

Focus | THE ECONOMY

UNDERSTANDING THE 'FISCAL CLIFF'

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The "fiscal cliff" is a term first used by Federal Reserve Chairman Ben Bernanke to describe the impact on the economy of about \$502 billion in expiring tax cuts and spending reductions, both separately set to occur within a two-day time frame at the end of the year. Bernanke warned that if Congress fails to deal with the issues, the fragile economic recovery could be dashed.

WHAT MAKES THE CLIFF?

AUTOMATIC SPENDING CUTS

(Sequestration)
\$64 billion

\$24 billion

DEFENSE CUTS

Part of the debt ceiling resolution included the stipulation that some spending cuts come from defense.

\$40 billion

NONDEFENSE CUTS

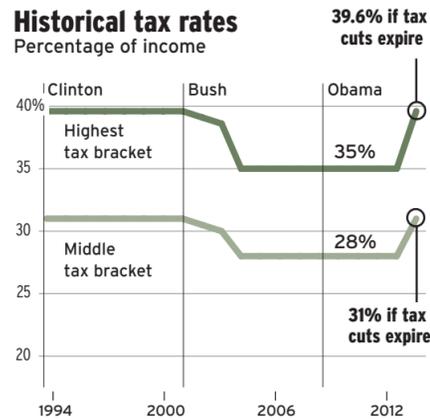
Among proposed cuts, Medicare is scheduled to be cut by 2 percent. For schools, the National Education Association warns that cuts would hit 9 million students, including those in Head Start and special education, with 80,000 jobs lost.

INCREASED TAXES

\$330 billion

EXPIRATION OF THE "BUSH TAX CUTS"

On Dec. 31, the 2001, 2003 and 2010 tax cuts (often referred to as the "Bush tax cuts") will expire. Congress must decide whether to allow the cuts to expire, to extend the cuts or to extend cuts to all except the wealthiest 2 percent of taxpayers. President Barack Obama and many Democrats support the 2 percent option, while Republicans favor extending the cuts to everyone.

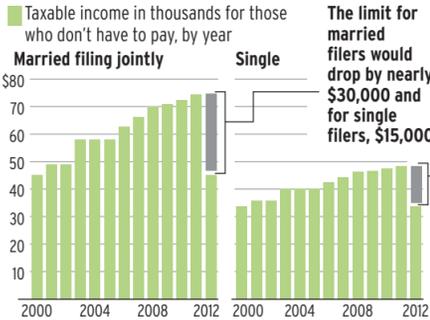


ALTERNATIVE MINIMUM TAX

The alternative minimum tax is an additional income tax that currently applies to household taxable income of \$75,000 or greater. The AMT has had a legislative patch dating back to 2000 that excluded many families. If Congress does not act, the AMT would be applied to millions more citizens.

Currently, only 4 million people pay the AMT. If no action is taken by Congress, 28 million Americans (those who make more than \$48,000 in taxable income annually) will be required to pay it. According to the Tax Policy Center, families affected by the AMT would have to pay an average of \$3,700 in additional taxes.

Who doesn't pay AMT



ESTATE TAX INCREASE

The estate tax is currently 35 percent on any assets over \$5.12 million. On Jan. 1, the tax will be 55 percent on assets over \$1 million unless Congress changes the law. Most Republicans support a complete repeal of the tax, while Obama urges a compromise of 35 percent on assets over \$3.5 million.

OTHER EXPIRING BENEFITS

\$108 billion

PAYROLL TAX CUTS EXPIRE

A key plank of Obama's stimulus plan, the payroll tax cut trimmed the employee portion of the Social Security tax from 6.2 percent to 4.2 percent. This legislation was part of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. Workers will pay an average of about \$1,000 more in taxes if the payroll tax cut expires.

UNEMPLOYMENT BENEFITS

Also coming to an end are the extended unemployment benefits, which provide jobless benefits for up to 99 weeks in many states. These items are likely to expire as there is little partisan disagreement over them.

NOTE: Large figures represent costs in fiscal 2013 and 2014.

GRAPHICS BY CAROLYN ALER AND RYAN MARX, CHICAGO TRIBUNE. SOURCES: CONGRESSIONAL BUDGET OFFICE, REUTERS, TAX FOUNDATION, TAX POLICY CENTER, TRIBUNE NEWSPAPERS REPORTING

WHERE THE TWO PARTIES AGREE

DEFICIT CUTS

Both sides are aiming for a deal that would slash \$4 trillion from the federal deficit over the next decade. They also agree that there are some ways not to do it.

SPENDING

On the spending side, neither party wants to see the automatic across-the-board cuts that would take place under sequestration, and both want to prevent the looming cuts in Medicare payments to doctors.

