

The art of snatching defeat out of victory - Part III

by **Alfredo Martin Bravo de Rueda Espejo**

Sat Jul 25, 2009 at 05:25:27 AM PDT



This is the third part of the series.

I must thank Cenk Uygur's 'Young Turks' (<http://www.theyoungturks.com/>). His show made me aware of many pieces of information I have used to make this series.

Alfredo Martin Bravo de Rueda Espejo's diary :: ::

5. Fiscal accountability

Recently David Leonhardt wrote a series of estimations allocating the share of the deficit between Bush and Obama (<http://economix.blogs.nytimes.com/...>, <http://www.nytimes.com/...> and <http://www.nytimes.com/...>). He used CBO estimations for the period 2001-12, which are based on changes in the economy and new legislation, to explain how the \$846 billion annual surpluses that were forecast in 2001 for 2009-12 turned into a \$1.22 trillion estimated deficit.

Leonhardt breaks down the budgetary items in four categories: economic changes; Bush administration legislation; Bush-era policies extended by Obama; and new Obama administration policies.

1. The first step was erasing \$291 billion from the \$846 billion surplus forecast in 2001 to estimating the budgetary cost of the 2001 recession and the slow recovery that followed in 2002 and 2003, when employment continued to decline.
2. From new legislation during the 2001-2003 period, the biggest items were the two tax cuts signed by President Bush. In all, the new legislation he signed during this period reduced the surplus estimates for 2009-12 by about \$550 billion. In the 2003-2007 period, Bush was responsible for both economic changes and new legislation but the growth that occurred from 2003 through 2007 still did not come close to producing enough tax revenue to pay for his agenda (the tax cuts, the wars in Iraq and Afghanistan, the Medicare drug benefit and other smaller initiatives). In all, Bush's policies reduced the budget estimates for 2009-12 by \$673 billion. Thus, his policies were the largest single cause of the swing from surplus to deficit.
3. The next step in the analysis was to separate out the cost of the current downturn, which began in late 2007. The method here was the same as the method for the 2001-3 downturn but the cost was bigger: \$479 billion.
4. Programs enacted by Mr. Bush and supported by Mr. Obama from 2009 through 2012:
 - a) Financial bailout — \$185 billion.
 - b) Other Bush programs continued by Obama -\$232 billion. It includes the wars in Iraq and Afghanistan; a patch to keep the alternative minimum tax from affecting more households; the Bush tax cuts that apply to households making less than \$250,000; and some changes to Medicare reimbursement.
5. Obama policies — \$201 billion from 2009 through 2012:
 - a) Stimulus package – It adds \$145 billion to the 2009-12 deficits. This number includes the \$40 billion additional tax revenue that the C.B.O. estimates will flow from the economic growth caused by the stimulus plan.
 - b) Obama agenda proposed in his first budget - \$56 billion. It includes changes to health care, energy, education, tax policy and other areas (On the positive side of the budget ledger, he has proposed eliminating Medicare subsidies for private insurers (a spending cut) and allowing Mr. Bush's tax cuts to expire for families making more than \$250,000, among other measures. On the negative side, he wants to make health insurance nearly universal, increase college financial aid and offer new tax credits to many families, among other things).

Properly assigning responsibility to Bush for his own policies and for the recession incubated at his sight, as well as of the part of responsibility for the resulting bailout and for his policies continued by Obama, all of

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which explain the overwhelming majority of the deficit as of the end of 2012, should give the Democratic party enough intellectual weapons to counterattack the outrageous Republican attacks trying to give Obama total responsibility for the final result. In fact, Republicans favor extending all the Bush tax cuts, which would send the deficit higher (Even the Cato Institute declared that "the G.O.P. is not serious about cutting down spending"). Nevertheless, we have seen how the Republican attacks have eroded Obama's political capital and his popularity while the Democratic party seems more interested in doing a second part of his cool Survivor ad.

Scott Wilson's 'Black-n-Gold. Obama's spending plans pose political risks' (<http://boards.msn.com/...>) of June 13 mentions a recent Gallup survey showing that although more than six in 10 Americans approve of Obama's overall job performance, fewer than half say they approve of how he is handling the deficit and controlling federal spending. The poll also shows a decline from the previous month in the percentage of Americans who approve of Obama's handling of the economy, although a majority still does.

