John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday April 7, 2021

The U.S. economy is booming. Manufacturing is running at the fastest pace since the early 1980s. Consumer confidence is soaring - 109.7, up 21.3% from February - and far better than the 96.0 economists expected. There were an astounding 916,000 new jobs created in March. And the new jobs number was revised upwards by 156,000 for January and February. Politicians in Washington want to take credit for the positive surge in the economy. Senator Chuck Schumer said: "If the American Rescue Plan could lead to these numbers, imagine what an even bigger, bolder American Jobs Plan will do for our recovery."

There is one big problem for Schumer and the political spinners. Much of the recent spending plan money has not been spent yet. It is hard to take credit for something that hasn't happened. Clearly the real cause of the good news is the rapid development and rollout of vaccines. "These job gains would have happened if Congress did nothing. The March job surge shows that the $1.9 trillion was largely unnecessary." (*The Wall Street Journal*, April 3, 2021)

Federal Reserve policy makers now project GDP will grow 6.5% this year, that is up from a 4.2% growth forecast last December. And that may turn out to be too pessimistic. When the economy is growing quickly forecasters tend to set their sights too low. For example, economists expected the economy to grow 2%-2.5% from 1996-1999. Looking back, we now know the actual growth rate was 4% in each of those four years.

The economy is recovering faster than expected. The rate of growth is high because the recession, while short, was devastating. Once the economy has recovered the rate of growth will slow down. Wall Street economists see growth settling down to a 2%-2.5% rate by 2022. That may turn out to be too optimistic because of a potential crowding out of credit for the private sector and the consequences from the coming Biden tax increases.

President Biden wants to raise the corporate tax rate to 28% from the current 21%. That would be a drag on the economy leading to lower wages and lower investment. Corporations really don't pay taxes. They are financial vehicles. The tax costs fall on consumers in the form of higher prices and on workers in the form of lower wages. Kevin Hassett, Aparna Mathur, Lawrence Kotlikoff and other economists have done extensive work showing how lower corporate tax rates result in higher wages. Higher after-tax profits mean more corporate investment, which means more productive workers, whom companies can afford to pay more. After the Trump corporate tax cut the wealth gap in the United States shrunk as wages for the lower income group rose much faster than for the upper income group.

As the editors of *The Wall Street Journal* say: "In other words, Mr. Biden's corporate tax increases will hit the middle class hard—in the value of their 401(k)s, the size of their pay packets, and what they pay for goods and services. This damage won't show up immediately, especially as the economy booms as Covid eases this year, but the corrosive impact will compound in coming years."

The outlook gets worse when you read more about the larger goal Biden and the Washington left want to achieve.

The larger Biden goal is to end global tax competition, much as its ban on state tax cutting seeks to end income-tax competition among the 50 states. "The United States can lead the world to end the race to the bottom on corporate tax rates," says the White House fact sheet. Mr. Biden says he wants "other countries to adopt strong minimum taxes on corporations" so nations like Ireland can no longer compete for capital with lower tax rates. "Only in Washington would the left punish American employers in the hopes that the rest of the world will be as self-destructive." (*The Wall Street Journal*, April 1, 2021)

The legendary economist Thomas Sowell says that competition breeds competence. In other words when you eliminate competition the result tends to be incompetence. Eliminating tax rate competition among U.S. states and world nations would result in fiscal incompetence.

Fortunately, other countries are not following the Biden corporate tax plan. After the Trump corporate tax cut the leaders of other major economies followed suit and cut corporate taxes. The trend is not slowing. The Tax Foundation reports that "several countries are planning to reduce their corporate tax rates in the coming years," as competition for mobile capital and jobs intensifies. The Netherlands will slash its rate to 21.5% this year from its current 25%. France and Sweden will be reducing their rates to 25.8% and 20.6%. And China's corporate tax rate is 25%. When you combine U.S. federal and state corporate taxes the U.S. rate is 32.4%. Clearly the Biden corporate tax plan is going in the wrong direction and will hurt the U.S. economy.

With regard to the lower corporate tax rate, French Finance Minister Bruno Le Maire said: "Producing in France will be cheaper—it's as simple as that." On the broader subject of raising taxes to pay rising national debt he said: "Yes, debt will have to be paid back. But not by raising taxes---by raising growth." If only the Washington left would get that message.

Not only is our longer-term economic growth being threatened by rising taxes; there is the potential for crowding out in the credit markets. As I wrote last week there are limits to how much bank capital is available for the purchase of Treasury securities and loans to private sector businesses and individuals. I am old enough to remember the phrase "crowding out." It was once popular and widely discussed as federal government debt increased. There was real fear that the government would soak up so much available credit that the economy would suffer from a lack of investment. Today we have government debt soaring with numbers that are astounding, so large that they would have shocked the old crowding out worriers. Yet I am not seeing that phrase in economic reports and forecasts. Never-the-less the numbers are the numbers and there really is a limited amount of available capital. The risk I see from the Biden policies and huge federal debt is an economy that slows to rates below 2% in 2022 and 2023.

The good news is that for the rest of this year the rollout of vaccines and a gradual return to normal means holding stocks is the best investment strategy.

I will have the next market review and update one week from today on Wednesday April 14, 2021.

All the best,

John Dessauer