Washington Must Avoid Tax Trap That Will Send Economy To Brink

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This is the first installment of a two-part article focusing on the Congressional Budget Office's "Budget and Economic Outlook: Fiscal Years 2010 to 2020," released Tuesday. The second part will take an expanded look after the actual "Budget of the United States Government for Fiscal Year 2011" is released next Tuesday.

Despite the president's efforts to put a better face on the disaster, the Congressional Budget Office tells a frightening story of an already-too-large public debt rising precipitously from 41% of GDP in 2008 to at least 92% in 2020 largely because of:

(1) About $2.7 trillion of what was essentially "optional" debt incurred in 2009, when the president and the Congress took advantage of the situation to enact long-term legislation on top of temporary economic stimulus measures.

(2) An additional $5.7 trillion of still-optional debt attributable to the president's proposals for future legislation detailed by CBO in June 2009 in "An Analysis of the President's Budgetary Proposals for 2010." (It is not too late. He can still back out in the interest of fiscal sanity.)

We can't tax our way out of the hole the president and the Congress are digging for us. Tax increases cost the economy more than they yield to the Treasury in revenue - and especially so in a recession.

We've already proved we can't spend our way out. It's a rare dollar of spending with a "multiplier effect" of as much as a dollar - usually it's less - so borrowing to spend only digs the hole deeper.

And we can't count on a miraculous surge in economic growth to rescue us from a debt crisis that, among other things, further depresses an already depressed economy.

It is the looming $5.7 trillion of additional debt attributable to presidential proposals not yet enacted that turns an already dangerous fiscal situation into a crisis scenario so severe that it cannot in reality be allowed to occur.

Therefore, the president should forgo these new initiatives or offset their costs with immediate cuts in spending elsewhere. Debt as a percentage of GDP would then be 66% in 2016 through 2019 and 67% in 2020 - obviously still unacceptably high, but potentially within the "solvable" range.

For example, just for starters, spending cuts sufficient to reduce debt by $2.7 trillion (the extra amount incurred in 2009) would get the debt-to-GDP ratio down to 62% in 2016, 61% in 2018 and 59% by 2020.

Call For Fortitude

The president and the Congress should go further and curb spending sufficiently to get debt down to no more than 60% of GDP by 2016 and headed rapidly downward thereafter. That task alone will require a degree of political fortitude not seen in Washington for many a day.

Creative accounting or some multitrillion- dollar "plug" figure representing hypothetical budget savings to be recommended in the future by an extracurricular commission or stacked-deck congressional panel will not be sufficient. Real and immediate changes in the law to cut spending are required.

The alternative is for the president and Congress to lead us into a "tax trap" that works like this: continue to spend, force the economy to the brink with debt, a plummeting dollar and a decline in America's credit worthiness - and then rush to the rescue with gigantic tax increases.

Cumulative tax increases of about $1.4 trillion over the period 2011 to 2020 would be necessary to bring the public debt down to 60% of GDP by 2016 under CBO's current-law baseline and hold it there. This implies a 4.5% increase in all tax rates except for payroll taxes.

$6.7 Trillion Tax Increase

If the president's proposals for further legislation are also enacted, a cumulative tax increase of about $6.7 trillion would be required. This larger amount implies a 21% increase in all tax rates except payroll taxes.

According to our Newclass economic model, the cost to the private-sector economy of the $6.7 trillion tax increase would be about $17.4 trillion or roughly $2.60 for every $1 of revenue yield. The economy would be permanently smaller by a whopping 5%, and the unemployment rate would be 2% higher.

Tax-induced economic hardship of such magnitude would doubtless call forth more spending, more debt and, ultimately, more taxes in an ever-worsening, self-propelling downward spiral.

Let us hope that this Congress and this president reject the tax trap and - instead - step up to the plate by cutting spending, putting the nation's finances in order, lifting the heavy hand of government and letting the private-sector economy resume doing its job of producing goods and services and making everyone better off.

That will be "change we can believe in," and a grateful nation will applaud.

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