

Northwood University's Monthly Economic Outlook

March 25, 2011

Introduction

As we enter the third month of 2011, the U.S. economy currently is moving in a positive direction as revised 4th quarter GDP for 2010 came in at 3.1%. We are concerned regarding the first half of 2011 based on what higher oil prices and Japanese parts production constraints will do to Spring automobile sales, coupled with the outlook for bi-partisan cooperation, the extension of the Bush tax cuts, and a personal savings rate of nearly 6.0%. We continue to be concerned about the mounting U.S. deficit, which is now greater than \$14.2 trillion and the mixed signals being sent from the Congress and The White House as to how to control the size and scope of government spending and the national debt. We are also concerned about the future value of the U.S. dollar with inflation signals being sent by the price of oil, gold, silver and food, as well as CPI data which shows inflation up 2.11% in February.

Key January/February Data

Positive Signs

According to the latest Manufacturing ISM Report on Business, the manufacturing sector of the U.S. economy continued to grow in February as evidenced by the Purchasing Managers index which increased to 61.4%, its highest level since January, 2004. U.S. productivity remains near record levels while cash balances for non-financial based U.S. corporations is at 1.98 trillion dollars. The Dow Jones Industrial Average rose 286 points in the month of February, an increase of 1.5%, while the survey of consumers intending to purchase an automobile over the next 6 months remained positive in February. The February Conference Board Global Leading Economic Indicators report shows U.S. and Europe were positive, growing at .1% and .5% respectively, while China was negative down .5%. The U.S. savings rate continues at a strong pace, once again realizing a rate of 5.8% in

February. Automobile, SUV and light truck vehicle sales were up 21.17% in February 2011, versus January, 2011 and more than 26% versus February, 2010. January and February suggest that inflation is running at an annualized rate of more than 3 percent. The U.S. unemployment rate dropped to 8.9%, down .1% from January, 2011, with private sector employment increasing by 192,000 jobs from January, 2011 to February, 2011. The Conference Board report on consumer confidence showed a substantial increase of more than 5.6% in February.

Negative Signs

While the national unemployment rate made progress in January, falling by .1%, it still stands at a sobering 8.9%. The average 30-year fixed mortgage rate rose from 4.79% in February to 4.86% at the end of February 2011. Gold surged in February and has settled at \$1412 per ounce in early March, while silver increased from its end of February high to close in early March over \$35.00 an ounce. The price movements in mortgage rates and silver, coupled with recent FED policy and the resignation of a key FED board governor gives us further reason to be concerned regarding future inflation. Unemployment benefits remain at record highs and will continue at these levels for at least the next 12 months. The U.S. dollar was mixed against the Euro in February and saw little change against the Yen. Finally, we continue to be concerned over Libya, Japan and the Middle East, as well as the slow resolution of the U.S. mortgage crisis. Sales of new homes hit a 40-year low in February and U.S. corporations are now holding \$1.2 trillion dollars overseas due to the cost of current U.S. tax policy.

Current Issues

The U.S. tax rate and regulatory structure in the U.S. is highly burdensome. By May of 2011, we will have the highest corporate income tax rate in the industrialized world. As Congress debates spending

cuts and tax reform, we are more than intrigued by the work of Dr. Karen Walby, Chief Economist, Americans for Fair Taxation below:

1. The Fair Tax or national retail sales tax, according to the Tax Foundation, America's oldest national tax research organization, would cause compliance costs to drop more than 90 percent and would replace all federal income and payroll taxes with a simple national sales tax exempting those with incomes below the poverty level from said tax.

2. The constantly growing complexity of our tax system is part of a trend that began in 1913 and has only accelerated with the nearly perennial enactment of new tax legislation with 4,428 changes to the tax code in just the last decade. In 2010 alone there were 579 changes, more than one per day! The continuous tinkering with the tax code has resulted in tripling the length of the tax code, now a mind-boggling 3.8 million words. The combined federal income tax code, regulations, and IRS rulings have grown from 14,000 pages in 1954 to 70,320 pages by 2009 – an increase of 502 percent.

3. In 2009, the total number of U.S. returns was 236.5 million, excluding informational returns. The number of penalties provides another good measurement of the complexity and cost. In 2003, Americans were assessed 36,228,339 civil penalties (26.4 million for the individual income tax alone). The corporate income tax required the issuance of 970,098 penalties and the employment tax had 7,918,580 penalties issued to businesses that employ people. To administer the tax laws, the IRS directly employs about one hundred thousand employees. The IRS budget is about \$11.7 billion outstripping growth in the economy and the population.

4. According to Taxpayer Advocate Service (TAS), individual taxpayers and businesses spend an estimated 6.1 billion hours each year complying with the filing requirements of the Internal Revenue Code (henceforth called “compliance costs”). The Tax Foundation estimated compliance costs to exceed \$265 billion. This amounts to imposing a 22.2-cent tax compliance surcharge for every dollar the income tax system collects. By 2015, compliance costs are expected to grow to \$482.7 billion.

5. Small firms in particular, according to the National Commission on Economic Growth and Tax Reform, are forced to waste 3 to 4 dollars complying with the law for every dollar they pay in taxes.

6. According to the Taxpayer Advocate Service, the IRS received 110 million calls in each of the last two fiscal years; 25 percent of which the IRS was unable to answer. In addition to the telephone calls, the IRS must process more than 11 million pieces of taxpayer correspondence annually.

Conclusions

The Fair Tax deserves a close look as it reduces the more than 700 incomprehensible sections of the Internal Revenue Code to one simple question. As all goods and services for final consumption are taxable, the retailer need answer only “how much did I sell to consumers?” The twin advantages of simplicity and visibility produce another benefit: Greater enforceability with less intrusiveness.

Contact Us

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