

me long to realize that Arch Galloway, more than any other, knew exactly what he was doing in this town. I decided early on to use Arch's attitude, style, and work ethic as a model for my own, and I think that is one of the best decisions I have ever made. His guidance has never let me down.

Mike Brumas, press secretary, Senator SESSIONS, said:

the use of use of superlatives is all too common these days. But someone trying to describe Arch Galloway's 10-year tenure on Capitol Hill is forced to reach for the highest of accolades—best, brightest, consummate professional, hardest worker. Arch Galloway brought the can-do spirit of a distinguished military career to Senator Sessions's office, and we all benefited by his example. He will be hard to replace and is already missed.

Madam President, I have had the opportunity to travel to Iraq on more than one occasion with Colonel Galloway. He is more than an employee in my office. He is a friend and a partner in service to our country. His career was exceptional in the Army on active duty. His service in my office has been exceptional. No one on the Hill, I think, is more respected than Archie Galloway for his hard work and professionalism. I am going to miss him. Our country is going to miss him.

I don't do this often, but I think on very special occasions, those who serve this Senate exceedingly well deserve a few moments of mention. I think it is true for Archie Galloway. I think all of us appreciate our staff members. So many serve in so many superb ways, but I have to tell my colleagues, this one was special. I am really going to miss him. I wish he and Carol every success. He has been a partner, a friend, and a patriot in his service to America.

I thank the Chair and I yield the floor.

The PRESIDING OFFICER. The Senator from Connecticut is recognized.

Mr. LIEBERMAN. Madam President, I wish to very briefly thank Senator SESSIONS for his tribute to Archie Galloway. I had the privilege to work with Arch and traveled with him at least a couple of times. He is a patriot. He served his country in many different roles, including the last period of time working with Senator SESSIONS, to the benefit of the Senate and his country. I wish him the best in the years ahead, and I look forward to continuing our friendship.

TEXAS INDEPENDENCE DAY

Mrs. HUTCHISON. Mr. President, I wish to take a moment, as they are talking about the way to proceed further, to read a letter I have read every year since I have been in the Senate on or around March 2, which is Texas Independence Day. Today is the 171st anniversary of the signing of the Texas Declaration of Independence. This is a document that declares that Texas would be a free and independent republic. This is a tradition that was started by my colleague, Senator John Tower. It is a most historic time for Texas be-

cause we celebrate Texas Independence Day every year because we know that fighting for freedom has made a difference in what our State has become. We love our history. We were a republic for 10 years, and then we came into the United States as a State.

The defense of the Alamo by 189 courageous men, who were outnumbered 10 to 1, was a key battle in the Texas Revolution. The sacrifice of Colonel William Barret Travis and his men made possible General Sam Houston's ultimate victory at San Jacinto, which secured independence for Texas. Sam Houston and Thomas Rusk, who was the Secretary of War for the Republic of Texas, were the first two United States Senators to serve from the State of Texas.

I will read the letter that was sent by William Barret Travis from the Alamo, asking for arms.

Fellow citizens and compatriots: I am besieged by a thousand or more of the Mexicans under Santa Anna—I have sustained a continual bombardment and cannonade for 24 hours and have not lost a man—the enemy has demanded a surrender at discretion, otherwise, the garrison is to be put to the sword, if the fort is taken—I have answered the demands with a cannon shot, and our flag still waves proudly from the wall—I shall never surrender or retreat.

Then, I call on you in the name of liberty, of patriotism and of everything dear to the American character, to come to our aid, with all dispatch. The enemy is receiving reinforcements daily and will no doubt increase to three or four thousand in four or five days. If this call is neglected, I am determined to sustain myself as long as possible and die like a soldier who never forgets what is due to his own honor and that of his country—Victory or Death.

WILLIAM BARRET TRAVIS,
Lt. Col., Commander.

As everyone knows that battle did continue. Colonel Travis did not receive any help, but it was the delay of those brave soldiers, numbering under 200, that allowed Sam Houston to reinforce his own army and take a stand at the battle of San Jacinto that happened April 21 of that year and did, in fact, determine that Texas would become an independent republic.

TAX RELIEF

Mr. GRASSLEY. Mr. President, I rise to discuss the tax relief that was passed by Congress and signed into law by President Bush in 2001 and 2003, and to bring some reality to an upcoming debate this month that involves the budget resolution. Since that tax relief was enacted in 2001 and 2003, and especially since last November, we have heard from the liberal establishment in Washington and elsewhere that this bipartisan tax relief must be ended and that taxes should be increased on millions of Americans of all income levels.

Today, I am going to look at what is driving the tax increase crowd and talk about why they are wrong and why increasing taxes is a bad idea. The liberal establishment uses deficit reduction as a primary excuse for their craving to

raise taxes, but before we applaud their efforts to balance the budget, let's think about their solution. When anyone says we need to increase taxes to balance the budget, what they are saying is they are unwilling to cut Government spending. In actuality, the tax increase crowd wants to increase Government spending.

