Insight

New Study Examines Economic Effects of the Fiscal Cliff

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Based on Administration's economic multipliers, going over the fiscal cliff means job losses that could be between 2.8 million and 10 million

Washington – The American Action Forum today released a study examining the economic effects of the fiscal cliff, a $600 billion combination of tax increases and across-the-board spending cuts, scheduled to go into effect on January 1, 2013. The fiscal cliff is twice the size of the growth in U.S. GDP ($300 billion) this year.

Forum President Douglas Holtz-Eakin and Ike Brannon, Director of Economic Policy, found that assuming current policy stays intact and the country goes straight over the fiscal cliff, based off Dr. Christina Romer's GDP economic multipliers, the U.S. economy could lose from 2.8 million jobs to as much as 10 million jobs.

Additionally, Holtz-Eakin and Brannon found that reaching the fiscal cliff will decrease the likelihood that small businesses will hire by 18 percent, and push the effective marginal tax rate for many workers and small businesses above 50 percent of their income.

Though the policy changes do not take effect until 2013, the impacts are already being felt across the economy as uncertainty increases and confidence and consumer spending decrease.

Read the Executive Summary below and the full study here:

The U.S. faces a $600 billion "fiscal cliff" at the end of 2012 that includes a $440 billion tax increase and $108 billion in across-the-board spending cuts. Going over the fiscal cliff will likely result in a recession if the administration and Congress fail to act. ***The negative fiscal shock exceeds Gross Domestic Product (GDP) growth in any year over the past two decades***, and when considering economic multipliers, the contraction could approach *ten percent*, which would amount to the biggest year-to-year decline since 1932. This upper-bound estimate would result in ***a loss of 10 million jobs***, according to the administration's methods.

Failing to extend the 2001-2003 tax cuts would not only increase taxes on every single taxpayer in the country but would also ***put millions of lower middle class households who are not currently paying taxes back on the tax rolls at a rate of fifteen percent***, and restore the marriage penalty. ***For workers and small businesses in the top tax brackets, the effective marginal tax rate for many—if not most—of these would spike to above and beyond 50 percent of their income in taxes***.

There are significant economic consequences to going over the fiscal cliff. Using conventional methods, ***we estimate that a 6 percentage point drop in GDP triggered by a jump off the fiscal cliff would increase unemployment by 2 percentage points, or to over 10 percent, resulting in an additional 2.8 million people unemployed***

, with large losses in California, Texas, Florida, and New York.

An increase the top effective rate from 35 percent to 42 percent would <u>lower the probability that a small business entrepreneur would add to payrolls by roughly 18 percent</u>. For those that do manage to hire, the growth in payrolls would be diminished by over 5 percent. ***The increase in tax rates would reduce the probability that a small business undertakes expansion by nearly 15 percent, and reduce the capital outlays of those who do by almost 20 percent***.