Written by **Raven Clabough** on November 8, 2012

Dow Jones Drops 313 Points Following Election Day

Just one day after President Obama was reelected to a second term, the Dow Jones industrial average plummeted 313 points. While some analysts believe the drop was in response to the election results, others assert that it was provoked by fearful anticipation of the impending fiscal cliff that the United States government will be forced to contend with by the end of 2012. The fiscal cliff refers to the terms of the Budget Control Act of 2011 that are scheduled to go into effect in 2013.

As noted by *USA Today*, when the Dow Jones closed on Wednesday at 12,933, it was "its lowest close since Aug. 2." Similarly, the S&P 500 and the Nasdaq had their lowest closes since August 6.

According to *USA Today*, the election results contributed to the drops at least a little: "Investor reaction is decidedly negative over the defeat of the more business-friendly Mitt Romney."

Likewise, fears were exacerbated on Wednesday when European Central Bank President Mario Draghi indicated that he was concerned about the outlook of Europe's economies, particularly Germany's.

However, the failure of Congress to reach a conclusion on how to avert the impending fiscal crisis by the end of the year is believed to be the most significant contributing factor to the 313-point drop. Many are concerned that Congress will be unable to reach a compromise during a lame-duck session.

"The chances of going off the cliff probably just increased," says Ed Yardeni, chief investment strategist at Yardeni Research.

Since the election did nothing to change the balance of power in Congress and in the White House, there seems to be little faith in the possibility for bipartisanship before reaching the fiscal cliff.

And the American people will be the ones to suffer for it. *Business Insider* has summed up the changes expected to take place in 2013, at approximately the same time. The changes include the following:

> The 2001 and 2003 tax cuts are set to expire.
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> The Alternative Minimum Tax (AMT) will hit more people.
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> Payroll taxes will increase by about $120 billion in 2013 if the tax cuts expire.
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> The sequester will slash defense spending.
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> Unemployment benefits are set to run out, which could cut payments by about $34 billion in CY [Calendar Year] 2013.
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> The debt limit will also be reached again around the same time.
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> And there are other miscellaneous issues such as "doc fix" and "tax enders" that need to be resolved.

The scheduled spending cuts came about as a result of the deficit super-committee's inability to produce a deficit-cutting agreement last year. In the end, Congress produced an agreement that included nearly $1 trillion in cuts to agency budgets over the course of the decade, and required automatic cuts to take place, dubbed a "sequester," of an additional $1 trillion.

The *Washington Times* explains, "Not only would taxes increase but 'deep, automatic cuts' would be applied to over 1,000 government programs — including Medicare and the defense budget."

According to the Congressional Budget Office (CBO), the scheduled changes will have a disastrous effect on the economy. The CBO released its analysis in its annual summer budget update, reporting,

> The sharp increases in federal taxes and reductions in federal spending that are scheduled under current law to begin in calendar year 2013 are likely to interrupt the recent economic progress.
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> By CBO's estimate, that fiscal tightening will probably lead to a recession in 2013 and to an unemployment rate that remains above 8 percent through 2014.

But despite assertions that the United States is nearing a fiscal cliff as a result of the expiration of the tax cuts and the spending cuts, economic expert Peter Schiff contends that the notion that the automatic spending cuts and the expiration of the Bush era tax cuts will create a fiscal cliff is somewhat exaggerated and has been concocted by those who falsely believe government spending generates economic growth.

As far as the spending cuts, Schiff explains:

> People tend to forget that the government can only get money from taxing, borrowing, or printing…. Money taxed or borrowed is taken out of the private sector, where it could have been used more productively. Printing money merely creates inflation. So the automatic spending cuts, to the extent they are actually allowed to go into effect, will promote economic growth, not prevent it.

It is the impact of the expiration of the tax cuts that may be cause for concern, though Schiff acknowledges that the "adverse" effects of the tax hikes could be defrayed by the reduction of government borrowing:

> The impact of the expiring Bush era tax cuts is much harder to assess. The adverse effects of the tax hikes could be offset by the benefits of reduced government borrowing (provided that the taxes actually result in increased revenue). But given the negative incentives created by higher marginal tax rates, particularly as they impact savings and capital investment, increased rates may actually result in less revenue, thereby widening the budget deficit.

According to economists such as Schiff, the bigger cause for concern than the combination of the expiration of the tax cuts and government spending cuts is the current national debt and the increased burden that will result from a rise in interest rates.

As long as the interest rate remains as it is now, below two percent, the debt service payments are "relatively manageable." But Schiff warns:

> On the current trajectory the national debt will likely hit $20 trillion in a few years. If by that time interest rates were to return to some semblance of historic normalcy, say 5 per cent, interest payments on the debt would then run $1 trillion per year. This sum could represent almost 40 per cent of total federal revenues in 2012!

As far as the fiscal cliff, analysts indicate that investors will be watching closely for signs from leaders of both political parties that an agreement may be reached.

"The re-elected president must immediately act to avoid the fiscal cliff," says David Kotok, chief investment officer at Cumberland Advisors. "Massive negotiations lie ahead."