The Economy Doesn't Need Any More Action From The Fed

By MIKE COSGROVE

Some Federal Reserve Bank presidents and governors are talking about the possibility of further action to encourage growth in the economy. What planet are they on?

Fed action can only influence nominal variables at this point in the cycle — not real variables such as employment, production and real economic growth. Everyone at the Fed knows that. Excess reserves at depository institutions currently total $1.46 trillion.

In August 2008 that number was about $2 billion. QE1 was implemented in response to the Lehman bankruptcy and excess reserves reached $1.1 trillion by November 2009. Then along came QE2 in November 2010.

The positive short-term effects of QE1 on real variables petered out in 2010 and any positive effects of QE2 were more than offset by the adverse health and regulatory policies passed and implemented in 2010.

Chairman Bernanke, in testimony last week, seemed to back away from recent comments by Janet Yellen, the Fed's vice chairperson, with her supportive comment on needing more monetary accommodation.

Mr. Bernanke seemed to imply that the Fed may act only if a disorderly breakup of the euro occurs and transmits a major financial shock to the U.S. financial system. The Fed would be making a major mistake by acting at this time.

Fiscal policy, through tax policy, and regulatory policy worked to stunt growth in the real variables of employment, production and real growth over the last two years. And unless tax policy changes, the U.S. economy hits the fiscal wall, stops and goes into recession at year-end.

That is the timetable unless current federal income tax rates are extended.

The Federal Reserve has nothing to do with that process and cannot do anything to prevent the economy from sinking if the U.S. economy does hit the fiscal wall at year-end.

Could other actions also improve growth in the real variables? Of course. Some of those actions include:

• The U.S. Supreme Court could declare ObamaCare's individual mandate unconstitutional.

Such a decision would remove a major uncertainty for businesses as business would then know one part of their compensation structure for the next few years.

Under ObamaCare, companies don't know the cost and don't know how ObamaCare will be implemented. That is especially true for smaller companies and for companies very early in their life cycle that create jobs.

Plus the cost burden and uncertainty that ObamaCare brings would be lifted from business and, in turn, can lift equity prices.

ObamaCare was signed into law March 2010. Growth in real GDP (year-to-year) peaked in this cycle shortly thereafter. QE2, to a limited extent, may have helped offset the anti-economic growth impact of ObamaCare as well as the adverse effects of Europe.

• The U.S. federal tax system is the most progressive among 24 OECD countries, according to the OECD. The top 10% of U.S. households pay 45.1% of the combined personal income and payroll taxes while they earn 33.5% of the income. That ratio makes the U.S. tax system the most progressive.

One might expect a country's leaders to attempt to have a federal tax system that would encourage growth, saving and investment and not focus on making the tax system even more progressive.

• More financial regulation such as Dodd-Frank, in the short term, works to diminish growth in real variables, shifting the focus in financial entities to regulation and away from the road of loan growth.

Plus financial regulation adds more costs that need to be eventually recovered from customers and/or employees or stockholders.

• The monumental increase in the U.S. sovereign debt amounts to an effective increase in taxes. Treasury debt outstanding on January 20, 2009 stood at $10.6 trillion, not adjusted for inflation.

Today it is $15.7 trillion which is an increase of $5.1 trillion, not adjusted for inflation.

That means the tax bill on those paying federal income taxes needs to increase and, discounted to the present, leads to fewer business starts, expansions and investment which slows growth in real variables.

Steps are needed on fiscal and regulatory dimensions to enhance growth in real variables such as production, employment and real growth.

There are only very small incremental steps that the Federal Reserve could take to enhance nominal growth at this point and those steps, of expanding the balance sheet or attempting to extend Operation Twist, both have large potential unintended consequences.

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