The Daily Dish

Recession Insurance

DOUGLAS HOLTZ-EAKIN | OCTOBER 1, 2018

Eakinomics: Recession Insurance

Despite my previous assessment that the probability of a recession in 2018 or 2019 is quite low, a pessimistic tone continues in recent economic commentary. *The Wall Street Journal* asks the question "Has the U.S. Economy Already Peaked?" and notes that there will be a downshift from the 2nd quarter growth rate when the 3rd quarter data on gross domestic product (GDP) are released. Fair enough, but slower growth is very different from a downright downturn. *The New York Times*' writer, Doug Irwin, has a very nice article on the mini-recession that went unnoticed in 2015 and 2016. His argument is essentially that — independent of policies undertaken by the Trump Administration — there were good reasons for the economy to accelerate in 2017-18, and comparably good reasons to expect it to cool somewhat as well.

Not enough time has passed to effectively evaluate the overall impact of the Tax Cuts and Jobs Act (TCJA). If one took a pessimistic view (that I do not), this suggests that there are reasons to be concerned about the outlook beyond 2019. In particular, Joel Prakken pointed out at a recent conference that in 2020 the reversal of the impact of the TCJA and the Bipartisan Budget Act of 2018 would be a sharp negative shift in near-term fiscal policy. The front-loaded effects of the TCJA would end and discretionary spending would have to — in the absence of legislation — snap back to the Budget Control Act (BCA) levels. The effect is a negative fiscal shock equal to -0.5 percent of GDP.

Of course, the TCJA may have substantial and positive impacts on investments and growth. The negative impact of actual and proposed tariffs may recede. The housing market may find its second wind. The pace of economic growth may be fine. But what should people do if they are worried about risks of the opposite? The best insurance is to accelerate the beneficial impacts of something they would want to do anyway. So, right now the Congress should get rid of the BCA levels and enforcement, avoiding a sharp fall in discretionary spending (and having the right amount of defense spending as a bonus). Right now, Congress should undertake "Tax Reform 2.0" and make all the provisions of the TCJA permanent. AAF's research documented the beneficial growth implications of eliminating uncertainty over the future of such key features as expensing, marginal rates, and others. (The House passed a variant of this strategy before leaving on recess; the Joint Committee found that it had beneficial growth impacts, albeit smaller than the AAF estimates.) These are both policies that should be done anyway; why wait?

The immediate objection is that it means spending more and taxing less, precisely at the moment when trillion-dollar deficits are in the offing. Yes, but there is one more policy that Congress will eventually have to enact whether it wants to or not: fixing the long-term budget outlook. Accelerating these reforms are the obvious way to buy recession insurance and have the budgetary outlook add up. It would have the advantage of resolving the uncertainty over Social Security, Medicare, and other parts of the explosive mandatory spending budget.

Economists are fond of reminding people “There Ain’t No Such Think As A Free Lunch” (TANSTAAFL — actually coined by novelist Robert Heinlein in *The Moon Is A Harsh Mistress*). Sad, but true. Until there is serious entitlement reform, there will not be budgetary room for many desirable policy initiatives — including minimizing the risk of a near-term downturn. Keeping the entitlement state in its current form is far from free.