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Let's Not Make a Deal

By PAUL KRUGMAN

Back in 2001, former President George W. Bush pulled a fast one. He wanted to enact an irresponsible tax cut, largely for the benefit of the wealthiest Americans. But there were Senate rules in place designed to prevent that kind of irresponsibility. So Mr. Bush evaded the rules by making the tax cut temporary, with the whole thing scheduled to expire on the last day of 2010.

The plan, of course, was to come back later and make the thing permanent, never mind the impact on the deficit. But that never happened. And so here we are, with 2010 almost over and nothing resolved.

Democrats have tried to push a compromise: let tax cuts for the wealthy expire, but extend tax cuts for the middle class. Republicans, however, are having none of it. They have been filibustering Democratic attempts to separate tax cuts that mainly benefit a tiny group of wealthy Americans from those that mainly help the middle class. It's all or nothing, they say: all the Bush tax cuts must be extended. What should Democrats do?

The answer is that they should just say no. If G.O.P. intransigence means that taxes rise at the end of this month, so be it.

Think about the logic of the situation. Right now, the Republicans see themselves as successful blackmailers, holding a clear upper hand. President Obama, they believe, wouldn't dare preside over a broad tax increase while the economy is depressed. And they therefore believe that he will give in to their demands.

But while raising taxes when unemployment is high is a bad thing, there are worse things. And a cold, hard look at the consequences of giving in to the G.O.P. now suggests that saying no, and letting the Bush tax cuts expire on schedule, is the lesser of two evils.

Bear in mind that Republicans want to make those tax cuts permanent. They might agree to a two- or three-year extension — but only because they believe that this would set up the conditions for a permanent extension later. And they may well be right: if tax-cut blackmail works now, why shouldn't it work again later?

America, however, cannot afford to make those cuts permanent. We're talking about almost \$4 trillion in lost revenue just over the next decade; over the next 75 years, the revenue loss would be more than three times the entire projected Social Security shortfall. So giving in to Republican demands would mean risking a major fiscal crisis — a crisis that could be resolved only by making savage cuts in federal spending.

And we're not talking about government programs nobody cares about: the only way to cut spending enough to pay for the Bush tax cuts in the long run would be to dismantle large parts of Social Security and Medicare.

So the potential cost of giving in to Republican demands is high. What about the costs of letting the tax cuts expire? To be sure, letting taxes rise in a depressed economy would do damage — but not as much as many people seem to think.

A few months ago, the Congressional Budget Office released a report on the impact of various tax options. A two-year extension of the Bush tax cuts, it estimated, would lower the unemployment rate next year by between 0.1 and 0.3 percentage points compared with what it would be if the tax cuts were allowed to expire; the effect would be about twice as large in 2012. Those are significant numbers, but not huge — certainly not enough to justify the apocalyptic rhetoric one often hears about what will happen if the tax cuts are allowed to end on schedule.

Oh, and what about confidence? I've been skeptical about claims that budget deficits hurt the economy even in the short run, because they undermine confidence in the government's long-run solvency. Advanced countries, I've argued, have a lot of fiscal leeway. But anything that makes permanent extension of obviously irresponsible tax cuts more likely also sends a strong signal to investors: it says, "Hey, we aren't really an advanced country; we're a banana republic!" And that can't be good for the economy.

Last but not least: if Democrats give in to the blackmailers now, they'll just face more demands in the future. As long as Republicans believe that Mr. Obama will do anything to avoid short-term pain, they'll have every incentive to keep taking hostages. If the president will endanger America's fiscal future to avoid a tax increase, what will he give to avoid a government shutdown?

So Mr. Obama should draw a line in the sand, right here, right now. If Republicans hold out, and taxes go up, he should tell the nation the truth, and denounce the blackmail attempt for what it is.

Yes, letting taxes go up would be politically risky. But giving in would be risky, too — especially for a president whom voters are starting to write off as a man too timid to take a stand. Now is the time for him to prove them wrong.