would "pay" for the tax cuts. If there aren't 60 Senate votes or enough "offsets," a tax cut can be made "temporary" as long as it fits inside other arcane rules. This is what happened in 2017. It's why the TJCA expires in 2025.

So, the same issue will come up next year when the Trump Administration tries to extend the current tax rates. Senate rules say that if tax rates stay at the exact same level they are today, this will "cost" approximately $4 trillion in revenue over the next 10 years. Therefore, the Senate needs 60 votes to do this.

The problem is that the CBO and JCT were totally off on their forecasts of tax revenue back in 2018 when they scored the TCJA. In April 2018, the CBO said revenues would be $4.4 trillion in 2024. The were actually $4.9 trillion. Inflation, you say? OK…the CBO estimated that tax revenues would average 17% of GDP between 2021 and 2024, but they actually averaged 17.7% of GDP. To put this in further perspective, from 1974-2023, the average federal tax share of GDP has been 17.3%.

In other words, the tax cuts did not lose anywhere near the revenue the CBO projected. Prior to the TCJA, the CBO said revenues would rise to 18.1% of GDP between 2021 and 2024. They estimated the TCJA would drop that to 17% of GDP, when in reality it averaged 17.7%. Why? Because government scores tax rate changes "statically." But we all know the world is not static. Behavior changes when people face different incentives, and tax rates are a big one.

The biggest problem today is not tax revenues…it is spending. Back in 2018, the CBO forecasted that total public debt would be $22.9 trillion at the end of FY 2024. The actual figure was $28.3 trillion. Congress never has a problem spending more, and the rules are biased against tax cuts.

It is true that tax rates are "scheduled" to rise in 2026 and the CBO estimates this will raise revenue. But the CBO underestimated revenue after the TCJA. So, if Congress cannot find a way to say "extending current tax rates costs nothing," the least it can do is admit that it underestimated the loss in revenue by 0.7% of GDP (17% vs 17.7%). That would mitigate more than 60% of the costs of extending the TCJA. Revenues did not fall from 18.1% of GDP to 17%...they were actually 17.7%.

Without moving to dynamic scoring, the government must pay for tax cuts with spending cuts or other tax hikes. In the past, Congress has scored potential savings from new rules in its budget, so why not score DOGE (the Musk-Ramaswamy enterprise) as cutting spending, even if it will come at some later date? Who actually thinks they won't be somewhat successful?

The most frustrating part of all this is that if a new Administration and Congressional majorities wanted to _raise_ taxes rather than reduce taxes the same burdensome legislative hurdles would not apply. A bill to raise taxes would be assessed using static scoring – no slower economic growth – and would show revenue going up, and then be allowed as a _*permanent*_ change to the tax code, with no need for periodic temporary extension bills like tax cutters will have to pass next year. That is totally unfair!

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-26 / 9:00 am	New Home Sales – Oct	0.725 Mil	**0.726 Mil**		0.738 Mil
11-27 / 7:30 am	Initial Claims – Oct 23	215K	**215K**		213K
7:30 am	Q3 GDP Preliminary Report	+2.8%	**+2.8%**		+2.8%
7:30 am	Q3 GDP Chain Price Index	+1.8%	**+1.8%**		+1.8%
7:30 am	Durable Goods – Oct	+0.5%	**-0.5%**		-0.7%
7:30 am	Durable Goods (Ex-Trans) – Oct	+0.1%	**-0.2%**		+0.5%
7:30 am	Personal Income – Oct	+0.3%	**+0.3%**		+0.3%
7:30 am	Personal Spending – Oct	+0.4%	**+0.3%**		+0.5%
11-29 / 8:45 am	Chicago PMI – Nov	45.0	**43.1**		41.6