

Northwood University's **Monthly Economic Outlook**

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Introduction

The United States economy is still trying to shake off one of the most challenging economies in its history. By many standards, 2009 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. Currently, 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. Real GDP increased at an alarmingly slow pace for the first half of 2010, decreasing from a finalized real growth rate of 5.6% in the fourth quarter of 2009 to 2.4% in the second quarter of 2010. This leaves second quarter GDP at levels not seen in almost a year. With many economists estimating that the first revision of second quarter GDP could leave growth as low as 1.7% stimulating greater uncertainty and concern.

Key June/July Data

Positive Signs

According to the latest Manufacturing ISM Report on Business the manufacturing sector of the U.S. economy grew in July at a decreasing rate as the Purchasing Managers Index fell .7% but is still at a healthy level. U.S. productivity remains near record levels while cash balances for corporations again are at an all-time high.

Private sector employment remained positive edging up by 71,000 jobs in July according to the Bureau of Labor Statistics. The DJIA gained back two-thirds of its June losses in July closing up more than 1,000 points at month's end while the survey of consumers intending to purchase an automobile over the next 6 months rebounded significantly up 9.7% in July. Finally, the Conference Board's Leading Economic Indicators for Europe and China were positive in July growing at .5% and .8% respectively.

Negative Signs

A disappointing U.S. Conference Board Report on July consumer confidence, lower job growth and slow home sales ended the month of July with much concern for U.S. investors and the economy as a whole. The Conference Board Report noted that consumer's intending to purchase a new home over the next 6 months declined by 5%, the lowest level since early in 1982. 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 remained at 9.5% in July with 14.6 million Americans unemployed and an additional 143,000 temporary census taker jobs eliminated in July. Total nonfarm payroll employment dropped by 131,000 while unemployment benefits were extended to a record 99 weeks by the U.S. Congress.

The U.S. Federal Reserve Bank recently decided to reinvest the proceeds from the sale of mortgage back securities into U.S. Treasuries in an effort to stem the fall of the U.S. Dollar in Europe and elsewhere. The dollar fell to a 15 year low of 84.72 versus the Japanese Yen after the action was announced.

Current Issues

The American economy is changing and not for the better.

Over the last 24 years, corporate tax rates in Organization for Economic Cooperation and Development (OECD) countries went from an average rate of 45% to less than 30%. The OECD represents thirty of the largest, freest and most productive economies in the world. Recently, with the increased mobility of multinational corporations, tax competition has intensified leaving businesses operating in the United States at a competitive disadvantage, with the second highest corporate tax burden in the world (39.27%), slightly lower than Japan (39.54%). From 2000 to 2009, 25 out of 30 OECD countries cut their corporate tax rate, 4 left it unchanged and Hungary increased its rate from 18% to 20%. The result is that the average rates in OECD countries dropped from 33.69% in 2000 to 26.60% today. The average OECD rate is nearly 13 percentage points below the U.S. tax burden on corporations, making it difficult for America to compete at a corporate tax rate 50% higher than the OECD average. Even more so, it is difficult to understand U.S. corporate tax rates given the lower corporate tax rates in former communist countries like Russia (24%), China (25%) and India (33%).

In 1980, the top 5 percent of tax returns

filed paid just over 36.84% of the total individual federal income taxes received by the government and paid an average tax rate of 26.85%. According to IRS data from 2007 (most recent available) the top 5% paid 60.14% of the individual federal income taxes received by the federal government and paid an average tax rate of 20.69%. Lower tax rates create incentives to work hard, earn more money, spend, save, invest and often pay more in net taxes as evidenced by the top 5% of income earners in 2007. Higher tax rates almost always create disincentives to work hard, produce more and pay taxes; proposed higher taxes on the top 5% of income earners is not what this nation needs.

Conclusions

Our concern regarding a double dip recession in 2011 or 2012 as noted in last month's economic update has only been heightened by the events of the past month. The U.S. economy is facing many obstacles and lacks consumer and business confidence. Why?

Today, there is no clarity, no dependability, no predictability and no continuity with the policies and traditions that made America great—the same policies and traditions that are currently transforming many economies around the world.

Confidence and strong sustainable growth will only return to this economy when rational tax and spending policy returns to Washington.

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