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Hillary Clinton and Recession of 2011

By James Pethokoukis : 06 Feb 2007

How predictable. The fiscal 2008 budget that President Bush put forward yesterday gets slammed for being unrealistic - if not downright mendacious. If the $2.9 trillion proposal actually got enacted as written - doubtful given that Bush is dealing with a Democratic-controlled Congress -- the plan would theoretically balance the budget by 2012. As Team Bush crunches the numbers, the U.S. government would run a $61 billion surplus in 2012 year after running tiny deficits in 2010 ($94.4 billion, or 0.6 percent of GDP) and 2011 ($53.8 billion, or 0.3 percent of GDP). All that while permanently extending the 2001 and 2003 tax cuts due to expire in 2010.

Of course, journalists and think-tank analysts had barely scanned the budget when critics started pointing out its supposed flaws. Among them: the budget assumes more upbeat economic conditions -- and thus more tax revenue -- than does the forecast from the Congressional Budget Office. (In 2011 and 2012, the White House forecasts 3.0 percent and 2.9 percent GDP growth vs. 2.7 percent for each of those years by the CBO.) As the liberal Center on Budget and Policy Priorities puts it, "The budget employs rosy revenue assumptions; it assumes at least $150 billion more in revenue than CBO does for the same policies."

Indeed, the CBO - viewed by the inside-the-Beltway crowd as the impartial umpire of all budget disputes -- also predicts a balanced budget by 2012. The catch is that it assumes the Bush tax cuts are *repealed* leading to a surge of revenue in 2011 and 2012. It forecasts that the budget deficit would drop from $137 billion in 2010 to just $12 billion in 2011. And in 2012, the budget would move into the black with a $170 billion surplus. Yet if the Bush tax cuts are extended, CBO predicts total deficits of $407 billion in 2011 and 2012 and then continuing thereafter.

No wonder Democratic presidential candidates are finding it so easy to pledge or strongly hint that if they are sitting in the White House in 2010, they will veto any effort to extend the tax cuts. One can easily envision President Hillary Rodham Clinton harking back to her husband Bill's 1993 tax hikes and economic success as historical justification for a repeat performance. Deficits are often used as reason for higher taxes, such as in 1993 and 1982. But to believe in higher taxes as sound economic policy in coming years, you also have to believe in the CBO's cheery forecast that hundreds of billion of dollars in new taxes will have little or no effect on economic growth.

Now you don't have to be an acolyte of supply-side guru Arthur Laffer to find that sort of "static analysis" a little weird. Most Americans probably would. So, apparently, did the economic team at Goldman Sachs, the old employer of Robert Rubin, President Bill Clinton's second treasury secretary. Thus the firm's econ wonks decided to try and simulate the real-

world effect of letting the Bush tax cuts expire at the end of 2010. Using the respected Washington University Macro Model, Goldman reset the tax code to its pre-Bush status, assumed all tax cuts expired, and watched how the economy reacted as 2011 began. What did the firm see? Well, in the first quarter of 2011 the economy dropped 3 percentage points below what it would have been otherwise. "Absent a tailwind to growth from some other source," the analysis concludes, "this would almost surely mark the onset of a recession."

So actually it's CBO's economic forecast, not Bush's, that is overly optimistic about future economic growth. But wouldn't the Federal Reserve jump in and cut interest rates, offsetting the fiscal drag of the tax hikes with easy monetary policy? The Goldman Sachs experiment assumes it would, but WUMM still shows the economy sinking:

"In an effort to resuscitate demand, the Fed immediately cuts the federal funds rate, bringing it 250 basis points below the status quo level over the next year and one-half ... Despite this, output growth remains well below trend over that period, putting downward pressure on inflation as slack in the economy increases."

And guess what? A recession would throw CBO's carefully calculated tax revenue assumptions out the window. Indeed, the CBO admits that recessions in 1981, 1990 and 2001, "resulted in significantly different budgetary outcomes than CBO had projected a few months before the downturns started."

Of course, it's been the history of tax increases that they tend not to bring in as much revenue as originally predicted. President Rodham Clinton or President Obama or President Edwards would likely find the same budgetary disappointment -- and then have to explain to an angry American public during the 2012 election season why their president decided to plunge the economy into a recession.