

The Politics of the "Fiscal Cliff"

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2 Dec 2012

So the elections are finally over and our illustrious federal officials now turn their attention to the so-called "fiscal cliff". At issue here is whether the Bush-era tax cuts will expire, along with the Social Security withholding reduction enacted in 2010 as a temporary stimulus measure. The "fiscal cliff" came about per an interim agreement reached last year, as a result of the debt-ceiling escalation in Aug 2011 and the subsequent failure of Congress to come to a consensus on a fiscal policy. The idea behind the interim agreement was simple: impose across-the-board spending cuts of \$1 trillion over ten years and let the Bush-era tax cuts expire on 1 Jan 2013 unless a long-term fiscal policy is enacted. The \$1 trillion in spending cuts, spread over ten years, result in \$100 billion in cuts every year, split approximately equally between defense and non-defense. This was regarded by its designers as so abhorrent that it would provide sufficient motivation for Congress and the President to actually make a deal. But the negotiations since the election have not been going too well; and of course both sides are busy blaming each other.

I will review the situation, and show how the Republicans, contrary to conventional wisdom, actually hold all the cards here. First, a few undisputed facts:

1. The President campaigned successfully on two notions: that tax rates must go up for the wealthy, and must come down for the middle class. He has said the marginal rates on the wealthy should go back to the 1990's; in other words, from 35% now to 39.4% as they were in the Clinton era.
2. If the "fiscal cliff" occurs, tax rates will go up for both the wealthy and the middle class.
3. The long-term fiscal problem of the nation cannot be solved by spending cuts alone, nor by tax increases alone; a combination of the two is necessary (i.e., a comprehensive package).
4. The history of past "comprehensive" reforms, as enacted under Reagan and Bush, Sr., shows that the Democrats always insist on tax increases immediately, with a promise of spending cuts in the distant future. Of course, politicians being who they are, those cuts never happen. It is safe to say that no Democrat in Congress will ever vote for any bill that actually cuts spending in the near term unless he is forced to do so.
5. No Democratic President will sign a bill that results in immediate spending cuts, unless he is forced to do so (like Bill Clinton).
6. If anything bad happens to the economy, the propaganda wing of the Democratic Party (i.e., CNN, CBS, ABC, NBC, and PBS; plus the major newspapers led by *The New York Times*) will blame the Republicans; if anything good happens in the economy, they will give Mr. Obama all the credit.
7. The Democrats and their propaganda wing have long held that the Republicans are the party of the rich (conveniently ignoring the fact that tax provisions favoring the wealthy were passed mostly by Democratically-controlled Congresses over the last 50 years).
8. The Democrats and their propaganda empire have claimed that the Republicans are holding the middle class hostage to protect the rich.
9. Mr. Obama has stated that he will only accept a "fiscal cliff" deal if it raises tax rates on the wealthy. He has claimed the wealthy are those with incomes over \$250,000.
10. The Republicans have thus far admitted that revenue increases are necessary and are willing to do so by removing some loopholes used by the wealthy and limiting some deductions. They do not want to raise tax rates on the wealthy due to a "tax pledge" made some years ago.

Here are a few observations and applications. First, consider the cuts in the "fiscal cliff" legislation. The cuts are across-the-board, without the necessary and prudent prioritization that rational people would do. However, let's be realistic: it actually imposes spending cuts immediately, and for that reason alone is probably the best that our ruling elite can do as things stand presently.

Secondly, the wealthy already pay a large portion of income taxes. So, if revenues are to be increased via the Republican preference (closing loopholes and limiting deductions), or increased by Mr. Obama's preference (raising marginal rates), the wealthy are going to pay more either way. In reality, the best thing for the nation is the Republican way, since it will do more to promote fairness in the tax code, and limits the ability of Congress to punish their enemies and reward their friends through the tax code.

Third, if we go over the "fiscal cliff", taxes will go up for those of us in the middle class. So taxes will go up -- what else is new; and how will it matter all that much? State and local taxes of all types have been going up all along. Recall that the Social Security withholding reduction was intended to be temporary anyway (it was also a bad idea). The increase in taxation via federal marginal rate increases is small compared to the already-occurring increases in the cost of living due to the Federal Reserve's currency-printing machine. If either side truly cared about the middle class, perhaps they would take action to restrain Mr. Bernanke.

Fourth, although most Republicans were dumb enough to sign "no-tax" pledges at the urging of Mr. Grover Norquist, the simple fact is that both the expiration of the Bush-era cuts and the repeal of the Social Security withholding reduction are already accomplished facts if a deal is not made. They cannot be accused of raising taxes if they allow law per a vote already taken in 2011 to occur. Only a moron would sign such a pledge anyway; since when did Mr. Norquist assume the authority to supersede the needs of the nation and the powers of Congress contained in the Constitution? If Mr. Norquist wishes to be emperor, perhaps he should run for the office.

Fifth, the "smart money" has known for months that our ruling elites are incapable of anything better than the impending "fiscal cliff". As for the future of the stock market, the "smart money" managers have probably already priced-in the effects.

Sixth, if one is going to be accused of something, one may as well do it.

With these facts and observations in mind, it seems to me that the Republicans hold all the cards here, and it is possible to get true reform that actually helps the nation. Mr. Obama needs to score political points by raising taxes on the wealthy (it won't solve the fiscal problem, but he needs to score points). He won re-election, so let him have his political points. The increases on the wealthy are his most famous political need, but not his most important one. Many of his supporters are middle-class. He needs a tax cut for them much more than he needs a tax increase on the wealthy. The Republicans in the House should immediately pass legislation that raises marginal rates on the wealthy to 50%, with no corresponding demands for spending cuts and no other conditions subject to objection. This is far above the rates that prevailed in the Clinton era. In fact, they should pass a series of bills that raise rates on the wealthy to 60, 70, 80, or 90%, and let the Senate Democrats and the President choose the one they want. This turns the argument around while costing the Republicans nothing: taxes are going up on the wealthy either way. If the Democrats think those marginal rates are too high, it will be incumbent on the Democrats to negotiate lower rates for the wealthy to protect their friends in the tall buildings in Manhattan. If the Democrats do not really want higher rates on the wealthy, by all means they shall have their "fiscal cliff". If they settle on the new rates for the wealthy, Mr. Obama will have his political points, but leaves the Republicans in control of what he needs more (the middle class tax cut). Then the Republicans can actually do what they've been accused of: hold the middle class tax cuts hostage -- not to protect the rich, but to get spending under control and thus stabilize and secure the nation's long-term financial health. They should demand immediate spending cuts in return for an immediate reduction in tax rates for the middle class, thus forcing the Democrats to do what is necessary but have never done before.