Why We Need New Leadership at the Federal Reserve
October 25, 2017
by Gary Halbert
of Halbert Wealth Management

1. President Trump Prepares to Name New Fed Chairperson
2. My View: It’s Time For a Change in Leadership at the Fed
3. President Considering Outsiders to Fill Fed Vacancies
4. See Who Pays the Most in Income Taxes in America
5. More Thoughts on Cutting Corporate Income Tax Rate

President Trump Prepares to Name New Fed Chairperson

President Trump is finalizing his decision on who will head-up the Federal Reserve when current Fed Chair Janet Yellen’s term is up in February. He also needs to appoint another person to fill the now vacant Fed Vice Chairman spot due to the resignation of Stanley Fischer earlier this month.

Mr. Trump interviewed Janet Yellen last Thursday and afterward the president reportedly said, “I like her a lot.” and suggested she is still a strong candidate for the job. Yet in an interview with Fox Business following the meeting, Mr. Trump mentioned by name two other leading candidates: Stanford University economist John Taylor and current Fed Governor Jerome Powell. The president is also said to be considering at least two other candidates.

Most of those who oppose President Trump on just about everything are urging him to reappoint Janet Yellen to another term. If not Yellen, then they say it should be Jerome Powell due to his experience at the Fed and the fact that his dovish views are very similar to Yellen’s.

The Yellen-Powell advocates are telling the president that the duo has avoided any big monetary mistakes, that they favor low interest rates and there’s no reason to take a risk on someone new. This despite the fact that Yellen seems intent on raising the Fed Funds rate several times over the next couple of years, as well as reducing its massive balance sheet.

My View: It’s Time For a Change in Leadership at the Fed

I would argue, however, that the Fed needs a change in leadership. Here’s why. Chair Yellen’s
tenure as head of the Fed has come during an unusually quiet financial and monetary period – one in which economic growth was 2% or less and inflation was low. Put bluntly, it didn't require a lot of leadership from the Fed.

Yet if President Trump succeeds at getting the tax reform he wants, additional deregulation and a large infrastructure program, the economy could heat up significantly. The economy already topped the 3% threshold in the 2Q at 3.1% in GDP. Most estimates I've seen for the 3Q are close to 3% despite the initial setback from the hurricanes. As rebuilding efforts get fully underway, this could stimulate the economy even more.

The Yellen-Powell Fed also appears to doubt that the economy can grow faster. Each quarter Fed Governors and regional bank presidents submit estimates for future growth. At the September 20 meeting, they raised their economic projection to only 2.4% for this year, despite GDP hitting 3.1% in the 2Q. And their median GDP estimate for 2018 is a mere 2.1%, followed by 2% in 2019 and 1.8% in 2020 and beyond.

Apparently, they are anticipating little growth impact from Mr. Trump's deregulation or tax reform. This fits with the Fed's dominant neo-Keynesian worldview that tax cuts aren't pro-growth, and the US is stuck in a long era of “secular stagnation.” That is the view of most progressives these days. I disagree.

Yet Donald Trump campaigned on policies designed to get economic growth back to 4% or higher. The question is whether a Yellen-Powell Fed would accommodate much faster growth or feels it must rapidly increase interest rates to slow it down. Given its ongoing concern about inflation, there's a very good chance Yellen-Powell would do just that.

President Considering Outsiders to Fill Fed Vacancies

President Trump may sense this and it may explain why he is also considering an outsider like John Taylor. Mr. Taylor is a respected economist and is best known for the Taylor Rule which is named after him. He worked in the George W. Bush Treasury and would bring an interesting perspective to the Fed.

Mr. Taylor is said to believe that the US economy can grow considerably above 2% without significantly higher inflation. That remains to be seen, of course, but he thinks it's worth trying.

Another candidate the president is said to be seriously considering is Kevin Warsh. Mr. Warsh is a former Fed Governor who was part of Ben Bernanke’s inner circle during the 2008 financial panic. He correctly diagnosed the weak capital and liquidity problems in the banking system, even as regulators at the New York Fed said the problem was confined to Bear Stearns.

His experience in the financial crisis could serve him well, especially as the Fed attempts to “normalize” interest rates at the same time it is trying to trim its massive $4.5 trillion balance sheet, while avoiding unsettling the financial markets.
Mr. Warsh also is said to have credibility with the leading central bankers in China, Europe and Japan that would be essential in any subsequent currency or financial crisis. He, too, is said to believe the US economy can grow well above 2% without triggering significantly higher inflation.