Yesterday, I focused on what extending the bipartisan tax relief package means to nearly every American who pays income tax. So today, as I promised yesterday, I want to examine the tax relief and to look at the impact it has on our economy.

Regardless of whether you look at Federal revenues, employment, household wealth, or market indexes, the impact of tax relief has been overwhelmingly positive. I am going to put a chart up that gives the figures I want you to consider as I go through the points I am making.

The first chart illustrates the growth of revenue with the red line and the growth in GDP with the green line. As we can see, revenues are currently increasing, and are projected to increase in the near future, even before tax relief is scheduled to sunset under current law in the year 2010. Clearly, tax relief has not destroyed the Government's revenue base. I want to point out that this chart shows percentage changes in revenue and percentage changes in GDP. So if the lines are flat in places, it means revenues and GDP are increasing at a constant rate.

The next chart graphs the Standard & Poor's 500 equity price index over a period of several years. So, here again, the lowest point of both the red line, representing the weekly S&P, and the green line, representing an average, seems to correspond closely with May of 2003, which, not coincidentally, is when dividend and capital gains tax cuts were signed into law. Aside from benefiting Americans directly invested in the stock market, this is good news for anyone with a pension who invests in the stock market as well. Of course, that happens to be well over half the people. I think somewhere between 56 and 60 percent of the people, either through pensions or directly investing in the stock market, have money reserves in the stock market. So this is not something that affects 10 or 15 percent of maybe the wealthiest people in the country, as it did 20, 25 years ago; more people are vested in the stock market, mostly through pensions.

According to the Federal Reserve—I have another chart—net wealth of households and nonprofit organizations has increased from a low of around \$39 trillion in 2002 to more than \$54 trillion in the third quarter of 2006. Since tax relief went into effect, our Nation's households and nonprofit organizations have benefited from more than \$15 trillion of new wealth.

This trend is also apparent when we are looking at employment. I show you yet another chart. Total nonfarm employment was calculated to consist of

around 130 million jobs in the summer of 2003 but is projected to be 137 million jobs in January of this year. This shows a 7 million increase in nonfarm employment since the 2003 tax relief bill was signed into law.

I have just described to you four indicators of prosperity. All four of them have increased since bipartisan tax relief was passed by Congress and signed into law. I wish to emphasize that word “bipartisan” tax relief legislation of 2001 and 2003. Federal revenues are growing steadily at a rate, then, greater than the gross domestic product. The S&P 500 ended a downward slide and began moving upward around the time of the 2003 tax bill. Also, since the 2003 tax bill became law, household and nonprofit wealth has steadily increased, and literally millions of new jobs have been created. I think it is more than a coincidence that all of these positive economic indicators are correlated with tax relief. I do not think anything short of willful ignorance could lead anyone to say tax relief has been bad for this country.

Now, going back to what I was saying before, the liberal establishment wants to reverse the tax relief that has done all the good things I was just talking about and that we demonstrated by chart, and all in the name of deficit reduction. However, this same crowd has not expressed any interest in reducing the deficit through reduced spending. I believe the reason for this is that this crowd, comprised of lobbyists, the big-city press, and the entrenched Federal bureaucracy, wants to raise taxes—your taxes—to spend your money on growing Government rather than working to trim spending. In fact, the more Government spends, the more power these interests are able to accumulate. The Federal bureaucracy gets to control more money, which will lead to more people hiring high-paid lobbyists to apply pressure to take a bigger piece of the pie the taxpayers are paying for. While these interests have no trouble thinking of themselves, they are not thinking of America’s families, America’s senior citizens, America’s small business owners, and hard-working workers across America. These people may not be able to hire lobbyists or write syndicated columns, but their welfare should be our top priority.

I am going to talk in greater detail about America’s families, seniors, small business owners, and workers, but for now, I just want to mention some more about our economy as a whole and how rolling back the 2001 and 2003 tax relief would have dire consequences for our whole economy.

There is an old saying that goes something like this: Figures don’t lie, but liars can figure. This saying is especially true in Washington, DC. Any given issue has champions on both sides of the aisle able to generate studies and research that just happens to support their position. I say this because the source for the information I am going to present now is not one of

those groups but, rather, the Goldman Sachs Group.

Goldman Sachs is an enormously successful and well-respected financial services firm. I do not think it is possible for any Democratic politician, liberal think-tanker, or liberal journalist to accuse Goldman Sachs of being a tool of my party, the Republican Party. Clinton Treasury Secretary Robert Rubin served as co-senior partner and co-chairman, and current New Jersey Governor and former Senator Jon Corzine served as chairman and CEO of Goldman Sachs. Our current Treasury Secretary also enjoyed a prominent career at that firm. So I would recommend that Republicans, but especially Democrats, pay attention when a Goldman economist sends up a red flag.