6. The deficit

Nevertheless, Leonhardt also finds that Obama does not have a realistic plan for eliminating the deficit. Without it, the Obama agenda is vulnerable beyond the short-term. Unfortunately the Democratic party wasted the opportunity given by the tragic fall of the bridge of Minneapolis as is wasting the more open attitude toward taxes shown in the initial polls about health care reform. Those momentums are being wasted and Republicans are gaining ground back using the disappointment for the unfulfilled overoptimistic expectations released by the Treasury unrealistically demanding that the Obama agenda does not increase taxes. If Obama does not take the next opportunity to properly set the debate about taxes instead of retreating on this issue, it will be increasingly difficult for Obama to abide by Pay Go rules and, without that, the Obama agenda is, as I said, and considering that Obama's option for new indebtedness are increasingly narrowing, extremely vulnerable beyond the short-term. I can understand the Obama had asked Congress a waiver of Pay Go rules for his stimulus package but asking a waiver to let Bush's tax cuts of 2001 and 2003 expire naturally falls into the bizarre (<http://thehill.com/...>). "A task force on taxes is set to report to Obama economic adviser and former Federal Reserve Chairman Paul Volcker on Dec. 4, just as Obama is preparing a budget for fiscal 2011" (<http://thehill.com/...>). Even programs aimed at achieving obvious savings require big investments at front that will be very difficult to sustain without increasing taxes. Thus even the CBO projection of 4% deficits over the next decade could end up being the optimistic scenario. Obama's is not more than 3%.

Health care reform could be Obama's chance to demonstrate or confirm the Republican scary tales about federal programs, so gaining a new momentum to reset the debate about taxes in December or validating the Republican tales as hard but true economic realities.

Leonhardt also says: "if the analysis is extended further into the future, well beyond 2012, the Obama agenda accounts for only a slightly higher share of the projected deficits.

How can that be? Some of his proposals, like a plan to put a price on carbon emissions, don't cost the government any money. Others would be partly offset by proposed tax increases on the affluent and spending cuts. Congressional and White House aides agree that no large new programs, like an expansion of health insurance, are likely to pass unless they are paid for."

Nevertheless, for the decade 2010-19 the CBO Director's blog (<http://cboblog.cbo.gov/...>) 'Preliminary analysis of the President's budget,' showed CBO's revised estimations that put the deficit at almost \$1.7 trillion (12 percent of GDP) for 2009, \$1.1 trillion (8 percent of GDP) for 2010 and at about 2 percent of GDP from 2012 to 2019. According to these estimations, Obama's budget proposals would add \$4.8 trillion to a cumulative deficit already at \$4.4 trillion, taking the total to about \$9.3 trillion and the 2009 deficit to \$1.8 trillion (13 percent of GDP). Of those \$4.8 trillion, \$2.1 trillion would result from reduced tax revenues, \$1.7 trillion from changes in spending programs and \$1.0 trillion from interest costs associated with the greater borrowing. A reason to worry, though, is that these estimates assume that the GDP will fall 1.5% in 2009 only to rebound to growths of 4.1% in both 2010 and 2011 and that the unemployment rate will peak to 9.4% in late 2009 and early 2010, what already sounds optimistic.

In his inform of May 21 'The state of the Economy' (<http://www.cbo.gov/...>) the CBO warns about the uncertainty in projecting the real GDP and that getting back to an unemployment rate of 5% could take years. Actually closing the gap between potential and actual real GDP could take until 2013.

The GDP Gap, 1965 to 2014
(Percent)

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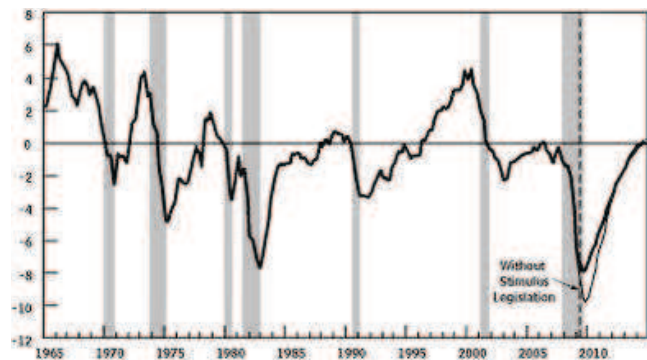
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Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

When evaluating the credit market, the CBO show positive signals:

- The 'risk of default on interbank lending, which had jumped to 365 basis points in October 2008, eased back to 123 basis points by early this year; most recently, on May 8, it stood at 60 basis points, the narrowest spread since March 2008'.
- 'A narrower spread between the yields on corporate bonds and 10-year Treasury notes also indicates some improvement in financial conditions. For high-quality AA-rated corporate debt, the spread peaked at the same time that the spread for interbank lending did and then started to lessen.' Nevertheless, 'the spread for BBB-rated debt remained elevated throughout the end of 2008 and the first quarter of 2009, reflecting the greater likelihood that lower-rated companies will have trouble paying their debt, particularly in an economic downturn, compared with higher-rated companies. Nevertheless, that spread has also narrowed by about 70 basis points over the past two weeks.'

The Risk Spread on Lending Between Banks, 2007 to 2009
(Percentage points)



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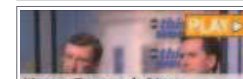
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