Northwood University's
Monthly Economic Outlook

September 10, 2010

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 showing mixed signs of improvement and 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 left second quarter GDP at a level not seen in almost a year. Unfortunately, the first revision of second quarter GDP released in August came in at a growth rate of just 1.6% stimulating greater uncertainty and concern.

Key July/August Data

Positive Signs

According to the latest Manufacturing ISM Report on Business the manufacturing sector of the U.S. economy grew in August at a strong rate as the Purchasing Managers Index rose .8% and remains at a healthy level. U.S. productivity remains near record levels while cash balances for corporations are at an all-time high with non-financial based U.S. corporations holding more than $1.8 trillion for investment. Private sector employment remained positive edging up by 67,000 jobs in August according to the Bureau of Labor Statistics. Pending home sales showed some improvement in August with fixed mortgage interest rates at record lows while the survey of consumers intending to purchase an automobile over the next 6 months remained positive in August. Finally, the Conference Board's Leading Economic Indicators for the U.S., Europe and China were positive in August growing at .1%, .5% and .8% respectively. The Conference Board Report on August Consumer Confidence turned slightly positive after back to back negative months and the U.S, savings rate hit 5.9% in August.

Negative Signs

Disappointing job growth and slower automobile sales ended the month of August with concern for U.S. investors and the economy as a whole. The DJIA was down 700 points for the month of August giving back most of the previous months' gains. 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 inched up to 9.6% in August with 14.86 million Americans unemployed and an additional 114,000 temporary census taker jobs eliminated in August. Total nonfarm payroll employment dropped by 54,000 while unemployment benefits remain at the record high extension of 99 weeks.

Current Issues

President Obama and the U.S. Congress need to carefully consider and debate the proper role and size of government in light of the $13.44 trillion dollar U.S. national debt and the slowing U.S. and global economy. We hope the following suggestions will resonate as possible solutions to the many questions said debate will leave Americans to resolve. Clearly Americans are worried about their futures and those of their children and grandchildren and blame politicians for much of their stress and economic condition.

1. Create a bi-partisan commission to investigate the reform of our federal corporate and individual tax systems and report back to

the American people in one year. Having the second highest corporate income tax rate in the industrialized world and having the top 1% of all individual income earners paying 40% of the total individual income tax burden creates disincentives to economic growth. Strong consideration of a proportional or flat rate tax or a narrow tax range based on the research of Arthur Laffer should be made. Countries such as China and Hungary seem to have had great success recently with lower, more incentive-based tax systems.

2. Create a bi-partisan commission to investigate a federal "Balanced Budget Amendment." As of 2002, 49 states have balanced budget requirements, most of which are written into their constitutions. Over the years, the total combined expenditure made by all 50 states annually is just under 50 percent of federal spending annually. Yet, the cumulative total of state debt realized over time is roughly one-tenth of the U.S. national debt…mandated budget constraints seem to work.

3. Create a bi-partisan commission that would study the opportunity to reduce the size, scope, and cost of government by considering the privatization of programs such as social security, VA Hospital Administration, maintaining and building roads, and space exploration. Many countries such as Germany, Chile, Mexico, and Japan are experimenting with privatization and having great success.

4. Roughly 29.6 percent of all land in the United States is owned by the federal government. If a constitutional constraint on government spending were adopted, it should force an end to the out of control government spending of the last 30 years. Then the federal government could consider the sale of some land and mineral rights to raise dollars to retire a significant portion of our national debt.

Conclusions

Our concern regarding a double dip recession in 2011 or 2012 noted in the last two economic updates 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?

There is still no clarity, no dependability, no predictability and no continuity between Washington, Wall Street and Main Street 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 as well as most of our state governments and major cities.

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