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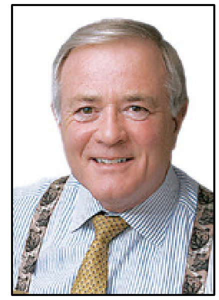

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Did Congress work out a fiscal lift?

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The long awaited and dreaded "fiscal cliff" finally arrived. In a previous column I described it as more of a fiscal slope than a cliff. We received a mixed bag of laws, which could have been better, but also could have been worse. It did provide clarity (not always welcome) for some stakeholders, but left many decisions to be made.

President Obama, after winning re-election, played a tough hand. Tax increases were on his mind, and he believed that he had a mandate to raise taxes because he campaigned on a policy of higher taxes. Describing his tax increases as "fairness," he called for higher rates for higher-income taxpayers. He insisted that Congress deal with tax rates, and declined to offer any spending cuts.

With the power of his pen, and the Senate on his side, Obama's only obstacle was the Republican-controlled House. While Congress and Obama knew that we had revenue and spending problems and a large budget deficit, the approaches of the president and the Republicans were vastly different. The president was not interested in spending cuts, but rather only more revenue. The Republicans believed that more revenue would come from a government more favorable to business and therefore the economy, and that spending reductions were needed.

The Democrats baited the Republicans by offering up no cuts, forcing the Republicans to name which entitlement programs they would cut, and by how much. Recognizing that putting a price tag on "sacred cows" was a losing hand, Republicans folded. The deal disappointed many people, but it extended the "Bush tax cuts" for some and mitigated tax increases for others.

It was not the deal Republicans wanted, but the best they were going to get. Budget cuts, never on the table except in the minds of the Republicans, were left for another day – one that may not ever arrive.

So, under this administration, the country is set on a path to increasing revenues through tax increases. It should come as no surprise that the president adhered to this policy. He did win the election after all, and made it clear that redistribution of wealth was his goal.

Tax rates went up for individuals with income over $400,000 and couples with income over $450,000. The alternative minimum tax was fixed at $50,600 for individuals and $78,750 for couples, with the rates being indexed for inflation.

For investors, the capital gains rate and dividend and interest tax rates were set at 20 percent, with an additional 3.8 percent tax on passive income to support "Obamacare." Individuals will see expiration of the 2 percent payroll tax holiday. The estate tax rate was set at $5 million for individuals and $10 million per household, indexed to inflation with the top estate and gift tax rate set at 40 percent.

For investors, things could have been worse. Dividend-paying stocks, municipal bonds and electrical utilities will still be worth holding for their income. With parity between dividends and interest on one hand, and capital gains on the other, some investors may still wish to hold stocks for longer terms, so they can time their tax bite. Companies may prefer to buy back stock rather than return money to shareholders through dividends.

The stock market got a lift from the compromise. It jumped 4.6 percent, with the S&P hitting five-year highs. U.S. Treasurys fell 4 percent as the threat of higher interest rates and the end of Federal Reserve support for the bond market loomed. Right now, the only good thing about Treasurys is that they are inversely correlated to stocks. While that has been a winning hand in the past, investing in equities may now be better – unless a "safe haven" is desired.

The debate now moves to raising the debt ceiling, where Republicans believe they have an advantage. However, that advantage may not be much given that the bills that are due largely are for money already appropriated or spent. Restraining spending is their only hope, but Congress recently passed a $60 billion Christmas tree bill ostensibly to aid victims of the Sandy "superstorm."

This example does not bode well for restraint. According to public opinion polls, most American voters believe that the U.S. faces a grave budgetary crisis unless deficits and debts are brought under control. Yet no one wants their pet programs cut. Ultimately, the U.S. must show a willingness to match expenditures to income or face another credit rating downgrade.

Of vital interest to all parties now is avoiding another recession. This means that Obama, Democrats and Republicans need to show an interest in economic policy that was absent in the president's first term.

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