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Daniel Mitchell: Time to tackle the 'fiscal cliff'

By Daniel J. Mitchell - Nov. 8, 2012

Now that the election is over, the crowd in Washington is finally beginning to focus on the "fiscal cliff."

First, we face the threat of higher tax rates for some or all taxpayers on Jan. 1. Second, there's also a possibility of a "sequester" – automatic budget cuts that also are scheduled to take place on Jan. 1.

And politicians have been spending so much money that we're about to bump up against the nation's debt limit.

So it's likely that all these issues will get joined as President Obama and congressional leaders attempt to negotiate a deal.

The higher tax rate portion of the fiscal cliff exists because 2001 and 2003 tax cuts are scheduled to expire at the end of the year. All taxpayers would see more of their earnings confiscated by the IRS beginning in January if Washington fails to act.

All tax brackets would increase, taxes on dividends and capital gains would rise, and families would see their child tax credits slashed.

The total yearly hike would be in the range of $400 billion.

This could have profound implications, both because of immediate reductions in take-home pay and the negative long-run impact of economic stagnation.

The sequester portion of the fiscal cliff exists because of last year's debt limit fight. It was a mechanism to ensure that something was done to restrain the growing burden of government spending.

If allowed to occur, the sequester would trim next year's federal budget by about $100 billion, with half the savings from military spending and half from nondefense spending.

This would be small compared to the potential tax hike, but definitely would be felt by program beneficiaries.

Many are worried about these potential changes, with Congressional Budget Director Doug Elmendorf warning that Americans should expect a "significant recession" and the loss of some 2 million jobs.

From my point of view, all the tax cuts should be made permanent. The bad news, to me, is that President Obama wants to raise rates on investors, entrepreneurs, small business owners and other "rich" taxpayers.

The sequester should be replaced by a more targeted set of fiscal reforms to restrain the growth of the entitlement state.

Finally, the debt limit should be raised in exchange for a workable and enforceable cap on government spending.