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The Business Journal
23

No-brainers and the fiscal cliff

Now that the election is over and the Petraeus/Broadwell scandal has died down, much of the media have turned their attention to the so-called fiscal cliff. According to the August 2011 deal that raised the federal debt ceiling, Congress has until Dec. 31 to agree on a package of deficit-reduction measures. If it fails to reach an agreement, a draconian package will automatically take effect, raising taxes and cutting spending.

The first thing to understand about this is that it’s not a cliff. The tax increases and spending cuts would start gradually and could be undone retroactively even if a deal isn’t reached until a few months into 2013. A last-minute deal would complicate things for the IRS and annoy many taxpayers, but the economy wouldn’t tank on Jan. 1.

Second, if the prospect of going over the “cliff” troubles you, you’re a Keynesian. The economics of John Maynard Keynes prescribes deficit spending in a depressed economy, which is what the U.S. economy still is more than three years after the Great Recession officially ended. So even though “Keynesian” has become a dirty word to many conservatives, politicians on both the right and left are opposed to the near-term deficit reduction that would take place if we go over the fiscal cliff.

To be sure, conservatives are more concerned about tax increases while liberals care more about spending cuts. But Republican presidential candidate Mitt Romney warned us that cuts in defense spending would cost lots of jobs. He was right, but it was very Keynesian of him.

Most economists agree. An analysis by the nonpartisan Congressional Budget Office projects that going over the cliff would, by the fourth quarter of 2013, cut 2.2 percentage points of the economy’s growth rate. What’s Wells Fargo’s baseline forecast for that quarter? 2.2 percent. Deficit reduction would erase what little growth is projected for a year from now.

The fiscal cliff puts at risk a number of policies that are no-brainers. For example, it would end the temporary 2 percent payroll tax cut. That would be crazy. As a matter of stimulus and a depressed economy, the payroll tax cut is much more important than the much-debated tax cuts for upper-income people, because lower- and middle-income folks are more likely to spend the money they receive.

A second no-brainer is much broader: Government spending should not be cut during a depression. And recent European experience shows us why. For example, Britain elected a conservative-moderate government in 2010 that initiated spending cuts. Before the election, the country’s recovery from the recession mirrored that of the U.S. From mid-2009 through late 2010, the U.S. economy grew at an annual rate of 2.5 percent as compared to 2.2 percent in the U.K.

Since then, the U.S. has continued to grow slowly, at a 1.9 percent annual clip. But the second quarter of this year, the British economy actually shrank. Government austerity drove the country back into recession.

Things picked up in the third quarter, thanks to a temporary stimulus package called the London Olympics, but leading forecasts expect a return to contraction in the fourth quarter.

Deficit reduction is very important, but now is not the time. Congress should make a deal on long-range deficit reduction that would take effect in a few years. But now that we’re all in agreement about the Keynesian thing, the best move Congress can make right now is to extend the tax cuts on lower- to middle-income people and repeal the spending cuts.

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Business Pulse Survey

What is your opinion on the University of Maryland leaving the ACC for the Big 10?

- Strong opinion on it.
- No strong opinion on it.
- Other 1%
- Sorry to see them leave, they belong in the ACC 49%

Other 1%

Based on 271 responses. Numbers do not total 100 due to rounding.

Opinion