In a report that is titled “Fiscal Policy: Marking Time until the Tax Cut Sunsets,” the U.S. Economic Research Group at Goldman Sachs, in this report, projects a recession—projects a recession—if the 2001 and 2003 tax relief is allowed to sunset. Now, this study actually came out in November of 2006, so I am a little surprised we have not heard more about it.

For this report, Goldman Sachs economists used the Washington University macro model. To give a little background on the Washington model, it is a quarterly econometric system of 611 variables, 442 equations, and 169 exogenous variables. The Washington model was developed and is maintained by Macroeconomic Advisers, Limited Liability Corporation, out of St. Louis, MO. Macroeconomic Advisers is where former Congressional Budget Office Director Douglas Holtz-Eakin serves as a senior adviser. Plus, the firm won the prestigious 2005–2006 National Association for Business Economics Outlook Forecast Award for their accurate GDP and Treasury bill rate forecasts. That ought to give them a great deal of credibility. Now, of course, Macroeconomic Advisers and their Washington model must be accurate enough for people to pay to use it, which is not true for every organization that has been modeling the effects on the economy of letting tax relief expire.

Getting back to the Goldman Sachs study, the authors assumed that Congress would let the 2001 and 2003 tax relief expire, so they reset taxes to their year 2000 levels, grossed them up slightly to match the Congressional Budget Office estimate of the revenue impact of letting the tax cuts expire, and allowed for an appropriate monetary response. For monetary policy, the study’s authors assumed that the Federal Reserve would call for interest rate cuts when output falls below its trend and for interest rate increases when inflation rises above its comfort zone.

The study states that:

In the first quarter of 2011, real GDP growth drops more than 3 percentage points below what it would otherwise be. Absent a strong tailwind to growth from some other

source, this would almost surely mark the onset of a recession.

If tax relief is allowed to expire, this study shows that a recession is likely to result. By not extending or making tax relief permanent, Congress will be deliberately inflicting a recession on the American people. Is a lot of hollow, high-sounding rhetoric about balanced budgets worth the job losses or business closures that would result in such a recession?

The study eventually predicts higher output but notes that consumption would be lower.

So that everyone has the opportunity to review this study, I ask unanimous consent, Mr. President, that it be printed in the RECORD, along with one of the very few news stories to note its findings.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

[From the U.S. Economic Analyst, Nov. 10, 2006]

FISCAL POLICY: MARKING TIME UNTIL THE TAX CUT SUNSETS

Near-term changes in US fiscal policy are unlikely despite the shift in control of the Congress. Key decisions on extending tax cuts are not forced until 2010, after the next election, while efforts to roll back these cuts before then would surely trigger a veto.

As the tax cut “sunsets” approach, the Congress regains power, as legislation will then be needed to extend the cuts. The choice will not be easy given the magnitude of the tax increase—about 1½% of GDP—that would occur if the tax cuts all expired and its likely impact on near-term growth.

In a simulation exercise, we confirm that this “do nothing Congress” scenario would quickly balance the budget but at the cost of a sharp hit to growth in the short term. Farther out, the benefits are higher output and lower inflation and interest rates, at the expense of less consumption—an inevitable price for this decade’s tax cuts.

The Democratic Party has regained control of both houses of Congress with a surprisingly strong showing in the mid-term election. Although the new leadership will clash with President Bush on many issues, several areas appear ripe for compromise, including immigration policy, a minimum wage hike, and Iraq policy. Each could have significant impact on the economy.

Third-quarter real GDP growth could be revised up to about 2% (annualized), but the fourth-quarter prognosis remains murky. Early reads on retail sales suggesting that October spending was weak, and the factory sector must begin to work off an inventory overhang. The labor market continues to impress, though we expect the jobless rate to begin trending higher soon as the housing correction triggers more job losses.

I. RETURN TO DIVIDED GOVERNMENT

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Third-quarter real GDP growth may have been a bit stronger than first reported, with data in hand suggesting an upward revision to about 2% (annualized). However, the fourth-quarter prognosis is murky, with

early reads on retail sales suggesting that spending was weak in October, and a substantial inventory overhang in the manufacturing sector. The labor market continues to impress, though we expect the unemployment rate to begin trending higher soon as the housing correction triggers more job losses.

Democrats Retake Congress

With surprisingly strong mid-term election gains, the Democratic Party has retaken a majority not only in the House of Representatives, but also in the Senate with a much thinner 51–49 edge (counting two independents who will caucus with the Democrats). This marks the first time that Democrats have controlled both houses of Congress since 1994; the size of the net changes (6 in the Senate, about 30 in the House) approaches those of previous “landslide” mid-term elections, especially given the relatively small number of competitive races.

