Retirement Income
JOURNAL

The Fiscal Cliff Has Been Avoided, But at What Cost?

By Editor Test *Thu, Jan 3, 2013*

Taxes will go up in 2013 relative to 2012—not only on high-income households, as widely discussed, but also on every working man and woman in the country, via the end of the payroll tax cut, says this Brookings Institution expert.

Some thoughts on the new fiscal agreement:

1. The economy needs a stimulus, but under the agreement, taxes will go up in 2013 relative to 2012—not only on high-income households, as widely discussed, but also on every working man and woman in the country, via the end of the payroll tax cut. For most households, the payroll tax takes a far bigger bite than the income tax does, and the payroll tax cut therefore—as CBO and others have shown—was a more effective stimulus than income tax cuts were, because the payroll tax cuts hit lower in the income distribution and hence were more likely to be spent.
2. The economy faces a long-term budget problem, but the bill substantially reduces future tax revenue relative to current law. Going over the cliff would have put us on a better budget path, but in one fell swoop Congress and the Administration put us right back on the worse budget path, less than 24 hours after we had moved to the new path.
3. This is another "kick the can down the road" event. It is a huge missed opportunity. Two things about this are worth noting. First, it is a really big can. The bill will cost about $4 trillion, not counting the added interest on the debt that will have to be paid. Second, the can didn't get kicked very far. The bill did not address the debt ceiling and it pushed the sequester —which neither party wants to see implemented—back to March 1. So, we are back at another cliff-hanger in a couple of months.
4. The timing of the votes in the Senate and the House—in 2013, rather than in 2012—confirms the notion that the No New Taxes pledge is still a binding commitment on Republicans. Because taxes had already gone up at 12:01 AM on January 1, no Republican violated the NNT pledge by voting for the new agreement. Some of the press has reported the bill as a tax increase on high-income households. It is not a legislated tax increase on high-income households. The tax increase occurred automatically at the beginning of the year, due to the expiration of previous cuts.

William Gale is the Arjay and Frances Miller Chair in Federal Economic Policy in the Economic Studies Program at Brookings. He is also co-director of the Tax Policy Center and director of the Retirement Security Project.