REVENUE

On the revenue side, both parties want to avoid an expansion of the alternative minimum tax, and they agree that the Bush tax cuts should be extended to 98 percent of taxpayers. Couples who make less than \$250,000 and individuals with income below \$200,000 should continue to receive those breaks, both sides have said.



President Barack Obama sits with House Speaker John Boehner, left, during a meeting with a bipartisan group of congressional leaders at the White House on Nov. 16.

WHERE THEY DISAGREE

BOEHNER'S POSITION

Speaker John Boehner has said that raising tax rates is unacceptable and insists that any attempt to do so would never pass the House. Most House lawmakers in the Republican majority have signed a pledge never to raise taxes.

Boehner wants to see all the tax cuts extended for another year to buy Congress time to put together a big deal. He has said that he would be open to producing new tax revenue in conjunction with an overhaul of the tax code that would also lower rates. Most experts say that approach would not raise enough money.

OBAMA'S POSITION

Obama opposes extending the Bush tax cuts for the wealthy — the top 2 percent of taxpayers — and has said that he won't sign a bill that continues those breaks.

He campaigned heavily on a pledge to "ask the wealthy to pay a little more" and views the election result as an endorsement of his position. Indeed, national exit polls show that 60 percent of voters support raising taxes on the wealthy. And a recent Gallup poll found that 56 percent say that at least half of any deficit-reduction deal should be accomplished through tax increases.

In his budget, Obama proposed a deficit reduction plan for the next decade that would raise \$1.5 trillion in new revenue, largely by allowing the tax cuts for the rich to expire, and would cut \$1.5 trillion in spending. Obama has signaled that he is open to making changes to entitlement programs as part of those spending cuts. The remaining \$1 trillion is already in place, through caps on discretionary spending that Obama signed into law last year.

FOUR POSSIBLE OUTCOMES

OFF THE CLIFF

1 Congress could do nothing, allowing income tax rates to rise to pre-Bush-era levels. Doing so would rattle Wall Street and cause consumer spending to contract. But it would also put new pressure on Republicans and would spare them from having to actually vote for a tax increase. The two parties could then negotiate lower tax rates for some or all taxpayers.

SHORT-TERM DEAL

2 Congress could buy some time for a broader deal if it puts a down payment in place to prevent panic on Wall Street. Democrats would insist on some sort of new revenue in exchange for spending cuts. Obama has called on Congress to extend the Bush-era tax rates for all but the wealthy, but Republicans are more likely to offer to close some loopholes or limit some deductions instead.

THE PUNT

3 Congress could postpone tax increases and spending cuts while talks continue, but that would put Obama in the position of having to renege on his campaign pledge to end the Bush tax cuts for the wealthy by Jan. 1.

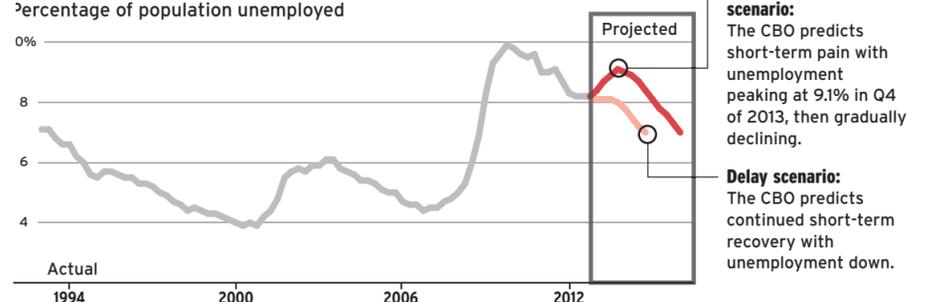
THE LARGE DEAL

4 Both Boehner and Obama would prefer this option, which would address spending and revenue in one grand bargain, but it is not likely to be accomplished during the lame-duck session, so a short-term solution to the "fiscal cliff" would have to take place first.

HOW THE ECONOMY MIGHT REACT

What would happen if we went off the "fiscal cliff"? The Congressional Budget Office projected just such a scenario. The result in the short term: The gross domestic product would drop by 0.5 percent in 2013, which would likely cause unemployment to rise and as a result imperil the economic recovery. It's widely believed going over the cliff could spook the markets and raise questions with credit-rating agencies. The two scenarios shown below represent letting the tax cuts expire and spending cuts go into effect (off-the-cliff scenario) or conversely continuing the tax cuts and delaying the spending cuts (delay scenario). The CBO projects the delay scenario would be easier on unemployment in the short term but would also add to the federal deficit, which could have longer-term consequences if it is not dealt with.

Historical and projected unemployment



Historical and projected deficit or surplus