The Trump administration said last week that the president hopes to make his decision on the new Fed Chair (and presumably Vice Chair) before he leaves for his next trip abroad in early November. So a decision could come by the end of this month or early next month.

It is my view that the Fed needs new leadership, not a continuation of the slow-growth, secular stagnation crowd that currently dominates central bank policy. Remember that Janet Yellen can still stay on the Fed Board, even if she is not the Chair, if the president chooses. He has options.

If I were advising the president, in light of his pro-growth policies, I would recommend that he consider a fresh face at the top of the Fed. That would be someone who knows how to manage a crisis, and someone who believes we can have faster growth without much higher inflation.

That’s just my opinion. We should know what the president decides in the next few weeks.

Who Pays the Most in Income Taxes in America

Let’s now shift our attention to tax reform. Now that the House and Senate have passed their respective budgets – and assuming a reconciliation of the two is possible to get a final bill for the president to sign – then the major focus in Washington has shifted to tax reform.

There is a vast divide on this issue between conservatives and progressives – nothing new there. But in this case, there is also a vast divide among the American people on the issue of tax cuts. In order to address this latter divide, we need to take a fresh look at who really pays the vast majority of income taxes in this country, and who doesn’t. This is very important.

Some politicians and many in the mainstream media love to exploit public ignorance. Few areas provide as many opportunities for political demagoguery as taxation. Today some politicians argue that the rich must pay their fair share and label the latest proposed changes in tax law as “tax cuts for the rich.”

Let’s look at who pays what when it comes to federal income taxes, with an eye toward attempting to answer this question: Are the rich paying their fair share?

According to the latest IRS data (for 2015), the payment of income taxes was as follows.

The top 1% of income earners, those having an adjusted annual gross income of $480,930 or higher, paid just over 39% of federal income taxes. That means about 892,000 Americans (less than one million) were stuck with paying almost 40% of all federal income taxes.

The top 5% of income earners, those having an adjusted annual gross income of $195,778 or higher, paid almost 60% of federal income taxes.
The top 10% of income earners, those having an adjusted gross income over $138,031, paid about 70.6% of federal income taxes. About 1.7 million Americans, less than 1% of our population, paid over 70% of federal income taxes.

Is that fair, or do you think they should pay more? But the fairness question goes further.

Tax Year 2015

The bottom 50% of income earners, those having an adjusted gross income of $39,275 or less, paid only 2.83% of federal income taxes. Is that fair, or do you think they should pay less?

Of this group, 37 million tax filers had no tax obligation at all for 2015. The Tax Policy Center estimates that 45.5% of US households will not pay federal income tax this year.

There’s a severe political problem with so many Americans not having any skin in the game. These Americans become natural constituencies for big-spending politicians. After all, if you don’t pay federal taxes, what do you care about big spending? You might even think more spending is better.

Also, if you don’t pay federal taxes, why should you be happy about a tax cut? What’s in it for you? In fact, you might see tax cuts as threatening your government benefit programs.

More Thoughts on Cutting the Corporate Income Tax Rate

Since I wrote about this issue at some length in my October 3 E-Letter, I won’t spend a lot more time on it today. There are, however, a couple of additional points to be made. As you know, our federal corporate income tax rate is 35%, one of the highest marginal rates in the developed world.

In fairness, I should point out that many profitable corporations in America pay considerably less in federal income tax than 35% due to the many tax loopholes and special breaks they enjoy. If tax reform is successful just ahead, many of these loopholes and breaks should be eliminated.

President Trump’s new tax plan calls for reducing the corporate rate to 20%. Not surprisingly, many on the left are crying foul, calling this just another tax cut for greedy corporations and their fat cat shareholders. Yet as I argued on October 3, cutting the corporate tax rate to something more reasonable benefits just about everyone.

And here’s something else a lot of Americans don’t understand: Corporations don’t pay income taxes – they just pass them along in one form or another.

For example, if a tax is levied on a corporation, it will have one of four main responses or some combination thereof. It will raise the price of its products, lower dividends, cut salaries or lay off workers. In each case, real people bear the tax burden. In essence then, corporations are merely tax collectors for the government... I’ll leave it there for today.
Wishing you all the best,
Gary D. Halbert

© Halbert Wealth Management