Fiscal Cliff is the culmination of expiring (Bush-era) tax cuts and subsidies and initiation of spending cuts ("Sequestration") and new taxes beginning in 2013.

Sequestration is an automatic budget cut, sanctioned under the 2011 Budget Control Act, that applies indiscriminately across the federal budget.

The total impact = over $600 billion without counting any knock on effects.
Other Changes in Revenues and Spending

- Reduction in Medicare’s payment rates for physicians
- Expiration of eligibility to start receiving emergency unemployment benefits
- Effects of the automatic enforcement procedures specified in the Budget Control Act
- Taxes included in the Affordable Care Act
- Other expiring provisions

Other Changes in Spending Policies

- Policies
- Changes in Revenue Policies

Source: Congressional Budget Office.

1 Various other provisions affecting the tax code are also slated to expire by the end of this year or expired at the end of 2011 but have lagged effects on revenues. The largest such provision involves the expiration at the end of 2012 of partial expensing of investment property.

2 The Budget Control Act (BCA) of 2011 imposed caps on discretionary programs that will reduce their funding by more than $1 trillion over the ten years from 2012 through 2021.
The Bush Year tax cuts are grouped into two pieces of temporary tax legislations.

- The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), lowered income tax rates, made estate and gift tax exclusions, and simplified qualified and retirement plan rules. All the tax cuts were set to expire at the end of 2010. [The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended EGTRRA for 2 years.]

- Reduction of individual tax rates to include:
  - created a new 10% bracket for the lowest income earners and
  - the lowest income range was indexed into the 10% while the rest remained in the 15% bracket
  - the 25% bracket would replace the 28% bracket by 2006
  - the 28% bracket would replace the 31% bracket by 2006
  - the 33% bracket would replace the 36% bracket by 2006
  - the 35% bracket would replace the 39.6% bracket 2006
  - increased the standard deduction for joint filers to between 174% and 200% of the deduction for single filers
  - increased the per-child tax credit
  - increased the exemption for the Alternative Minimum Tax
The Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA") was signed into effect on May 28, 2003.

Among other provisions, the JGTRRA accelerated certain tax changes passed under EGTRRA, increased the exemption for the individual Alternative Minimum Tax, and lowered taxes on dividends and capital gains.

The top capital gains rate of 20% was lowered to 15%, and the top individual rate on dividends was lowered from 35% to 15%. These cuts were set to expire after 2008. [The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 further extended JGTRRA for 2 years.]

The combination of EGTRRA and JGTRRA is often referred to as the Bush Tax Cuts.
• Increase the US debt ceiling by $2.1 trillion, which is expected to be sufficient to fund the US government through February 2013.

• Set up binding limits or “caps” on annual appropriations bills projected to reduce funding for discretionary programs by more than $1 trillion through 2021.

• Expect the House and Senate to vote in the fall of 2011 to amend the Constitution to mandate a balanced budget every year. [The House defeated the amendment on November 18 and the Senate defeated it on December 14.]

• Create a Joint Select Committee on Deficit Reduction (“Supercommittee”) to draft legislation to reduce projected deficits by no less than $1.2 trillion through 2021 in addition to the discretionary caps. [The Committee failed to reached an agreement on November 21, 2011.]

• If the Supercommittee deadlocks, a fail-safe mechanism (“Sequestration”) would be enacted to ensure that $1.2 trillion in deficit reduction would be a reality. This means an equal reduction in national defense spending and all other budget items to include entitlements.
Our assessment of the probability for each of the five likely Fiscal Cliff Scenarios:

- **10% - Grand Bargain** = a deal is struck before 2013 between the two parties to avoid sharp austerity and to gradually phase in increasing revenues and reducing deficit.
- **15% - Extension** = “kicking the can down the road” by extending or delaying Bush-era tax cuts and sequestration for a year or two
- **40% - Muddling Through** = A combination of small deals, extensions, and letting some part of the Fiscal Cliff to occur in 2013
- **25% - Bungee Jump** = Go over the Fiscal Cliff and, depending how the country and the financial market react, a series of deals are made to reverse a part of the Fiscal Cliff.
- **10% - Go over the Fiscal Cliff.**
Since 2009 Q4, real GDP has been sub-3% with the exception of 2011 Q4.
The realization of the full Fiscal Cliff will push the U.S. economy into a recession towards the end of 2013 as the full impact of various components of the Fiscal Cliff are translated into the economy.
The political grandstanding of the lawmakers and the game of chicken they are playing continue the delay from resolving the Fiscal Cliff. This uncertainty, created in 2011, has and will continue to negatively impact this fragile economy.
Many companies are making one-time extraordinary dividend payments before 2013 in anticipation of tax increases next year which divoids the companies from making productive business investments and expansions.