With Democrats setting the agenda, the initial focus of Congress next year is likely to be on the six issues highlighted in the campaign: (1) reinstatement of PAYGO budget rules; (2) repeal of tax preferences for integrated oil companies; (3) reductions in student loan rates; (4) direct negotiation of Medicare prescription drug prices; (5) an increase in the minimum wage, and (6) implementation of the September 11th Commission recommendations.

Although President Bush and the Democratic Congress are likely to clash on many fronts, several major issues with ramifications for the economy appear ripe for compromise:

1. Immigration. Continued large inflows of undocumented immigrants and bipartisan acknowledgement that current policies are insufficient to address the situation have created fertile ground for legislative progress. A potential compromise on immigration policy would likely involve a combination of increased quotas for legal immigration, tougher enforcement of those quotas, and some sort of procedure through which illegal immigrants could eventually apply for US citizenship.

2. Minimum wage. As noted above, Democrats have targeted a significant increase in the national minimum wage, to \$7.25 from \$5.15 per hour, as part of their initial agenda. A majority in both houses of the current Congress had already supported an increase even before the election, but the deal was never consummated. More than half (26) of the states already have higher minimums, covering a significant portion of the US labor force.

3. Iraq. Iraq policy could see a fundamental shift, with Donald Rumsfeld's departure as Secretary of Defense an indicator of possible changes ahead. The upcoming report by a special commission chaired by former Secretary of State James Baker and former Congressman Lee Hamilton (who also co-chaired the September 11 Commission) could offer both parties political cover for a change of course. This might ultimately reduce the drain on the federal budget from Iraq-related expenditures.

However, compromise is less likely on many other issues. The White House appeared to be considering making entitlement reform its top priority in Bush's last two years in office, but this now seems unlikely given the huge political obstacles and the likelihood that lawmakers' focus will soon turn to the 2008 presidential election. Federal spending is unlikely to be dramatically different, though divided government historically has meant more controlled spending about in line with GDP growth (−0.02 points per year) versus slightly faster (+0.23 points) when government was under control of a single party.

Tax policy seems unlikely to change either. Most important tax cuts don't expire until 2010, and there is little Democrats in Congress can do to alter tax policy, given the likelihood of a Bush veto. In addition, Democrats appear far from unified on repealing many of these tax cuts, and the resulting fiscal tightening would pose temporary downside risks to the economic outlook. There is a small risk that tighter budget rules could force the cost of extending these cuts to be offset by tax increases elsewhere. Most likely, these would come from the closing of corporate “loopholes” or other business-related revenue raisers. Relief from the Alternative Minimum Tax (AMT) will be extended, but plans to require the cost of any tax cuts to be offset could put two of the Democrats' priorities in conflict (see this week's center section for a fuller discussion of the fiscal outlook).

More Growth Then, Less Now?

Economic news this week implied that third-quarter growth might turn out to be a bit stronger than initially estimated. In particular, better export performance and lower oil imports resulted in a substantially narrower trade deficit for September—\$64.3 billion versus August's downward-revised \$69.0 billion shortfall. This, combined with more inventory building than Commerce officials assumed, puts our best guess for third-quarter real GDP growth slightly above 2% (annualized). Upcoming reports on retail sales and inventories could still swing this figure.

However, the market's focus is on the outlook, and here we remain cautious. In theory, the sharp drop in energy prices over the past three months should boost consumer spending in the fourth quarter, but this acceleration has yet to materialize. Early reads on retail sales activity—the official government data are due out Tuesday—suggest that October spending was weak. In fact, we have trimmed 0.2 points from our retail sales estimates, to −0.4% overall and −0.3% excluding autos. Meanwhile, the manufacturing sector will have to begin working off a significant inventory overhang.

The labor market continues to impress. For example, initial jobless claims moved back down near the 300,000 level, implying that last week's rise was a head fake and reinforcing the generally strong tone of the October employment report. Although the labor market is clearly tight at present, we expect job losses—particularly from the housing sector—to begin pushing up the unemployment rate within the next few months.

II. FISCAL POLICY: MARKING TIME UNTIL THE TAX CUT SUNSETS

Near-term changes in U.S. fiscal policy are unlikely despite the shift in control of the Congress. Key decisions on extending tax cuts are not forced until 2010, after the next election, while any efforts to roll back these cuts before then would surely trigger a presidential veto.

As the tax cut “sunsets” approach, the Congress regains power, as legislation will then be needed if the tax cuts are to be extended. The choice will not be easy given the magnitude of the tax increase—about 1½ percent of GDP—that would occur if the tax cuts all expired and its likely impact on near-term growth.

In a simulation exercise, we confirm that this “do nothing Congress” scenario would quickly balance the budget but at the cost of a sharp hit to growth in the short term. Farther out, the benefits are higher output and lower inflation and interest rates, at the expense of less consumption—an inevitable price for this decade's tax cuts.

