Popular Economics

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Popular Economics Weekly

Who Loves Taxes?

So much good economic news is coming of late that some of the pessimism is being drowned out from the longest lasting downtown since the Great Depression. The economy is growing again, stocks rallying, and consumers are spending with robust holiday sales. So the pessimists are now focusing on the possibility that this will be a ‘W’, vs. ‘U’ shaped recovery—but in 2011. Why the return to recession in 2011? Surprise, surprise, it turns out that 2011 is when the Bush tax cuts expire, and tax cuts always stimulate growth, right,?

However, one would think that now is not the time to retain tax cuts that are responsible for 23 percent of the current $1.59 trillion federal deficit, according to the Center on Budget and Policy Priorities (CBPP). But that is a political rather than economic issue, since most economists agree that the debt can only be paid down with new revenues. This is because lost revenues from all tax cuts since 2000, and the current recession amount to 50 percent of the deficit. War costs account for another 11 percent, while the various government stimulus plans account for 27 percent of the current deficit, according to CBPP.

The optimists can begin to crow because real estate is really beginning to recover, as home construction as well as home sales and housing prices have continued to rise, while shrinking inventories. Nationwide housing construction rose 8.9 percent in November to a seasonally adjusted annual rate of 574,000 units, per the Commerce Department.

And in the third quarter, housing production rose across all regions of the country with a 16.4 percent increase in the Northeast, a 3 percent gain in the Midwest, a 12.3 percent increase in the South and a nearly 2 percent gain in the West. This is good news because it shows that the 7-month inventory of new and existing-homes for sale is stimulating greater new-home construction. In Q3 overall, builders took out 13 percent

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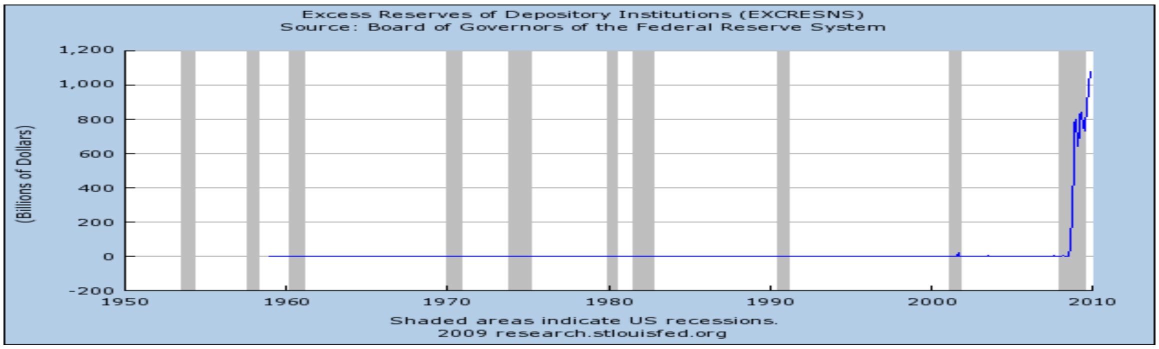
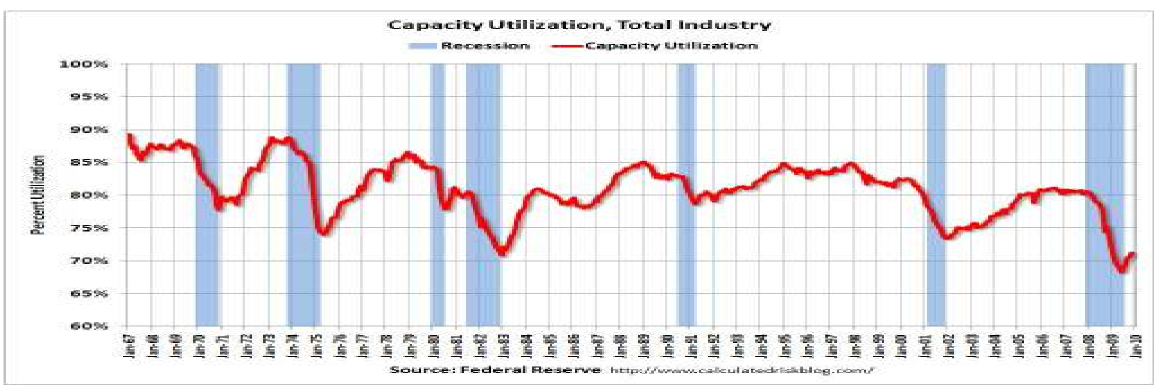
more in housing permits and started construction of 9 percent more new homes over Q2, according to the U.S. Dept. of Housing and Urban Development (HUD).

History has shown us that tax cuts don't help during recessions, as we have said in past columns because cuts don't directly stimulate the demand needed to create new jobs. Tax savings are hoarded by businesses during such times, and by consumers that have to pay down their debts. A real eye opener is that excess reserves held by depositary institutions supervised by the Federal Reserve has risen to more than $1 trillion, from $0 at the begging of this recession.



More good news is that industrial production increased 0.8 percent in November. Manufacturing production advanced 1.1 percent, with broad-based gains among both durables and nondurables, a sign of increased exports. Capacity utilization for total industry moved up 0.7 percentage point to 71.3 percent, which is still 9.6 percentage points below its average for the period from 1972 through 2008, so if history is any guide, it will be another year before normal growth is restored.



And lastly, the Conference Board's Index of Leading Economic Indicators rose for the eighth straight month—0.8 percent, and has reached its July 2007 high, which means that economic growth will continue into next year—no 'W' shaped recurrence of this recession is forecast, in other words. The Conference Board's Ken Goldstein said, "Looking ahead, we can expect a slowly improving economy through 2010."

All of this news could mean as much as 4 percent GDP growth in the fourth quarter, as the increased demand pushes producers to replenish their depleted inventories in goods and services.

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