Pressure Rises on Fiscal Crisis

White House, Lawmakers Try to Push Ahead Amid New Warnings Over Inaction

By DAMIAN PALETTA, CAROL E. LEE and NAFTALI BENDAVID

The White House and Republican lawmakers faced pressure to reach a solution to the looming budget crisis after a nonpartisan agency detailed Thursday how inaction would push the U.S. economy back into recession next year, and skittish investors continued to drive stocks lower.

Fiscal Cliff 101

Last August, President Obama and Congress put the U.S. economy on course to go over a “fiscal cliff.” With the 2012 presidential election decided, WSJ's David Wessel tells you everything you need to know about the "cliff" but were afraid to ask.

Economists from the Congressional Budget Office detailed new warnings of an economy speeding toward a so-called fiscal cliff created by a combination of government spending cuts and tax increases set to take effect Jan. 1.

White House officials are considering proposals with the twin aims of avoiding the fiscal cliff and sparking negotiations on a broader deficit-reduction deal. Any plan is expected to echo President 's campaign call for higher taxes on wealthy Americans, in addition to spending cuts.

Voters "clearly chose the president's view of making sure the wealthy Americans are asked to do a little bit more in the context of reducing our deficit in a balanced way," top White House adviser David Plouffe said Thursday. Mr. Obama planned Friday to give his first post-election statement on the issue.

Congressional leaders said they would watch the tone and substance of Mr. Obama's remarks to gauge how the president planned to work with Republicans to reduce the federal deficit.

The White House has said it would seek to extend the Bush-era tax cuts to households earning less than $250,000 a year but raise rates on people earning more. Many congressional Republicans have said the lower rates should be extended to all taxpayers for at least another year.
The CBO on Thursday detailed its view that if Washington policy makers don't act before the end of the year, the economy would contract by 0.5% in 2013. The unemployment rate would jump from 7.9% to 9.1% by the end of 2013, according to the CBO—a nonpartisan arm of Congress.

Political leaders vowed to try to avoid the "fiscal cliff" of spending cuts and tax increases that could push the U.S. into another recession. Damian Paletta reports on Markets Hub. Photo: Getty Images.

If all the spending cuts and tax increases are avoided, CBO forecast the U.S. economy would grow by about 1.7% next year.

In a 14-page analysis, CBO economists offered Congress an itemized list of choices and consequences. Waiving cuts in domestic and defense spending would, for instance, add three-quarters of a percentage point to economic growth by the end of 2013. Extending all Bush-era tax cuts—but excluding the payroll tax holiday—would add about 1.5 percentage points.

Warnings from the CBO and private-sector economists, as well as a couple of rocky days in the stock market this week, have pushed politicians to at least sound more willing to compromise on their differences than in the past. The Dow Jones Industrial Average fell 2.4% Wednesday and 0.9% Thursday.

"We've already had half of a lost decade," David Stockton, a former top Fed economist now at the Peterson Institute for International Economics, said of the U.S. economy Thursday. "I think going over the fiscal cliff in this manner would be sure to bake in at least a lost decade and probably then some."

Since Mr. Obama's election victory, White House and congressional leaders of both parties have taken a more conciliatory stance. That has stirred hopes of a bipartisan deficit-reduction deal
among some—and agitated people in both parties who object to any compromise calling for higher tax revenues on one hand, and cuts to government entitlement programs on the other.

"Personally, I think the conditions are exactly perfect for us to move ahead with this right now," said Sen. Bob Corker (R., Tenn.), who won re-election Tuesday. "It is going to take the president being committed to doing this and sitting down and rolling up his sleeves and making it happen."

House Speaker of Ohio in a conference call Wednesday told fellow Republicans to avoid drawing lines in the sand. "We don't want to box ourselves in, and we don't want to box the White House out," he said, according to someone familiar with the call.

Mr. Boehner said Wednesday in a televised address that he was open to "new revenue," though not higher tax rates, in a deficit-reduction deal but only if the deal included major spending cuts.

Ever since, Democrats have been trying to parse his words. Many took it as a sign that he was willing to make new concessions. "It makes me very hopeful we can do something big in the next month and a half," Sen. Charles Schumer (D., N.Y.) said Thursday.

CBO also projected that avoiding the fiscal cliff would take the federal debt from last year's 73% of gross domestic product to 86% in 2020.

The White House is looking for a formula that would stabilize the government's debt as a share of the economy to around 75%, according to one person familiar with the matter. Before the 2007-09 recession, the debt-to-GDP ratio was below 65%.

Offering a framework rather than a detailed proposal could be attractive to the White House because of concerns that Republicans might reject a plan with too many details.

The White House also was trying to decide whether any offer should include deficit-cutting proposals that Democrats might find unappealing, such as changes to Medicare and Social Security.

"He's going to try to send a message that he'll be flexible too, and he wants to effectively demonstrate that as early in this process as possible to try to set a new tone," said one White House adviser.

Democrats, including Senate Majority Leader Harry Reid (D., Nev.) were expected to demand more involvement in any deficit-reduction talks than they had in the talks Mr. Obama had with Mr. Boehner. Messrs. Boehner and Reid said Wednesday they were ready to open discussions, leaving the White House to make the next move.

Democrats and Republicans have said there likely wasn't enough time to resolve all the budget issues by year-end but they could make progress by legislating a broad agreement this year and making final details in 2013.

Write to Damian Paletta at damian.paletta@wsj.com, Carol E. Lee at carol.lee@wsj.com and Naftali Bendavid at naftali.bendavid@wsj.com