Written by **Bob Adelmann** on May 23, 2012

Congressional Budget Office Predicts U.S. Recession

The latest report from the non-partisan Congressional Budget Office (CBO) released on Tuesday said that if the country falls off the "fiscal cliff" — variously also called "taxmageddon" — it will likely enter a new recession. With the ending of the Bush-era tax cuts, the termination of extended unemployment benefits, the reimposition of the payroll tax rates back up to 6.2 percent from the current 4.2 percent, and the "sequester" cuts in government spending demanded by the agreement that Congress hammered out last summer in order to raise the debt ceiling, the CBO predicts that the country's Gross National Product (GNP) will go negative for at least two quarters, which is the classic definition of a recession.

But, adds the CBO, if Congress does nothing, the longer-term benefits could be significant: a lowering of the annual deficit by about $600 billion in the first year, and lower deficits in the out years. This would reduce the danger of spiraling interest costs on the $16.4-trillion national debt along with a lower risk of further credit downgrades of the government debt by various rating services. In other words, according to the CBO: pain now or pain later.

If, as is likely, the Congress just simply sits on its hands and waits until after the November election or January 20 when the next Congress takes over, the problem just gets worse. As the CBO notes:

> Growing debt would increase the likelihood of a sudden fiscal crisis, during which investors would lose confidence in the government's ability to manage its budget and the government would thereby lose its ability to borrow at affordable rates. Such a crisis would confront policymakers with extremely difficult choices. Again, the current high level of debt relative to the size of the economy means that further substantial increases in debt would be especially risky in this regard.

Parsing the language, what the CBO is saying is that if Congress doesn't act to cut spending significantly, the bond market will. Those massive increases in deficits, added to the already incomprehensibly large national debt, will inevitably, perhaps very soon, awaken lenders to the inescapable fact that the government of the United States is broke — insolvent, bankrupt — and the only way it would be able to find lenders would be at the cost of much higher interest rates.

At the moment about $450 billion a year is spent just on debt service. If interest rates doubled, from the current average of about 3 percent to just 6 percent, interest charges would approach $1 trillion a year or frighteningly close to half of all government revenues. This doesn't take into account the addition of $1 trillion every year to that national debt.

But that hard fact doesn't seem to faze any of the politicos running for reelection. Instead they are using the CBO's report as fodder for their reelection campaigns. For example, Senator Majority Leader Harry Reid (D-Nev.) is insistent on raising taxes in exchange for any spending cuts:

> If Republicans want to walk away from the bipartisan spending cuts agreed to last August, they will have to work with Democrats to replace them with a balanced deficit reduction package that asks millionaires to pay their fair share.

Rep. Chris Van Hollen (D-Md.) added:

> CBO observes that simply extending all of our current tax and spending policies will produce unsustainable deficits and debt, which will also send the economy into decline. We need to act and we must do so in a balanced way.

Senator Orrin Hatch (R-Utah), in the fight of his political life, notes:

> You can call this a fiscal cliff. You can call it Taxmageddon as others have done. Whatever you call it, it will be a disaster for the middle class. And it will be a disaster for the small businesses that will be the engine of our economic recovery.

Senator Minority Leader Mitch McConnell (R-Ky.) even tried to blame the “impasse” on the President:

> We don’t control the entire government. We control the House of Representatives only. We’d like to do something about the nation’s biggest problem — spending and debt, which is, of course, the reason for this economic mess and this high unemployment — and whenever the president is willing to engage, we’re ready to go.

Even Fed Chairman Ben Bernanke is putting distance between himself and the fiscal cliff:

> It’s very important to say that, if no action were to be taken by the fiscal authorities, the size of the fiscal cliff is such that I think there’s absolutely no chance that the Fed could or would have any ability to offset, whatsoever, that effect on the economy.

Senator Jeff Sessions (R-Ala.) appears to be the only commentator on the scene who knows exactly what is going to happen as a result of this frightening report from the CBO: precisely nothing:

> It looks like there will not be a vote until after the election, but I can’t say that for certain — but it certainly looks like that.

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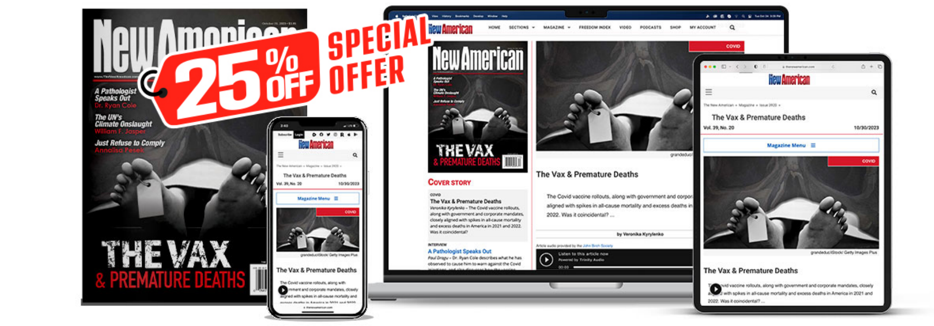

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