Is the Fiscal Cliff "Taxmageddon," or Too Little, Too Late?

The anti-tax foundation Americans for Tax Reform has labeled the end of the Bush-era tax cuts that are scheduled to expire at the end of this year — in conjunction with the start of new taxes, such as those brought on by ObamaCare mandates — "Taxmageddon," but would the tax increases built into the law by Congress actually be a catastrophe for the economy, keeping in mind that automatic spending cuts are set to begin as well?

In 2010, Congress renewed the temporary Bush tax cuts for a year, and it did the same in 2011 through the end of this year. But with a budget crisis looming last summer, Congress passed a separate law called the Budget Control Act of 2011 that built in a series of automatic spending cuts into the law (called "sequestrations") that would cut some $120 billion per year over 10 years from discretionary spending compared with expected spending increases. The sequestrations would also take effect January 1. The Budget Control Act of 2011 would cut half ($60 billion) from defense spending and half from other domestic spending across the board.

The combination of expiring tax cuts and the beginning of spending cuts is more popularly called the "fiscal cliff," and it would bring about a slight cut in federal spending (less than two percent overall) and a 12-percent increase in federal tax revenue beginning on January 1, 2013.

Americans for Tax Reform summed up the looming tax increases the following way: "The 10% bracket rises to a new and expanded 15%, The 25% bracket rises to 28%, The 28% bracket rises to 31%, The 33% bracket rises to 36%. The 35% bracket rises to 39.6%." The FICA payroll tax for Social Security would rise back to 7.65 percent of income, from its current 5.65 percent. In addition, several key middle-class income-tax exemptions will diminish, such as the $1,000 per child tax credit, which will be reduced to $500. These would be the main direct impacts on the budgets of middle-class Americans.

But the impact of the government actions on economic growth is difficult to assess. The capital gains tax would also increase from 15 percent to 23.8 percent, an increase that would definitely discourage investment. And there's little disagreement that failure of Congress to remove the "fiscal cliff" would result in a short-term recession. The *Wall Street Journal* opined September 21 that the "fiscal cliff" would bring on a recession: "Pretty much everyone — Ben Bernanke, the Congressional Budget Office, both presidential candidates — seems to agree that the policies are a recipe for a sure-fire recession, although there's far less agreement about what to do to replace them." But the threat of the "fiscal cliff" has not yet led to layoffs, according to the *Wall Street Journal*, which reported, "So far, though, there's little sign of a surge in layoffs."

Though free-market economists believe the "fiscal cliff" will bring a measure of needed fiscal discipline to Washington, they also believe there will be some short-term pain. Frank Shostak, an adjunct scholar at the Ludwig von Mises Institute, regards the fiscal cliff as a positive development in the economy, though it would nevertheless likely lead to a necessary recession to correct the economy. "We suggest that a cut in government outlays should be seen as great news for wealth generators. It is of course bad news for various artificial forms of life that emerged on the back of increases in government outlays." Shostak notes that deficit spending is a tax increase already, as taking on new debt requires higher taxes later, but that real spending cuts would benefit the economy. Indeed, interest charges on the national debt already drain some $450 billion annually from the federal treasury, and these charges can only increase when interest rates inevitably rise.

Meanwhile a debate, sponsored by the National Association for Business Economics, between Obama and Romney advisors resulted in predictable political grandstanding. Romney stand-in Kevin Hassett predictably claimed that he opposed all tax increases, favoring additional tax cuts — yet refused to name specific cuts of the size needed to bring the budget into balance. The Obama underling Jeffery Liebman called for ever-greater spending and soaking the "rich" with more taxes, under the guise that this would balance the budget, though there's no chance of that happening. The debate followed release of a poll by business economists, which showed that most business economists believe the deficit needs to be closed by a combination of spending cuts and tax increases.