Near-Term Fiscal Policy: No Major Shift

Talk of imminent change in fiscal policy, focused on tax hikes, has surfaced as Democrats have regained control of the Congress. They netted about 30 more seats in the House of Representatives, giving them a comfortable margin. In the Senate, the Democratic margin is much thinner—a 51–49 edge.

However, this shift in control of Congress does not translate into an immediate shift in fiscal policy for four reasons. First, the budget deficit has narrowed sharply over the past two years, as shown in Exhibit 1. This may reduce the sense of urgency in the minds of many lawmakers, and therefore their willingness to strike deals even though the longer-term imbalance remains serious and unresolved. Second, the main components of President Bush's signature tax cuts—enacted with “sunsets” to contain their budget impact—do not expire until the end of 2010. Hence, the thorny issue of extending these cuts need not be addressed until after the next Congress (and president) is elected in 2008. Third, any effort to roll back these cuts before their scheduled expiration would almost surely trigger a presidential veto, which the Congress could not override, and it would provide the GOP with an election issue to boot. Therein lies the fourth reason, that the impending 2008 presidential election will limit the time and scope for meaningful progress.

Similar logic applies to the spending side of the ledger, where any efforts to trim outlays for defense or homeland security would be fraught with political risk. Our working assumption is that total spending on national security will not change much, although the composition might shift; for other discretionary spending we expect gridlock between a Democratic majority that would like to restore some programs and a Republican president whose veto pen will suddenly be full of ink. The same probably holds for Democrats' announced intention to push for direct negotiation of Medicare prescription drug prices.

One issue the new congressional leadership will face is how to handle the various tax measures whose renewal has become an annual ritual in recent years. By far the largest of these is the temporary fix of the alternative minimum tax (AMT), without which the number of taxpayers affected by this obscure tax calculation would soar. Although renewing the AMT would boost the deficit by an estimated \$65 billion for fiscal year (FY) 2008, it enjoys bipartisan support. This is because many of its unsuspecting victims live in “blue” states. Hence, the new Congress will probably find some way to make it happen and pass most of the other ones (another \$16 billion) as well. In doing so, the Democrats risk compromising another objective they have championed in recent years, namely to reinstate pay-as-you-go (PAYGO) rules for federal budget legislation. Unlike the administration and the current congressional leadership, who favor PAYGO only for outlays, Democrats have pushed to have these rules apply to taxes as well. Notably, the decision to resurrect PAYGO does not require the president to sign off, as it can be implemented simply as part of the budget resolution. Hence, an early test of the Democrats' resolve to control the budget deficit will be whether they restore PAYGO or something similar and, more critically, whether they adhere to it.

2010: A Year of Wreckoning?

On balance, our expectations for significant change in fiscal policy during the next two years are low. Thereafter, the calculus changes radically as the 2010 sunsets approach. Absent legislative action, the tax

code essentially reverts to its pre-2001 provisions on January 1, 2011. Marginal tax rates on ordinary income rise significantly, dividend income loses its special treatment, the capital gains tax rate goes back to 20 percent, the marriage penalty reappears, the child tax credit drops, and the estate—oops, death—tax springs back to life.

One implication of this situation is that the initiative reverts to Congress, specifically the one to be elected in 2008. It can opt for fiscal balance simply by doing nothing and letting the tax cuts expire, or it can pass legislation to extend any or all of the cuts. Although the president—whoever that may be—obviously still has the right of veto, he/she obviously cannot reject a bill that has not reached his/her desk.

More importantly, the stakes are high, as the sunsets potentially telescope into one year the reversal of tax cuts implemented in various stages between mid-2001 and early 2004. According to Congressional Budget Office (CBO) estimates, tax revenue would rise by \$236 billion between FY 2010 and FY 2012 if all of the tax cuts were to expire. Scaled to the estimated size of the economy at that time, this is a fiscal drag of about 1½ percent of GDP.

Even the most die-hard fiscal hawks are apt to think twice about the implications of this for the near-term performance of the economy. After all, a tax increase of this magnitude, imposed all at once, would likely throw the economy into recession. How bad would it be, and what would the benefit be in terms of budget improvement and longer-term economic performance?

Costs and Benefits of Letting Tax Cuts Expire

To provide some perspective on these questions, we simulated the effects of allowing all the tax cuts to expire as scheduled—or, to twist Harry Truman's famous phrase, a “do nothing Congress” scenario. Specifically, using the Washington University Macroeconomic Model (WUMM), we reset taxes to their 2000 levels, grossed them up slightly to match CBO's estimate of the revenue impact of letting the tax cuts expire, and allowed for appropriate monetary policy response. On the latter, we assume that the Fed follows a rule calling for rate cuts when output falls below its trend and rate hikes when inflation is above its “comfort zone.”

