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Fiscal cliff combines tax hikes, spending cuts

WASHINGTON (AP) — So just what is this ‘‘fiscal cliff’’ that has the financial markets rattled and economists and policymakers alike in a tizzy over the potential for sending the economy into another tailspin?

It’s a one-two punch of expiring Bush-era tax cuts and major across-the-board spending cuts to the Pentagon and domestic programs that could total $800 billion next year, based on Congressional Budget Office estimates.

The cliff is the punishment for previous failures of a bitterly-divided Congress and White House to deal with the government’s spiraling debt or overhaul its unwieldy tax code.

The largest component of the cliff comes with the expiration of tax cuts enacted in 2001 and 2003 and extended two years ago in the wake of President Barack Obama’s drubbing in the 2010 midterm elections.

It also includes sharp spending cuts imposed as a consequence of the failure of last year’s deficit-reduction supercommittee’’ to reach agreement. There are other elements, chiefly a 2 percentage point cut in payroll taxes orchestrated by Obama and unemployment benefits for the long-term jobless that would disappear.

Specifically, the fiscal cliff includes:

—The expiration of Bush-era tax cuts on income, investments, married couples and families with children and inheritances.

—A $55 billion, 9 percent cut in defense spending next year and another $55 billion in cuts to domestic programs, including a 2 percent cut to Medicare providers.

—The expiration of unemployment benefits for the long-term jobless and a sharp cut in reimbursements for doctors participating in Medicare.

—The expiration of Obama’s temporary 2 percentage point cut in payroll taxes.

—The imposition of the alternative minimum tax on some 26 million households, which would raise their taxes by an average of $3,700.

—A variety of smaller taxes cuts for both businesses and individuals collectively known as tax ‘‘extenders’’ in Washington-speak. They include a tax credit for research and development and a deduction for sales taxes in states that don’t have an income tax.

A Congressional Budget Office study in May estimated that the fiscal cliff would force tax hikes and spending cuts totaling over $600 billion in the first nine months of next year — or perhaps $800 billion or so over the entire year if allowed to stay in effect.

A subsequent less detailed CBO update estimates a somewhat smaller impact. The agency is expected to release a new estimate soon.

The fiscal cliff would require such a sharp cut in the deficit that the economy would contract, economists say.

Not all elements of the fiscal cliff are guaranteed to be averted. New taxes on family investment income exceeding $250,000 set to take effect Jan. 1 as a way to help pay for Obama’s health care law are unlikely to be forestalled; and the common wisdom in Washington is that temporary payroll tax cuts and unemployment benefits won’t be extended.

Some Democrats have called on Obama to propose renewing the payroll tax cut, but he has not taken a position.

Some experts say that the economy could withstand going over the fiscal cliff for a short period of time because the Treasury Department might be able to adjust tax withholding tables to mitigate its affects and that agency budget chiefs could be flexible in allocating the automatic cuts, known as a sequester, and buy several weeks’ worth of time to negotiate.

Some Democrats want Obama to play hardball on the fiscal cliff to try to force Republicans to accept increased tax rates on income exceeding $250,000 for couples. Republicans warn that type of approach would get Obama’s second term off to a bad start. ■