Most In U.S. Won't Be Able To Escape 'Fiscal Cliff'

Christopher S. Rugaber, AP Economics Writer

WASHINGTON (AP) — Everyone who pays income tax — and some who don't —will feel it.

So will doctors who accept Medicare, people who get unemployment aid, defense contractors, air traffic controllers, national park rangers and companies that do research and development.

The package of tax increases and spending cuts known as the "fiscal cliff" takes effect in January unless Congress passes a budget deal by then. The economy would be hit so hard that it would likely sink into recession in the first half of 2013, economists say.

And no matter who you are, it will be all but impossible to avoid the pain.

Middle income families would have to pay an average of about $2,000 more next year, the nonpartisan Tax Policy Center has calculated.

Up to 3.4 million jobs would be lost, the Congressional Budget Office estimates. The unemployment rate would reach 9.1 percent from the current 7.9 percent. Stocks could plunge. The nonpartisan CBO estimates the total cost of the cliff in 2013 at $671 billion.

Collectively, the tax increases would be the steepest to hit Americans in 60 years when measured as a percentage of the economy.

"There would be a huge shock effect to the U.S. economy," says Mark Vitner, an economist at Wells Fargo.

Most of the damage — roughly two-thirds — would come from the tax increases. But the spending cuts would cause pain, too.

The bleak scenario could push the White House and Congress to reach a deal before year's end. On Tuesday, Congress returns for a post-election session that could last through Dec. 31. At a minimum, analysts say some temporary compromise might be reached, allowing a final deal to be cut early next year.

Still, uncertainty about a final deal could cause many companies to further delay hiring and spend less. Already, many U.S. companies say anxiety about the fiscal cliff has led them to put off plans to expand or hire.

A breakdown in negotiations could also ignite turmoil in financial markets, Vitner said. It could resemble the 700-point fall in the Dow Jones industrial average in 2008 after the House initially rejected the $700 billion bailout of major banks.

Since President Barack Obama's re-election, nervous investors have sold stocks. The Standard & Poor's 500 index sank 2.3 percent last week, its worst weekly drop since June. The sell-off resulted in part from anxiety over higher tax rates on investment gains once the fiscal cliff kicks in.

Last week, Obama said he was open to compromise with Republican leaders. But the White House said he would veto any bill that would extend tax cuts on income above $250,000.

Republican House Speaker John Boehner countered that higher tax rates on upper-income Americans would slow job growth. Boehner argued that any deal must reduce tax rates, eliminate special-interest loopholes and rein in government benefits.

More than 50 percent of the tax increases would come from the expiration of tax cuts approved in 2001 and 2003 and from additional tax cuts in a 2009 economic stimulus law.

The first set of tax cuts reduced rates on income, investment gains, dividends and estates. They also boosted tax credits for families with children. Deductions for married couples also rose. The 2009 measure increased tax credits for low-income earners and college students.

About 20 percent of the tax increase would come from the expiration of a Social Security tax cut enacted in 2010. This change would cost someone making $50,000 about $1,000 a year, or nearly $20 a week, and a household with two high-paid workers up to $4,500, or nearly $87 a week.

The end of the Social Security tax cut isn't technically among the changes triggered by the fiscal cliff. But because it expires at the same time, it's included in most calculations of the fiscal cliff's effects.

And it could catch many people by surprise.

"Every worker in America is going to see a reduction in their paycheck in the first pay period of 2013," Vitner noted.

An additional 20 percent of the tax increase would come from the end of about 80 tax breaks, mostly for businesses. One is a tax credit for research and development. Another lets companies deduct from their income half the cost of large equipment or machinery.

Mark Bakko, a Minneapolis accountant, says many mid-size companies he advises are holding off on equipment purchases or hiring until the fate of those tax breaks becomes clear. Bakko noted that the research and development credit typically lets a company that hired an engineer at a $100,000 salary cut its tax bill by $10,000. The credit has been routinely extended since the 1980s.

The rest of the tax increase would come mainly from the alternative minimum tax, or AMT. It would hit 30 million Americans, up from 4 million now.

The costly AMT was designed to prevent rich people from exploiting loopholes and deductions to avoid any income tax. But the AMT wasn't indexed for inflation, so it's increasingly threatened middle-income taxpayers. Congress has acted each year to prevent the AMT from hitting many more people.

Under the fiscal cliff, households in the lowest 20 percent of earners would pay an average of $412 more, the Tax Policy Center calculates. The top 20 percent would pay an average $14,000 more, the top 1 percent $121,000 more.

All this would lead many consumers to spend less. Anticipating reduced sales and profits, businesses would likely cut jobs. Others would delay hiring.

Another part of the cliff is a package of across-the-board spending cuts to defense and domestic programs — cuts the CBO says would total about $85 billion. Congress and the Obama administration agreed last year that these cuts would kick in if a congressional panel couldn't agree on a deficit-reduction plan. The magnitude of the cuts was intended to force agreement. It didn't.

Defense spending would shrink 10 percent. Defense Secretary Leon Panetta has said those cuts would cause temporary job losses among civilian Pentagon employees and major defense contractors. Spending on weapons programs would be cut.

For domestic programs, like highway funding, aid to state and local governments and health research, spending would drop about 8 percent. Education grants to states and localities; the FBI and other law enforcement; environmental protection; and air traffic controllers, among others, would also be affected, the White House says.

Hospitals and doctors' offices could also cut jobs if an $11 billion cut in Medicare payments isn't reversed.

Extended unemployment benefits for about 2 million people would end. The extra benefits provide up to 73 weeks of aid.

"It would be nice if we could ... address these issues before the very last moment," said Donald Marron, the Tax Policy Center's director.

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