The Fiscal Cliff

Summary
The"fiscal cliff" is a series of tax increases and spending cuts that will start in January, 2013 unless a negotiated settelment is reached before then.

The cliff is the culmination of several fiscal showdowns between the Republican and Democratic parties. Settlements have relied on short-term fixes and extentions as opposed to long-term solutions.

Nearly two-thirds of the cliff is due to the expiring Bush tax cuts and Social Security payroll tax cut (which was always to be a temporary measure). Tax increases represent 81% of the cliff while spending cuts respresent 19%.

Estimates are that 90% of American households will see a 2013 tax increase. The estimated middle class increase is almost $2,000. The uncertainty caused by the cliff is negatively impacting consumer confidence and businesses willingness to invest and hire.

If we fall over the cliff, the Congressional Budget Office estimates the U.S. economy will fall back into recession and the unemployment rate will increase to over 9%.

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What Is the Fiscal Cliff?

In January 2013, tax law changes and spending reductions are scheduled to take place reducing the deficit by almost $500 billion. This amount is so large that it is popularly known as the "fiscal cliff". If Congress fails to act, and all these changes take place as scheduled, it will almost certainly push the economy back into recession.

During the past few years, there have been a series of increasingly contentious fiscal showdowns between the Republicans and Democrats. The fiscal cliff is essentially the culmination of these showdowns. Both Republicans and Democrats have failed to reach a long-term, comprehensive deal on deficit reduction, tax and entitlement reform. Instead, they have used short-term extensions and "fixes".

The failure of the bipartisan "supercommittee" to find the necessary level of budget savings now requires automatic spending cuts -- equally allocated between defense and non-defense spending. The following table highlights the major components of the fiscal cliff:

Summary Of Fiscal Cliff Components

	$ Bill	% Total
Tax Changes		
Bush Tax Cuts & AMT	$225	46%
Payroll Tax Cut	85	18
Expensing of Investment	65	13
Affordable Care Act Taxes	18	4
Total Tax Changes	$393	81%
Spending Cuts		
Automatic Spending Cuts	$54	11%
Emergency Unemployment Ends	26	5
Medicare Doctor Payment Cut	11	2
Other	3	1
Total Spending Cuts	$94	19%
Total	$487	100%

Source: Peter G. Peterson Foundation

Expiration of the Bush era tax cuts and elimination of the Social Security payroll tax cut represents nearly two-thirds of the fiscal cliff components. The expiring cut in Social Security taxes was always intended as a temporary stimulus measure. Policy debate has been about when it would expire, not whether.

Consequences Of Falling Over The Cliff

It is estimated that almost 90% of Americans would see their taxes rise during 2013. For most households, the two biggest increases would be the expiration of the temporary cut in Social Security taxes, and the expiration of the Bush tax cuts. Households with low incomes would be affected by the expiration of tax credits expanded or created as part of the 2009 stimulus law, while upper income taxpayers will be hit by new health reform taxes. One estimate is that the average American household will pay $3,500 more in taxes during 2013. Middle income households are estimated to see an average tax increase of almost $2,000.

The projected sharp and sudden fiscal contraction would damage our already weak economy. The Congressional Budget Office (CBO) projects that the economy would fall back into recession during the first half of 2013 and the unemployment rate would climb back over 9% by the end of next year.

