

Paul Krugman - New York Times Blog

January 2, 2013, 10:25 am

Perspective on the Deal (31 December 2012)

To make sense of what just happened, we need to ask what is really at stake, and how much difference the budget deal makes in the larger picture.

So, what are the two sides really fighting about? Surely the answer is, the future of the welfare state. Progressives want to maintain the achievements of the New Deal and the Great Society, and also implement and improve Obamacare so that we become a normal advanced country that guarantees essential health care to all its citizens. The right wants to roll the clock back to 1930, if not to the 19th century.

There are two ways progressives can lose this fight. One is direct defeat on the question of social insurance, with Congress actually voting to privatize and eventually phase out key programs — or with Democratic politicians themselves giving away their political birthright in the name of a mess of pottage Grand Bargain. The other is for conservatives to successfully starve the beast — to drive revenue so low through tax cuts that the social insurance programs can't be sustained.

The good news for progressives is that danger #1 has been averted, at least so far — and not without a lot of anxiety first. Romney lost, so nothing like the Ryan plan is on the table until President Santorum takes office, or something. Meanwhile, in 2011 Obama was willing to raise the Medicare age, in 2012 to cut Social Security benefits; but luckily the extremists of the right scuttled both deals. There are no cuts in benefits in this deal.

The bad news is that the deal falls short on making up for the revenue lost due to the Bush tax cuts. Here, though, it's important to put the numbers in perspective. Obama wasn't going to let all the Bush tax cuts go away in any case; only the high-end cuts were on the table. Getting all of those ended would have yielded something like \$800 billion; he actually got around \$600 billion. How big a difference does that make?

Well, the CBO estimates cumulative potential GDP over the next decade at \$208 trillion. So the difference between what Obama got and what he arguably should have gotten is around 0.1 percent of potential GDP. That's not crucial, to say the least.

And on the principle of the thing, you could say that Democrats held their ground on the essentials — no cuts in benefits — while Republicans have just voted for a tax increase for the first time in decades.

So why the bad taste in progressives' mouths? It has less to do with where Obama ended up than with how he got there. He kept drawing lines in the sand, then erasing them and retreating to a new position. And his evident desire to have a deal before hitting the essentially innocuous fiscal cliff bodes very badly for the confrontation looming in a few weeks over the debt ceiling.

If Obama stands his ground in that confrontation, this deal won't look bad in retrospect. If he doesn't, yesterday will be seen as the day he began throwing away his presidency and the hopes of everyone who supported him.

That Bad Ceiling Feeling (2 January 2013)

More thoughts about the fiscal deal:

One good thing is that the deficit scolds are furious: they had their hearts set on exploiting this crisis to push through benefit cuts, and it didn't happen — part of the larger good news that Obama didn't gut Social Security or Medicare this time around.

And as I pointed out yesterday, the numbers are disappointing, but the disappointment isn't that big a deal. Let me offer more detail on that.

Before the deal, it was widely expected that Obama could get \$800 billion in revenue. You may wonder how this reconciles with the much bigger numbers in his original proposal; the answer is that part of this came from the estate tax, on which he couldn't count on backing from Senate Dems, but most of it came from going beyond just getting rid of the Bush tax cuts — he was proposing that itemized deductions be turned into tax credits at a maximum of 28 percent, which would have collected a lot of additional revenue from people in the 39.6 bracket. And that wasn't something he could get just by going over the cliff.

So the disappointment, to simplify, is that he got \$600 billion instead of \$800 billion. Now, you want to scale that by the size of the fiscal problem.

The deficit is no problem now, but eventually we will emerge from the liquidity trap, and at that point you do want to start stabilizing debt. How big a deal is that? If you look at the CBO numbers, under their "alternative fiscal scenario" (Bush tax cuts extended and realistic spending), in 2022 the deficit would be 5.5 percent of GDP, about 2 percentage points higher than would be required to stabilize debt at 90 percent of GDP.

So what we eventually need is something like 2 or more points — probably more, because aging and the rise in health care costs won't stop in 2022. Now, that's nothing like the catastrophic sense about the budget you get from the usual suspects, but it is big compared with anything we've seen so far.

As I pointed out in the last post, nominal GDP over the next decade should be around \$200 trillion. An \$800 billion revenue take would be 0.4 percent of GDP; the \$600 billion Obama got is 0.3 percent. Not big stuff, and either way the big fight over taxes versus benefit cuts is still to come.

So, why am I feeling so despondent, and why do so many other progressives feel the same? Because of the way Obama negotiated. He gave every indication of being more or less desperate to cut a deal before the year ended — even though going over the fiscal cliff was not at all a drop-dead moment, since we could have gone weeks or months without much real economic damage.

Now, given his evident antsiness to cut a deal in this case, how credible is his promise to hang tough over the debt ceiling, which is a much brighter red line? He may say that he absolutely, positively won't negotiate over the ceiling — but nothing in his past behavior makes that believable.

Maybe this time will be different. Maybe the Treasury is secretly preparing to invoke the 14th amendment, or issue a trillion-dollar platinum coin, or direct that the whole budget gap be taken out of spending dear to Republicans. But I have to say that I now expect Obama to cave on the ceiling; and so, of course, do the Republicans, which means that the crisis is going to happen.

The only thing that might save this situation is the fact that Obama has to be aware just how much is now riding on his willingness to finally stand up for his side; if he doesn't, nobody will ever trust him again, and he will go down in history as the wimp who threw it all away.

But even that may not be enough. I guess we'll see.