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Introduction

The United States is trying to shake off one of the most challenging economies in its history. By most standards for business it was the worst year since the Great Depression. Annual U.S. Gross Domestic Product (GDP) declined 2.4 percent, while Global GDP declined by 2 percent. In May of 2008 the market value of the NYSE (the largest single estimate of wealth in the United States) was just over \$28.5 trillion. By March of 2009 it had collapsed to \$10.0 trillion, erasing \$18.5 trillion in market value from the asset base of this country. Today, the U.S. economy is improving but still faces daunting financial issues, indecisive consumers and investors, unpredictable and unprecedented government fiscal and regulatory policy, record levels of government spending and a mounting record national debt.

Key May/June Data

Positive Signs

According to the latest Manufacturing ISM Report on Business, the manufacturing sector of the U.S. economy failed to grow for the 10th consecutive month as the Purchasing Managers Index (PMI) fell 3.5% but is still at a healthy 56.2%. U.S. productivity is near record levels while cash balances for corporations are at an all-time high. Private sector employment edged up by 83,000 jobs in June.

Negative Signs

A disappointing Conference Board Report on June consumer confidence, lower than initially reported growth in the Chinese economy, and concern over the European

Debt Crisis ended the month of June on a low note for U.S. investors and the economy as a whole. The Conference Board Report noted that consumer's intending to purchase a new automobile over the next 6 months sunk to the lowest level since 1967 while those intending to purchase a new home over the next 6 months declined to 1982 levels. As of the end of the trading day on June 30, the Dow Jones Industrial Average was down 1,484 points or 13.19% from its year to date high in late April and down more than 200 points for the year. U.S. businesses are burdened by the second highest average corporate income tax rate in the industrialized world at 39.27% with the likelihood of a tax increase in the future better than average. The U.S. unemployment rate is expected to remain at 9.5% to 9.7% for the near term with 225,000 temporary census taker jobs eliminated in June.

Current Issues

Many economists and politicians are concerned about the future of the U.S. economy after disappointing economic results from almost two years and nearly \$1.5 trillion in TARP and stimulus spending leaving unemployment hovering around 9.5%. Today, many are calling for additional stimulus dollars suggesting that increased government spending is truly the solution and recent policy underestimated "the severity of the problem" and the level of stimulus spending needed. However, it seems the presidencies of John F. Kennedy and Ronald W. Reagan serve as strong cases for the effectiveness of tax cuts in stimulating economic growth during difficult times. Recall what President Kennedy said about his

own tax-cut based stimulus package in 1962: “In short, to increase demand and lift the economy, the federal government’s most useful role is not to rush into a program of excessive increases in public expenditures, but to expand the incentives and opportunities for private expenditures.” President Kennedy’s tax cut was implemented after his death by President Johnson in 1964, with personal income tax rates declining 23.1 percent for the top income earners and 30 percent for the lowest. Corporate income tax rates were reduced by 9.6 percent the same year. The economy responded with an average annual real growth rate of 4.65 percent in U.S. GDP from 1963 to 1968, and unemployment dropped from 6.6 percent in 1961 to 3.7 percent in 1968. President Reagan’s across the board tax cut of 25 percent was phased in from 1981-1983 and helped bring the U.S. economy out of the severe economic recession of 1981-82 which saw the prime interest rate peak at 21.5 percent in 1981 (the highest since the Civil War), real GDP declined by 2.2 percent in 1982, and unemployment reach 10.8 percent also in 1982. The economy responded with an average annual real GDP growth rate of 3.87 percent from 1982 – 88, unemployment declined to 5.4 percent by 1988, and real tax revenue grew by 25.5 percent from 1983 to 1988. Recall that average government spending exceeded average tax revenue growth by 4.22 percent for most of the 1980’s, thus creating the budget deficits of the Reagan years and hopefully providing evidence that tax cuts (today) can be powerful and government spending must be kept in check. Finally, a recent study by President Obama’s Council of Economic Advisors, Chairperson Christina Romer and her fellow University of California, Berkeley

economist husband, David Romer, (published before she joined the president’s leadership team) found the “multiplier effect” for tax cuts is much greater than the “multiplier effect” of government spending programs. In fact, it directly contradicts the 2009 Obama administration’s research that the government spending multiplier was 1.57 while the tax cut multiplier was only .99. The Romer’s research concluded that the “multiplier effect” of tax cuts is 3.0. In fact, a study by Valerie Ramey (University of California, San Diego) finds the government spending multiplier to be only 1.4 while Andrew Mountford (University of London) and Harold Uhlig (University of Chicago) determined that tax cuts are four times more effective than increased government spending to jump-start a failing economy. The following is an example of the theory behind the “multiplier effect”: If government cut taxes by \$100 billion dollars and “the multiplier” was 2, the tax cut would lead to \$200 billion in additional GDP.

Conclusions

Due to economic uncertainty, companies will continue to cut costs and strive for productivity increases while attempting to hold quality at high levels. Pressure to outsource will continue unless the cost of doing business in the U.S. improves. The need to cut wasteful government spending is at an all-time high and it should be coupled with a Kennedy-Reagan style (across the board) tax cut which will increase tax revenue to the government and ignite consumer and investor confidence. If we do not, there is a high likelihood of a double dip recession in 2011 or 2012.



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