
Experts with Unrealistic Expectations

By Editor Test Thu, Nov 15, 2012

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The CEOs of many of the largest U.S. financial services companies sent an open [letter](#) to President Obama and Congress on October 18, urging them to resolve the "fiscal cliff" problem quickly and rein in the nation's deficit spending.

"We urge you to work together to reach a bipartisan agreement to avoid the fiscal cliff and take concrete steps to restore the United States' long-term fiscal footing," they wrote.

Signers of the appeal, which was written on the letterhead of the Financial Services Forum, included Steven Kandarian of MetLife, John Strangfeld of Prudential, John Stumpf of Wells Fargo, Lloyd Blankfein of Goldman Sachs, Jamie Dimon of JP Morgan Chase and 10 other CEOs.

In asking Washington officials to "avoid the fiscal cliff," the executives presumably meant avoiding the currently scheduled reversion to Clinton-era tax rates on income, capital gains and dividends, as well as an automatic \$120 billion-a-year cut in discretionary spending known as "sequestration."

In the same letter, however, the CEOs asked the president and Congress to "restore the nation's long-term fiscal soundness by negotiating policies that will produce a stabilization and then downward trend in the ratio of federal debt to GDP over the medium term."

But, as New York Times columnist Paul Krugman recently pointed out, those two wishes are in conflict. At best, it sounds like a recommendation to "kick the can down the road." The Congressional Budget Office has [forecast](#) that avoiding the fiscal cliff—that is, failing to raise taxes and lower spending—would contribute to unsustainable growth in the federal debt.

The request from the CEOs resurrects supply-side economic thinking, a dead theory that says lower income taxes lead to tax revenue-enhancing growth. That thinking has been called "voodoo" and "zombie" economics. It has been disavowed by some of its original proponents. There's no grand bargain that can simultaneously soften the impact of the cliff in 2013 and lead to smaller deficits.

The letter exaggerates the impact of the fiscal cliff. "Sequestration" would eliminate only 3% of next year's budget; that's a bump in the road, not a precipice. In its latest assessment, the Congressional Budget Office said, "If all of that fiscal tightening occurs, real GDP will drop by 0.5% in 2013... That contraction of the economy will cause employment to decline and the unemployment rate to rise to 9.1% in the fourth quarter of 2013. After next year, by the agency's estimates, economic growth will pick up, and the labor market will strengthen..."

That's not ideal. But it's not catastrophic. It would be more dangerous in the long run to avoid the cliff, according to the CBO. "In years beyond 2022, rising deficits under the alternative fiscal scenario [which assumes that the Bush tax rates and other measures are maintained indefinitely] would lead to larger negative effects on GDP and GNP and to larger increases in interest rates," the CBO report said. "Ultimately, the policies assumed in the alternative fiscal scenario would lead to unsustainable federal debt."

It's wishful thinking to believe that the country can have gain without pain. And it's disingenuous for the CEOs of major financial services companies—who can easily afford the haircut they'll take when the Bush tax rates expire—to imply that we can.

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