THE DAILY CALLER

Slash Corporate Taxes First, Then Yellen Can Normalize

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Speaking before a packed audience at the prestigious Economic Club of New York, Fed chair Janet Yellen basically announced that there would be no rate hikes for quite some time — maybe once before year end, maybe not. Her key point was that the global economy is worse today than it was in December, back when the Fed took its target rate up a quarter point. I think she's right.

I also think she is paying more attention to forward-looking, inflation-sensitive financial and commodity-market prices. This is good. *Very* good.

Yellen cited shrinking inflation spreads in the Treasury bond market, declining commodities (until recently), a flattening of the Treasury yield curve, and a stronger dollar. The sum total of these market-price indicators is stagnant growth and virtually no inflation. Hence, there's no need for the Fed to militantly raise its policy rates.

This price-rule approach is a lot better than the Fed's flawed models, which are based on a false tradeoff between lower unemployment and higher inflation. I've said it a million times: More people working does not cause inflation. Instead, more people prospering and producing makes the existing money supply *less* inflationary.

Austan Goolsbee, former chairman of the Council Economic Advisors, has long argued that Fed models have consistently over-predicted the economy. As a result, the Fed has consistently had to lower its forecasts in the face of stagnant 2 percent growth.

The possibility that Janet Yellen is escaping the defective Phillips-curve mentality gives one a bit of confidence, especially if she is watching market prices. She even noted in her speech that the Fed's favorite inflation indicator actually fell in February, and is up only 1 percent over the last year.

Now let me make a second point. Most financial-market people think the Fed's ultra-low target rates indicate ultra-easy money. They're wrong. The principal reason that market interest rates are so low is that the economy is stagnant and inflation is virtually nonexistent. Along with a strong greenback and falling commodity prices, you could argue that the Fed is *tighter* than anybody thinks.

I don't want more QE, which was a failed experiment. The fact is, rock-bottom interest rates generally indicate near-zero inflation and relative monetary tightness. If market interest rates were surging, that would be a sign of higher inflation, undoubtedly because the Fed was too *easy*.

Milton Friedman taught us this over 50 years ago. Interest rates are lousy monetary indicators. Better to watch the money supply or the velocity turnover rate of money, which can be captured by tracking nominal GDP. Over the past year, money GDP has increased only 3.1 percent. That's a sign of monetary tightness, not ease.

As free-market economist Alan Reynolds of the Cato Institute recently noted, government interest rates were rock bottom in the 1930s. That's because the Fed and most other central banks were way too tight.

Even worse today, having stuffed banks with excess reserves, central banks in Europe and Japan are punishing those banks with *negative* interest rates. They're also punishing savers. This is not good policy.

What we have now in these uncertain times is not so much a monetary problem as a major *fiscal* problem. In particular, corporate tax rates must be slashed in the U.S. for large and small businesses. We also need full cash tax expensing for new investment and an end to the double taxation of foreign profits.

This would rejuvenate economic growth. In the global race for capital, the U.S. would emerge victorious.

Incentives *matter*. I'm not just talking about 4 or 5 percent economic growth, but higher wages and stronger employment-participation rates. And my guess is that, as real economic growth jumpstarts, real interest rates would move higher. And *that's* when the Fed can follow market interest rates upward by raising its policy rates.

By the way, it's the same problem overseas. Europe and Japan and so many other countries are ignoring tax policies, which are in sore need of growth repair. Japan needs tax cuts across the board: corporate, personal, sales, you name it. Europe has relatively low business tax rates. But it needs to slash taxes on personal income, estates, and retail sales (VAT). Negative interest rates won't do the trick, but new tax incentives to work, save, and invest will.

So I support Janet Yellen's moratorium on rate hikes. But I wish she would be more outspoken about the need for corporate tax reform. If the U.S. economy starts moving back toward its potential — 4 or 5 percent economic growth over the next bunch of years — the Fed can normalize its interest-rate structure by following higher market interest rates which would respond to faster economic growth.

What we basically have here is a *tax* problem, not so much a monetary problem.