The Scary Cliff ... fiscally ... What does it mean?

The Fiscal Cliff issue results from various laws that were previously enacted that were intended to reduce the U. S. budget deficit. With no change in the law, all of the deficit reduction changes will happen as of January 1, 2013.

- The tax relief (Bush tax cuts) will end. So the government will be having a larger income of money from increased taxation.
- Spending by all government agencies will be cut. (Exceptions = social security benefits, veteran's benefits, federal pensions) So the government will be spending less money. Hopefully that savings can replace some of the money that holds us in debt.

These two events happening at the same time is what worries Congress. How will increased taxes at the same time as less government spending affect job creation and hiring, job retention, and consequently the economy

On the next page, we've included an infographic that compares two different solutions for this problem

| *Congressional Budget Office plan (<u>CBO plan</u>)* | *<u>Alternate Scenario</u>* |
|---|---|
| Allow tax breaks and spending cuts to go into effect. | Congress extends current tax breaks and spending. |

*Study the graphic on the next page as you try to answer these questions.*

1. How much was the 2012 Budget deficit?

2. How much will the deficit be reduced by if the CBO plan is adopted?

3. How much will the deficit be reduced by if the Alternate Scenario is adopted?

4. What does economic growth probably mean?

5. How will economic growth be affected in the two scenarios pictured in the graphic?

6. If the Congressional Budget Office's Plan is allowed to happen, how will unemployment be affected according to the graphic?

7. Study the graphic and make one more observation about the Fiscal Cliff that you are prepared to present in class.

# FISCAL TIGHTENING IN 2013 and Its Economic Consequences

Under current law, a sharp reduction in the federal budget deficit between 2012 and 2013 will cause the economy to contract, the Congressional Budget Office projects, but will also put federal debt on a path more likely to be sustainable over time. To illustrate the effects of fiscal tightening, CBO compared its projections under current law (the "baseline" projections) with projections under an alternative set of policies—two scenarios in a broad spectrum of choices.

## CBO's August 2012 Baseline

Reflects the assumption that current laws generally remain unchanged, implying that lawmakers will allow tax increases and spending cuts scheduled under current law to occur and that they will forgo measures routinely taken in the past to avoid such changes.

## An Alternative Fiscal Scenario

Maintains what might be deemed current policies, as opposed to current laws, implying that lawmakers will extend most tax cuts and other forms of tax relief currently in place but set to expire and that they will prevent automatic spending reductions and certain spending restraints from occurring.

### The Deficit in 2013 Compared with 2012

**Federal Budget Deficit in 2013**
(Billions of dollars in the fiscal year)

| | Baseline | Alternative Fiscal Scenario |
|---|---|---|
| Deficit in 2012 | $1,128 B | $1,128 B |
| Federal Budget Deficit in 2013 | $641 B (Baseline Deficit in 2013) | $1,037 B (Baseline Deficit in 2013 + Extend Tax Cuts* + Prevent Spending Cuts*) |
| Reduction in the Deficit in 2013 Compared with 2012 | $487 B | $91 B |

**Reduction in the Deficit in 2013 Compared with 2012**
(Billions of dollars in the fiscal year)

### The Economy in 2013

**Economic Growth**
(Change in inflation-adjusted gross domestic product, 4th quarter 2012 to 4th quarter 2013)

Baseline: −0.5% | Alternative: +1.7%

**Unemployment Rate**
(4th quarter 2013)

Baseline: 9.1% | Alternative: 8.0%

### The Path of Federal Debt Through 2022

**Debt Held by the Public**
(Percentage of gross domestic product)

| Year | Baseline | Alternative Fiscal Scenario |
|---|---|---|
| 2002 | 34% | 34% |
| 2007 | 36% | 36% |
| 2012 | 73% | 73% |
| 2017 | 68% | 83% |
| 2022 | 58% | 90% |

## A Broad Spectrum of Fiscal Policy Choices

### Decisions for 2013

More Fiscal Tightening ← → Less Fiscal Tightening

- Allow the changes scheduled under current law to occur or take other steps to shrink the deficit from 2012 by $487 billion or more.
- Shrink the deficit from 2012 by less than $487 billion by extending some of the expiring tax cuts, curbing the spending cuts, or adopting other combinations of policies.
- Seek to stimulate the economy by cutting taxes, increasing spending, or doing both, thereby running a larger deficit in 2013 than in 2012.

### Implications for Future Policy Decisions

Reductions in taxes or increases in spending in 2013, relative to what would occur under current law, would have near-term economic benefits but would add to the already large accumulation of government debt. Because current policies would ultimately lead to an unsustainable level of federal debt, policymakers will need—at some point—to adopt policies that will require people to pay significantly more in taxes, accept substantially less in government benefits and services, or both.

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Source: Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022*, August 2012; http://go.usa.gov/7QY
Publication Date: August 2012

*Extend Tax Cuts—extend all expiring tax provisions, other than the payroll tax reduction, and index the alternative minimum tax for inflation. Prevent Spending Cuts—cancel the automatic spending cuts required by the Budget Control Act and maintain Medicare's payment rates for physicians at the current level.