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The Cliff is Dead, Long Live the Cliff

After much rhetoric, posturing and media focus on nothing but “the cliff,” it seems like an after thought now. The net result will be about a 1% impact on US GDP. The so called “balanced approach” the President posturing during the US election ended up being about a 45 to 1 “balance” of tax increases to spending cuts.

The President promised - openly and often – that under no circumstances would he raise taxes on the Middle Class, that individuals earning less than $250,000 would not be affected. It was the center of his platform and can be recited verbatim as he said speech after speech:

> “If your family earns less than $250,000 a year, you will not see your taxes increased a single dime. I repeat: not a single dime”

Well even though the “Fiscal Cliff” deal raised the figure to $400,000; that promise looks like a broken one. Even the rather left-of-center Brookings Institute Tax Policy Center reported last week that those earning between $30,000 and $250,000 are going to see their pay cheques reduced sharply. In the case of the former, they’ll pay another $450 in taxes, and the latter about $1800 more. All of the increases are due to the subtle and submerged tax rule changes taking place.

What is fascinating is how the politically well connected reap the benefits regardless of what party is in office. While the President quietly broke his promise on 100 million working Americans from having to pay more taxes, others in Silicon Valley and Hollywood get gigantic economic gifts from the Fiscal Cliff deal. Many of these bills have pork barrel attached to them to get them passed and the recent deal was no exception:

- Huge R&D benefits which help Silicon Valley
- $9 billion extension of active financing exception for manufacturing and banks (which also helps keep jobs offshore)
- $1.2 billion for renting in Liberty Zone in the World Trade Center (this is huge win for Wall Street)
- $430 million to Hollywood to help “struggling” film makers (plus individual TV episodes can get up to $20 million break)
- $331 million on railroad maintenance
- $220 million excise tax on rum returned to Puerto Rico and Virgin Islands
- $70 million in NASCAR write offs
- $4 million for electric motorcycles
- $1 million for allowing coal on native land to be treated as “alternative” fuel

It’s no wonder Washington (and most politics) today are so dysfunctional. So while Silicon Valley, Hollywood and Wall Street made out well out of the deal, small business, the real job creator in any economy, will take a huge hit with higher taxes, Obamacare, and higher regulations.

Even though the Fiscal Cliff was resolved for now, Congress delayed dealing with the debt ceiling. In fact, looking ahead, one could argue the USA now has 4 separate “cliffs” to deal with in 2013:

- Debt ceiling cliff in February/March
- Sequester cliff in March
- Farm bill cliff in September
- Job benefits due to expire in December

So theoretically we could be dealing with this nonsense much of the year, and could dominate media airwaves.

This could only mean one thing: the top 5-10% will be asked again and again to pay more of their “fair share.” The USA is not yet France with a 75% marginal tax rate, but neither are they Russia with a 13% flat tax rate.

As youth unemployment in Europe tips the scales in the 30 to 50% range, their youth is totally demoralized and the crime rate has already begun to creep up. They are being sold the notion that some sort of “justice” is in the works. Politicians nowadays seem to dovetail so-called social justice with economic justice, and that seems to be the path America is on.

For all the hype and the attention to the series of cliffs mentioned above, the real cliff will come when these young kids finally realize the solution meted out as a “cure” on their behalf is actually worse than the disease. I’m referring to high taxes and other punitive action taken in the name of economic redistribution to level the playing field.

This is the exact script Europe began to follow in the 1970’s as they raised taxes in the name of equality. Europe peaked in the 1970’s as those taxes came on and on and on and sucked up resources, incentive and opportunities, especially for the youth. Now they are paying the piper.

Amazingly, higher taxes continue to be the center piece of plans to revive those Euro economies, yet they continue to slump. Many are arguing for more government spending, taxes on gas emissions, food taxes, etc…

The youth unemployment in Europe is exploding, and is an eventual powder keg. The USA is not there yet, but the path is in that direction:

Nation	Youth Unemployment	Highest Tax Rate	VAT Tax
USA	15.6%	39.6%	N/A
EU	24.4%	N/A	N/A
Germany	8.1%	47.5%	19.0%
France	27.0%	46.8%	19.6%
Italy	37.1%	47.3%	21.0%
Portugal	38.7%	49.0%	23.0%
Spain	56.5%	26.6%	21.0%

(Wall Street Strategies: 9-Jan-2013)

(Germany has similar taxes as others in Europe, but has a better educated work force and lower personal income taxes)

Many individual US states are already on their way to a Euro type scenario due to big spending, high debt and high taxes. New York, California, Massachusetts and Illinois are there (coincidentally, all traditionally Democratic states).

The game for now is to sell higher taxes on those dastardly wealthy folk as a solution to all woes. It may please a certain part of the population to hear that, but it will eventually erode the foundations of any nation.

The economic solution which Europe and the USA need has already been done……in Canada in the mid 1990's. We raised taxes $1 for every $7 of spending cuts combined with economic growth. You need all 3 pieces to make it work, but a growing economy (which created jobs) is the key. And spending cuts need to be the centerpiece to tax increases, not the other way around, and certainly not at a 45 to 1 ratio.

Ironically, the above recipe was at the core of the losing Romney/Ryan ticket in the US Presidential election, but was rejected by the American public. I agree with president Obama 100% on one point; a balanced approach is needed.

But we have yet to see that out of the White House or Washington in general.

Stay tuned,

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