Exhibit 2 illustrates the main results of this exercise, showing how key variables would diverge from a status quo forecast in which the tax cuts are extended. The results are as follows:

Reversing the tax cuts quickly closes most, if not all, of the fiscal deficit. The immediate effect is to cut the deficit by about 1½ percent of GDP, as shown in the top panel of Exhibit 2. This is about three-fifths of the shortfall we currently project for FY 2011, based on assumptions we consider realistic. Under the more restrictive assumptions underlying the CBO's baseline projections, the budget comes very close to balance, as indicated in that agency's latest budget update as well as its estimates that extending the tax cuts would boost the deficit by 1.6 percent of GDP relative to its baseline.

More budget progress occurs in the out years. The budget improvement persists and even increases over time without further changes in tax law. This reflects the beneficial effects of a sharp reduction in interest expense, which results both from reduced borrowing and lower interest rates. Five years out, the budget improvement swells to about 2½ percent of GDP, covering about three-quarters of our projected deficit and putting the budget into modest surplus under the CBO assumptions.

The economy suffers a lot of short-term pain. The jump in taxes on January 1, 2011 squeezes disposable income and hence consumption. This feeds through to the rest of the economy, sharply curtailing growth and prompting an aggressive easing in monetary policy. The lower two panels of Exhibit 2 lay out the major elements of the macroeconomic story.

In the first quarter of 2011, real GDP growth drops more than 3 percentage points below what it would otherwise be. Absent a strong tailwind to growth from some other source, this would almost surely mark the onset of a recession. In an effort to resuscitate demand, the Fed immediately cuts the federal funds rate, bringing it 250 basis points (bp) below the status quo level over the next year and one-half, as shown in the bottom panel of Exhibit 2. Despite this, output growth remains well below trend over that period, putting downward pressure on inflation as slack in the economy increases. Inflation drops by 150 bp during the sag in growth before coming back up as the monetary stimulus pushes output back toward, and eventually above, trend.

In the longer run, economic growth benefits from “crowding in.” When the government runs a large deficit, “crowding out” occurs in the capital markets: Its borrowing, backed by the power to tax, takes priority over private borrowing and therefore denies some companies the funds they need for investment that is usually more productive than the government's use of the funds. As a result, growth suffers and real interest rates rise.

The opposite occurs in our simulation. Restoring better balance to the government's books reduces the deficit and hence the growth in its debt. This frees funds that now flow to the private sector allowing the capital stock to grow more rapidly and pushing down interest rates. As shown by the gap between the lines in the bottom panel, real interest rates end up substantially lower. This, eventually, raises output by about 1 percent above the level that would have prevailed without the tax increase.

At first glance, this seems like a straightforward case of short term pain (recession) leading to longer term gain (higher output). Unfortunately, this assessment is a bit too optimistic. Although output is higher than it otherwise would be, consumption is lower. Since the 2001 tax cuts helped thrust the budget back into deficit, the federal government has borrowed to fund its spending and, via the tax cuts, some consumer spending as well. A reversion in 2011 to higher taxes simply recognizes that fact and starts paying off the debt. If instead Congress chooses to maintain the cuts, they just push the due date for the 2000s spending bill even further into the future. In that case, the ultimate payment—the drop in consumption—would be even higher.

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[From TCS DAILY, Feb. 6, 2007]

HILLARY CLINTON AND RECESSION OF 2011

(By James Pethokoukis)

How predictable. The fiscal 2008 budget that President Bush put forward yesterday gets slammed for being unrealistic—if not downright mendacious. If the \$2.9 trillion proposal actually got enacted as written—doubtful given that Bush is dealing with a Democratic-controlled Congress—the plan would theoretically balance the budget by 2012. As Team Bush crunches the numbers, the U.S. government would run a \$61 billion surplus in 2012 year after running tiny deficits in 2010 (\$94.4 billion, or 0.6 percent of

GDP) and 2011 (\$53.8 billion, or 0.3 percent of GDP). All that while permanently extending the 2001 and 2003 tax cuts due to expire in 2010.

Of course, journalists and think-tank analysts had barely scanned the budget when critics started pointing out its supposed flaws. Among them: the budget assumes more upbeat economic conditions—and thus more tax revenue—than does the forecast from the Congressional Budget Office. (In 2011 and 2012, the White House forecasts 3.0 percent and 2.9 percent GDP growth vs. 2.7 percent for each of those years by the CBO.) As the liberal Center on Budget and Policy Priorities puts it, “The budget employs rosy revenue assumptions; it assumes at least \$150 billion more in revenue than CBO does for the same policies.”

Indeed, the CBO viewed by the inside-the-Beltway crowd as the impartial umpire of all budget disputes—also predicts a balanced budget by 2012. The catch is that it assumes the Bush tax cuts are repealed leading to a surge of revenue in 2011 and 2012. It forecasts that the budget deficit would drop from \$137 billion in 2010 to just \$12 billion in 2011. And in 2012, the budget would move into the black with a \$170 billion surplus. Yet if the Bush tax cuts are extended, CBO predicts total deficits of \$407 billion in 2011 and 2012 and then continuing thereafter.