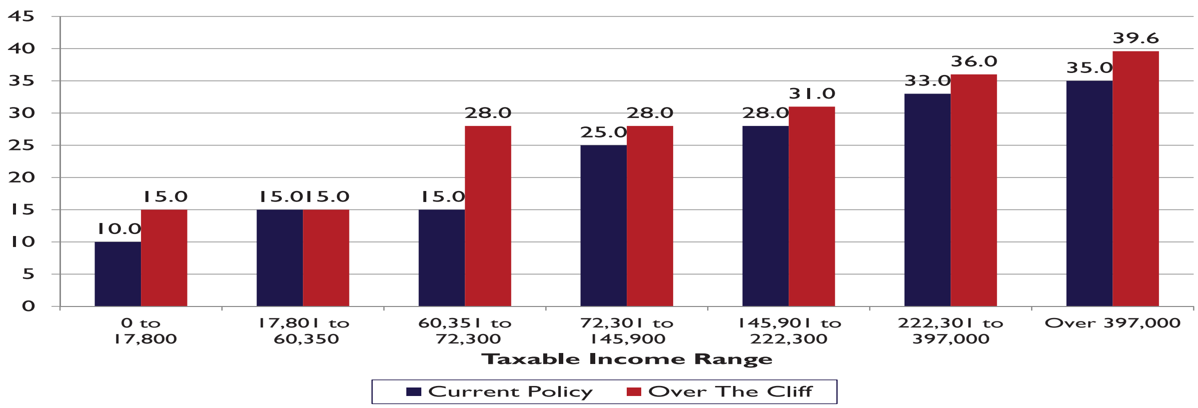
In addition, it is widely believed that the uncertainty surrounding the fiscal cliff has already taken a toll on today's economy by undermining both consumer and business confidence. There is already significant anecdotal evidence that businesses are restraining from hiring and investing due to the uncertainty around future economic conditions.

Simply extending current tax and spending policies would, within the decade, place deficits and debt on a rising path that would harm our economy. If current policies don't change, CBO estimates that debt will climb to 90% of GDP within a decade -- impacting future economic growth. Slower economic growth, as well as demographic changes, imply debt will soar to an unsustainable level of 200% of GDP within 25 years.

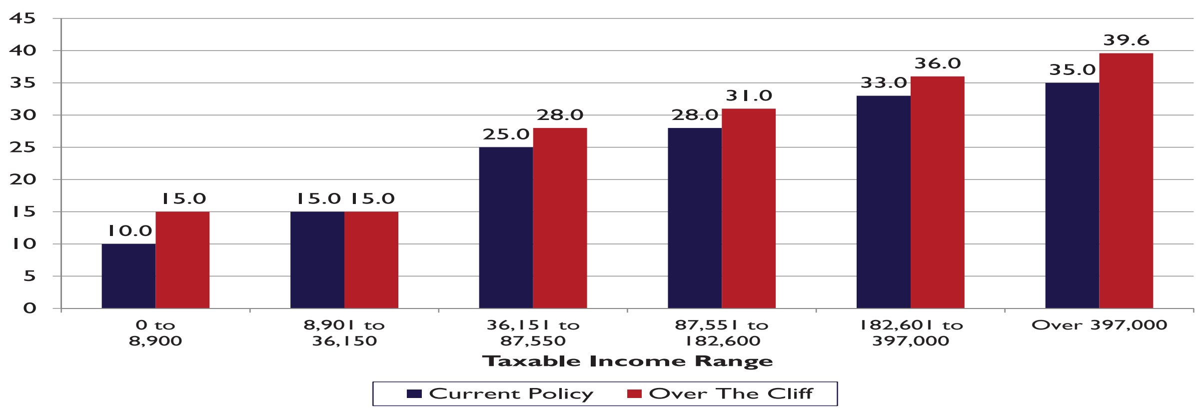
To complicate Congressional negotiations on the fiscal cliff, the U.S. debt ceiling (the legal limit of U.S. public debt) will likely be reached sometime in early 2013. Congress clearly has their work cut out for them as they try to create a deal (probably dealing with both issues) in such a dysfunctional political climate.

Some believe Congress is planning a deliberate "cliff dive" that would allow them, upon their January return, to put together a new package of policies they can frame as tax cuts. We hope this is not the case because, unless one party has total control, a negotiated settlement would still need to be reached (which, by recent history, implies a short-term focus). For the sake of our children and grandchildren, we need to develop a long-term solution -- now!

Marginal Tax Rate Comparison: Married Filing Jointly



Marginal Tax Rate Comparison: Single Taxpayer



Standard Deduction And Personal Exemption Comparison