At Issue:

Should tax cuts on high earnings be extended?

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In 2001, Congress assembled a time bomb with a 10-year fuse. Unless the lame duck Congress acts with atypical urgency, all tax cuts enacted in 2001-2003 will vanish on Dec. 31.

If lawmakers fail to defuse the tax time bomb by the end of the year, withholding taxes will increase dramatically. Moreover, if lawmakers and the president can't agree on a solution by year's end, the top tax on dividends would jump from 15 percent to 39.6 percent, ensuring a stock market crash. The estate tax would jump to 55 percent with only a $1 million exemption. Marginal tax rates would rise by 3-5 percentage points across the board.

President Obama has appeared eager to hurl himself on top of this bomb. He threatened economic homicide and political suicide by threatening to veto any solution that did not impose much higher taxes on two-earner couples and small businesses earning more than $250,000. Yet the president has had eight months to enact the tax hikes in his 2011 budget. If he couldn't do it then, he certainly can't now. Everyone knows this is playing with fire. The targets of Obama's planned tax increases account for a fourth of all consumer spending, and a greater fraction of entrepreneurship and investment.

Christina Romer, formerly Obama's top economic adviser, found that a U.S. tax increase amounting to 1 percent of gross domestic product (GDP) reduces real GDP by nearly 3 percent within three years, with employment falling 1.1 percent. Harvard economists Alberto Alesina and Silvia Ardagna found that "fiscal adjustments, those based upon spending cuts and no tax increases, are more likely to reduce deficits . . . [and] less likely to create recessions."

Under the fanciful assumption that Obama's tax hikes on "the rich" did no damage to the economy, his plan is estimated to raise $35 billion next year. That would cover the budget deficit for just nine days. This is all risk and no reward.

The White House is now rumored to be willing to compromise on legislation that postpones the president's planned tax hikes on upper-income families while supposedly making "permanent" all other Bush tax cuts. That may not be the ideal solution, but it buys time for the new Congress to tackle the budget in an economy that is rising slowly rather than falling fast. Letting President Bush's tax cuts for incomes over $250,000 expire on schedule at the end of December is the right move from the standpoint of both equity and economic efficiency.

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Recent decades have witnessed a stunning shift in incomes from the middle class to those few at the top. Between 1980 and 2005, about 80 percent of the country's total income gains went to the top 1 percent of the population, according to a report by MIT researchers Frank Levy and Peter Temin. Moreover, while incomes stagnated for middle-class Americans in recent decades, they surged for the wealthy — in stark contrast to the decades between the mid-1940s and mid-1970s, when income growth was widely shared. The average middle-income American family had $13,000 less after-tax income in 2007 than it would have had if incomes of all groups had grown at the same average rate since 1979.

Tax policy is one of the best tools we have to help offset the troubling trend of growing inequality. Unfortunately, President Bush's tax cuts have had the opposite effect, providing much larger benefits — both in dollar terms and as a percentage of income — to people at the very top than to middle- and lower-income people.

In fact, people making more than $1 million a year get an average of about $129,000 each year from the Bush tax cuts, according to the Urban Institute-Brookings Institution Tax Policy Center. The main reason, of course, is the huge tax cuts targeted specifically at high-income households. Extending the tax cuts for high-income people would only make inequality worse. (High-income people would still benefit from an extension of the so-called "middle-class" Bush tax cuts, since the first $250,000 of their income would be taxed at the lower marginal tax rates.)

Extending the high-end tax cuts doesn't make sense from an economic perspective, either. The Congressional Budget Office (CBO) rated it the least cost-effective of 11 options for boosting economic growth and job creation. A far better alternative would be to extend President Obama's Making Work Pay tax credit, which is targeted to people who live paycheck-to-paycheck but is also scheduled to expire at the end of December. This would generate two to three times the economic growth and job creation as extending the high-end Bush tax cuts, according to CBO.

The right course, then, would be to let the high-end Bush tax cuts expire, locking in significant long-term budgetary savings, while temporarily extending the Making Work Pay credit while the economy remains weak.