

# A Fiscal Cliffhanger

Uncertainty about how Congress will address the fiscal cliff leaves states playing a guessing game.

BY JEFF HURLEY

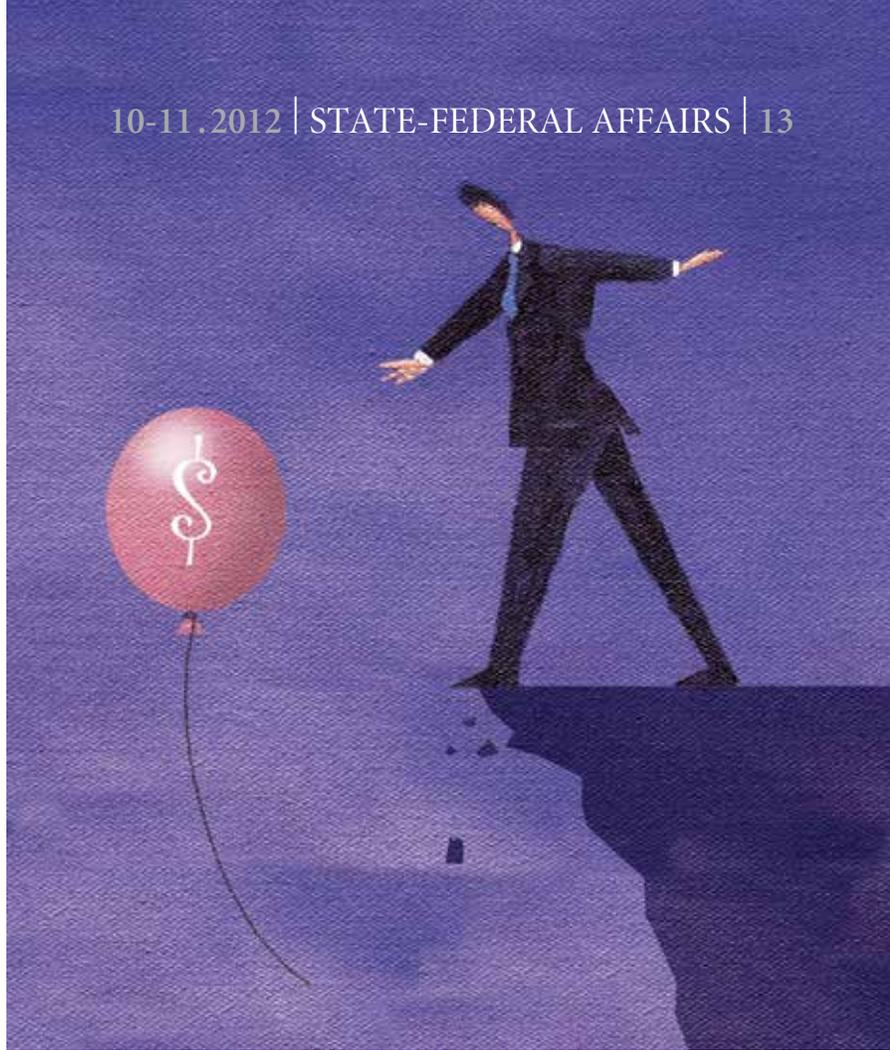
**W**hat may either stunt economic growth or cost the federal government up to \$8 trillion? The answer depends on how Congress deals with the fiscal cliff, a topic casting a long shadow over conversations about how to reduce the nation's growing debt.

The term "fiscal cliff" was coined by Federal Reserve Chairman Ben Bernanke last spring to describe the combination of tax increases—or, more accurately, tax cuts set to expire at the end of 2012—and spending cuts that will occur at the beginning of 2013. These tax increases and spending cuts will happen automatically unless Congress acts to stop them.

Experts predict going over the fiscal cliff will set the country's economy reeling. The Congressional Budget Office reports that if no action is taken, the deficit in FY 2013 would be cut in half, but the unemployment rate would increase by a full percent.

So what's contributing to this deep abyss? On the revenue side, the largest and most controversial piece is whether to extend the tax cuts enacted in 2001 and 2003 and renewed in 2010. If the cuts are not extended, marginal income tax rates will go up, along with others, such as estate, capital gains and dividends taxes. Other cuts ready to expire—on employee payroll taxes, for example—also will eat away at Americans' wallets. Adding to the unease, if Congress does not act, the reach of the alternative minimum tax will be expanded and nearly 30 million households would pay significantly more money to the Internal Revenue Service. Lack of federal action is certain to affect states' budgets to varying degrees, depending on how a particular state's tax system is linked to the federal tax code.

On the spending side of the fiscal cliff are the automatic, across-the-board cuts referred to as sequestration. Sequestration was triggered after the congressional "supercommittee" failed to reach a deal in 2011 to reduce the federal deficit by at least \$1.2 trillion over nine years. These cuts would be evenly distributed among defense and non-defense discretionary spending. A number of programs, such as Medicaid and Temporary Assistance for Needy Families, are exempt. However, the White House released a report in September estimating that non-exempt discretionary funding for state-federal programs in areas such as education,



public safety and energy would be reduced by 8.2 percent in FY 2013. Defense spending would be cut by 9.4 percent. Beyond sequestration, the extended unemployment benefits and Medicare payments to physicians would also be reduced, making the spending cut side of the fiscal cliff even steeper.

Some states are preparing for the cliff by taking preemptive action. Vermont and Virginia, for example, have set aside state funds in anticipation of cuts to state-federal programs. Utah enacted legislation requiring all state agencies to disclose total federal receipts and develop contingency plans in the event federal funds are reduced by 5 percent or 25 percent.

Perhaps what's most daunting to state lawmakers, however, is all the uncertainty surrounding the fiscal cliff. Congress' lack of action raises many questions that states need answered in order to plan their own budgets.

Efforts to resolve the problem have failed to take root. Numerous budget proposals, such as the president's FY 2013 budget and U.S. House Budget Chairman Paul Ryan's budget resolution, advocated eliminating sequestration in favor of comprehensive deficit reduction plans. But compromise was elusive.

Moving forward, federal lawmakers can do nothing, allowing tax cuts to expire and sequestration to occur. They could extend the expiring tax cuts and repeal the reductions in discretionary spending. Or they could combine parts of all these options.

A pre-election deal failed, and Congress now has a limited number of days during the lame-duck session to reach agreement across a very wide partisan chasm. If Congress extends the tax cuts and postpones the spending cuts, this cliffhanger will be punted to the 113th Congress.

*Jeff Hurley is a senior policy specialist who tracks federal budget issues for NCSL.*