
Jeffrey Sachs: 5 Points on the Critical State of the Economy

Here is my general assessment of where we are from an economic point of view, putting the political dynamics mostly aside for the moment.

I believe that we should do much better on fiscal policy than we are doing as a nation.

(1) **There is no room, nor case, for broad-based personal or corporate income tax cuts or credits or rebates.** (Much smaller temporary subsidies of house and auto purchases, especially on fuel-efficient cars, make a little bit more sense, though I don't love those either). The deficit is hemorrhaging and will do so for years to come. Despite some ideological claims to the contrary, there will be no scope for sizeable cuts in spending as a percent of GDP, since five core areas (defense and homeland security, veterans affairs, social security, health care, and interest on the debt) take up all federal revenues, meaning that everything else in the budget (education, energy, science, transport, housing, income support, diplomacy, courts, public administration) is effectively on borrowed funds. And with aging, health care cost increases, etc., the underlying chronic deficits will tend to rise, not fall. We will therefore need increased not decreased taxes. Finally, note that temporary tax cuts are likely to have little stimulus effect, even if they could be afforded;

(2) **Immediate and sizeable spending increases in the stimulus package should be directed to a few areas:** significant support for our crisis-ridden state and local governments, especially for health (Medicaid), education, and other urgent public services; income support (unemployment, anti-poverty including food stamps and child nutrition); health care coverage for the uninsured (as well as ade-

quate Medicaid funding mentioned earlier); and a significant multi-year rollout of infrastructure of all sorts (roads, rail, other mass transit, ports, water, energy, broadband, etc.)

(3) **Future taxes (and revenues as a share of GDP) will have to increase,** partly by rolling back the Bush tax cuts on the wealthy (certainly), and partly by introducing new revenues on carbon (e.g. by auctioning carbon permits or taxing carbon) and eventually I believe by introducing a VAT or something similar.

(4) The claim that we should reject infrastructure spending because it rolls out over several years is disastrously wrongheaded. **We need a buildup of serious high-return public investments, and we can and should start now.** The added stimulus will be useful in future years, but even more useful will be the infrastructure! The most rapid spending will come from sizeable immediate transfers to state and local governments, to the poor, to those without health insurance, and the start-up of some infrastructure spending, and this initial boost will be enough to «buy time» for a sustained and meaningful growth in infrastructure in later years.

(5) We need a medium-term expenditure framework in which budget and tax policies are presented with a five-year time horizon. In such a medium-term framework, **we would have significant deficit spending this year -- yes, perhaps \$1 trillion in total not counting TARP --** but then falling over time by a programmed step-by-step increase in government revenues (rollback of tax cuts, new carbon levies, closing corporate loopholes, and probably introducing a modest VAT). The spending side will eventually taper off in certain categories (e.g. the

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emergency transfers to the state and local governments), but overall **medium-term levels of public spending are likely to increase from 21 percent of GDP to perhaps 24 percent of GDP. Revenues should increase from around 18 percent of GDP to around 24 percent of GDP over a period of 5-7 years.**

Such a package would require several weeks to put into motion, and some parts might require several months, but that would be time well spent if we would thereby restore a sensible fiscal framework. It would be better to set the medium-term direction of fiscal policy, and to get it right (significant short term stimulus through spending not tax cuts, rising public investments in infrastructure over several years, and a rising trajectory of taxes relative to GDP) over the course of a few more weeks and even months, rather than to do things haphazardly and unconvincingly within a deadline of a few days.

Of course, to give the administration its real due, it might be impossible to achieve anything if the opposition proves unmovable to this kind of package, so taking something highly flawed now rather than a better framework that is never enacted (!) would make sense. I regret and worry, however, that we haven't yet had the kind of public discussion about what's **really needed for the medium term**, and how we can get there. I don't really know if it's «now or never.» If that's true, let's have the legislation now. It just doesn't feel right to me, however. And I do worry that the tax cuts and coming mega-deficits might well frustrate a subsequent convergence on a more meaningful and sustainable trajectory in the coming months and years.

Finally, this is not meant to be a comprehensive agenda, only a sketch of broad macro policy. We need major systemic reforms in health, energy systems, foreign policy, science and technology, and much more, which will have significant budgetary

implications, but which requires ample public debate and policy formulation.

Finally, finally, there is a massively important global context which is not even discussed in our current debates. The role of Asia in helping to get the U.S. and Europe out of this mess should not be underestimated. Attacking China is completely wrongheaded in that perspective. We need policy coordination, not bickering. There are important exchange rate, monetary, and financial policy considerations at a global cooperative level which can and should speed recovery.

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