No wonder Democratic presidential candidates are finding it so easy to pledge or strongly hint that if they are sitting in the White House in 2010, they will veto any effort to extend the tax cuts. One can easily envision President Hillary Rodham Clinton harking back to her husband Bill's 1993 tax hikes and economic success as historical justification for a repeat performance. Deficits are often used as reason for higher taxes, such as in 1993 and 1982. But to believe in higher taxes as sound economic policy in coming years, you also have to believe in the CBO's cheery forecast that hundreds of billion of dollars in new taxes will have little or no effect on economic growth.

Now you don't have to be an acolyte of supply-side guru Arthur Laffer to find that sort of “static analysis” a little weird. Most Americans probably would. So, apparently, did the economic team at Goldman Sachs, the old employer of Robert Rubin, President Bill Clinton's second treasury secretary. Thus the firm's econ wonks decided to try and simulate the real world effect of letting the Bush tax cuts expire at the end of 2010. Using the respected Washington University Macro Model, Goldman reset the tax code to its pre-Bush status, assumed all tax cuts expired, and watched how the economy reacted as 2011 began. What did the firm see? Well, in the first quarter of 2011 the economy dropped 3 percentage points below what it would have been otherwise. “Absent a tailwind to growth from some other source,” the analysis concludes, “this would almost surely mark the onset of a recession.”

So actually it's CBO's economic forecast, not Bush's that is overly, optimistic about future economic growth. But wouldn't the Federal Reserve jump in and cut interest rates, offsetting the fiscal drag of the tax hikes with easy monetary policy? The Goldman Sachs experiment assumes it would, but WUMM still shows the economy sinking;

“In an effort to resuscitate demand, the Fed immediately cuts the federal funds rate, bringing it 250 basis points below the status quo level over the next year and one-half. . . . Despite this, output growth remains well

below trend over that period, putting downward pressure on inflation as slack in the economy increases."

And guess what? A recession would throw CBO's carefully calculated tax revenue assumptions out the window. Indeed, the CBO admits that recessions in 1981, 1990 and 2001, "resulted in significantly different budgetary outcomes than CBO had projected few months before the downturns started."

Of course, it's been the history of tax increases that they tend not to bring in as much revenue as originally predicted. President Rodham Clinton or President Obama or President Edwards would likely find the same budgetary disappointment—and then have to explain to an angry American public during the 2012 election season why their president decided to plunge the economy into a recession.

MR. GRASSLEY. The Goldman Sachs study was clearly not written by cheerleaders for tax relief; indeed, the authors seemed to share the point of view of many in this Chamber that a cut in spending is not an option. The authors regard an eventual drop in consumption as a forgone conclusion of tax relief and equate it with the necessity to pay back what had been borrowed over the previous decade. At the very least, the study says: "The economy suffers a lot of short-term pain."

Congress needs to act to extend or make permanent tax relief enacted in 2001 and 2003 or we risk plunging the country into a frivolous recession. I say frivolous because the recession will be the result of vanity on the part of those who use balancing the budget as a cover for tax-and-spend politics.

More cause for concern of the impact of tax increases comes to us from China. I am sure everyone is aware that the Shanghai Composite Index lost 8.8 percent of its value this past Tuesday. According to various news reports, including a dispatch from the Associated Press, a factor in the drop may have been rumors that a capital gains tax on stock investment was in order.

I ask unanimous consent that an ABC NEWS article entitled "Shanghai Shares Rebound Nearly 4 percent" be printed in the RECORD.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

SHANGHAI SHARES REBOUND NEARLY 4 PERCENT

(By Elaine Kurtenbach)

SHANGHAI, CHINA.—Chinese stocks recovered Wednesday following their worst plunge in a decade as regulators shifted into damage control, denying rumors of plans for a 20 percent capital gains tax on stock investments.

The Shanghai Composite Index gained 3.9 percent to 2,881.07 after opening 1.3 percent lower. On Tuesday, it tumbled 8.8 percent, its largest decline since Feb. 18, 1997.

Bullish comments in the state-controlled media appeared to reassure jittery domestic investors, who account for virtually all trading.

China will focus on ensuring financial stability and security, the official Xinhua News Agency cited Premier Wen Jiabao as saying in an essay due to be published in Thursday's issue of the Communist Party magazine *Qiushi*.

Markets across Asia were still rattled, with many falling for a second day. Japan's

benchmark Nikkei Index sank 2.85 percent, while stocks in the Philippines tumbled 7.9 percent. Malaysian shares fell 3.3 percent, while Hong Kong's market fell 2.5 percent.

