



Everything You Wanted to Know About the Fiscal Cliff But Were Afraid to Ask

By: Scott Ross November 29th, 2012

The fiscal cliff — it's all anyone can talk about, but maybe there are a few things you're unclear on. Now you can spare yourself the embarrassment of asking or the frustration of Googling.

What is the fiscal cliff?

It's the confluence of expiring tax cuts and automatic budget cuts, scheduled for Jan. 1, that would combine to total more than \$600 billion in 2013.

What are the tax cuts, and how will they affect me?

The Bush tax cuts were proposed by President George W. Bush and passed by Congress in 2001 and 2003 and lowered the marginal tax rates for nearly all taxpayers. The cuts have been extended several times but are now scheduled to expire on Dec. 31. According to the White House, if the cuts expire, your average American family of four would see its annual tax bill go up about \$2,200, or about \$42 a week.

And the spending cuts?

During the debt-ceiling crisis, Democrats and Republicans made a deal: If the two parties didn't agree to budget cuts by the end of 2012, drastic cuts would automatically kick in. They include \$27 billion from the defense budget, another \$27 billion from non-defense spending and \$12 billion from Medicare. There aren't many specifics about the cuts, though Defense Secretary Panetta did say, "A sequestration budget is not one that I could recommend."

What would the combination of spending cuts and rising taxes mean?

The Congressional Budget Office says the combination of the expiration of the Bush tax cuts and the massive spending cuts -- going over the figurative cliff -- would be disastrous for the U.S. economy: It would shrink the GDP by 0.5 percent, push unemployment back above 9 percent and probably start another recession.

What do Democrats want?

President Barack Obama primarily hopes to maintain the tax cuts for all but those making more than \$250,000.

What do Republicans want?

The GOP would like to see the Bush tax cuts extended for all taxpayers, including those making more than \$250,000, for the foreseeable future. Most Republican lawmakers

have signed Grover Norquist's Taxpayer Protection Pledge (PDF), a promise to oppose any effort to increase taxes or decrease deductions.

Is there room for compromise?

According to several experts, yes. Some Republicans are already backing off the Norquist pledge, opening up room for negotiation. A compromise could focus on raising tax revenues via fewer deductions, instead of raising the tax rate.

"I agree with Grover — we shouldn't raise rates — but I think Grover is wrong when it comes to we can't cap deductions and buy down debt," Sen. Lindsey Graham, a South Carolina Republican, said on ABC's 'This Week with George Stephanopoulos.' "What do you do with the money? I want to buy down debt and cut rates to create jobs, but I will violate the pledge, long story short, for the good of the country, only if Democrats will do entitlement reform."

A package that limited deductions, and didn't raise tax rates, "would not be a violation of Grover (Norquist)'s pledge," says Dan Mitchell of the libertarian-leaning Cato Institute. "Republicans in the Senate and probably some in the House would probably go along with (that)."

Isabel Sawhill of the Brookings Institution, a liberal-leaning think tank, also sees room for agreement with a cap on deductions, but she doubts that popular deductions like the mortgage interest or charitable giving will be singled out.

"There are several ways to do that," Sawhill said. "One is a hard dollar cap on deductions, if you want your mortgage interest deduction, fine, but you can't have your charitable deduction. That would tend to hit the wealthy more."

Sawhill also thinks Obama might be willing to raise the level for the tax hike to \$500,000, as Warren Buffett has suggested. And there could be reforms to entitlements — specifically Social Security, Medicare and Medicaid, which the GOP would love but to which Democrats are resistant.

What do the American people want?

Based on the November election, it seems clear that voters favor the Democrats' tax-the-rich stance. The Dems just won the White House and picked up two Senate seats and eight House seats. Plus, a Pew Center poll conducted this summer showed that Americans favor by a 2-to-1 margin a tax hike on the rich.

While Sawhill may share the public's desire to see the tax cuts extended for the bottom 98 percent, she says the American people don't realize just how bad things are.

"The public is in denial, the polls show that," she said. "They think it's a lot easier to close this gap than elected officials do. ... Either we have to pay a lot more, not just the wealthy, but the middle class, or we have to scale back."