On Tuesday, concerns about possible slowdowns in the Chinese and U.S. economies sparked Wall Street's worst drop since the Sept. 11, 2001, terror attacks. The Dow Jones industrial average lost 416 points, or 3.3 percent.

Analysts said they expected China's stock market to stabilize and keep climbing over time although further near-term declines were possible given concerns that prices may have risen too precipitously in recent months.

Tuesday's "sell-off does not reflect any fundamental change in the outlook for China's economy," Yiping Huang and other Citigroup economists said in a report released Wednesday. "A sharp contraction in excess liquidity that would reinforce damage in the stock market remains unlikely," it said.

China's big institutional investors are all state-controlled and would be unlikely to sell so heavily as to completely reverse gains that more than doubled share prices last year. With a key Communist Party congress due in the autumn, the authorities have a huge stake in keeping the markets on an even keel.

"They are acting now to nip a nascent bubble in the bud," says Stephen Green, senior economist at Standard Chartered Bank in Shanghai, adding that it's a challenge given generally bullish sentiment and the massive amount of funds available for investment.

"So they have to somehow calibrate the rhetoric and policy actions to keep a lid on this, while not triggering a collapse," Green says.

One option is a capital gains tax on stock investments. Rumors that such a tax may be enacted are thought to have been one factor behind Tuesday's sell-off.

But the Shanghai Securities News ran a front-page report denying those rumors. The newspaper, run by the official Xinhua News Agency and often used to convey official announcements, cited unnamed spokesmen for the Ministry of Finance and State Administration of Taxation.

China has refrained from imposing a tax on capital gains from stock investments, largely because until last year the markets were languishing near five-year lows. The Shanghai Securities News report cited officials saying that the government had little need to impose such a measure now, given that tax revenues soared by 22 percent last year.

The exact cause of Tuesday's decline in China was unclear, given the lack of any significant negative economic or corporate news.

Some analysts blamed profit taking following recent gains: the market had hit a fresh record high on Monday, with the Shanghai Composite Index closing above 3,000 for the first time.

Others pointed to comments by former Federal Reserve Chairman Alan Greenspan, who warned in remarks to a conference in Hong Kong that a recession in the U.S. was "possible" later this year.

Adding to those factors was a persisting expectation that China might impose further austerity measures, such as an interest rate hike, to cool torrid growth: China's economy grew 10.7 percent last year the fastest rise since 1995 and most forecasts put growth at between 9.5 percent and 10 percent this year.

China's markets took off after a successful round of shareholding reforms helped alleviate worries over a possible flood of state-held shares into the market. Efforts to clean up the brokerage industry and end market abuses also helped.

Their confidence renewed, millions of retail investors began shifting their bank savings into the markets in search of higher returns last year. Strong buying by state-controlled institutional investors and overseas funds also helped.

China still limits foreigners' purchases of the yuan-denominated stocks that make up the biggest share of the markets, though that is gradually changing as regulators allow increasing participation by so-called qualified foreign institutional investors.

Stocks have shown unusual volatility this year, with the Shanghai index notching one-day drops of 4.9 percent and 3.7 percent already this year before recovering to hit new records.

But there are limits to how far shares are allowed to drop in a single trading day: total single-day gains and losses are capped at 10 percent.

MR. GRASSLEY. The same AP report notes that regulators have already denied those rumors and that the Shanghai Securities News ran a front page report to the same effect yesterday. Incidentally, the Shanghai Composite Index gained 3.9 percent yesterday.

I think the Chinese regulator's swift debunking of rumors that a capital gains tax was going to be enacted shows the negative impact such a tax could have on growing markets and expanding economies.

As I have said before, what is missing from the debate on extending tax cuts and clearly missing from the reasoning of the authors of the Goldman Sachs study is the option, and necessity, of reducing Government spending. The right thing to do is to let Americans keep as much of their own money as we can and not seize it from them to promote special interests, encourage high-priced lobbyists or give free rein to the big city press to tell everyone else what to do.

It is often said by the Democratic leadership that tax cuts are not free. That statement is true. Tax cuts score as revenue losses under our budget rules. What is equally true, if you listen to economists and, more importantly, the American taxpayer, is that tax increases are not free as well. Taxpayers have to write a check to Uncle Sam.

Tax increases change taxpayer behavior. Tax increases will affect work, investment, and other economic activities. From an economic policy standpoint, tax increases, especially those that are used to cover more Government spending, have a policy cost. Tax increases are not free to the taxpayers and are not free to a growing economy.

So I would ask that the Democrat leadership, as they draw up their budget resolution, to hopefully keep this in mind. Tax increases have consequences to the American taxpayer and consequences to the American economy.

U.S. SENTENCING COMMISSION NOMINATIONS

MR. LEAHY. Mr. President, I thank the majority leader for his help in connection with the confirmation of members to the Sentencing Commission. I