

Sustainable Developments

Needed: A Fiscal Framework

Rather than arguing about the value of taxes or spending, economic planners need to take a systematic long view

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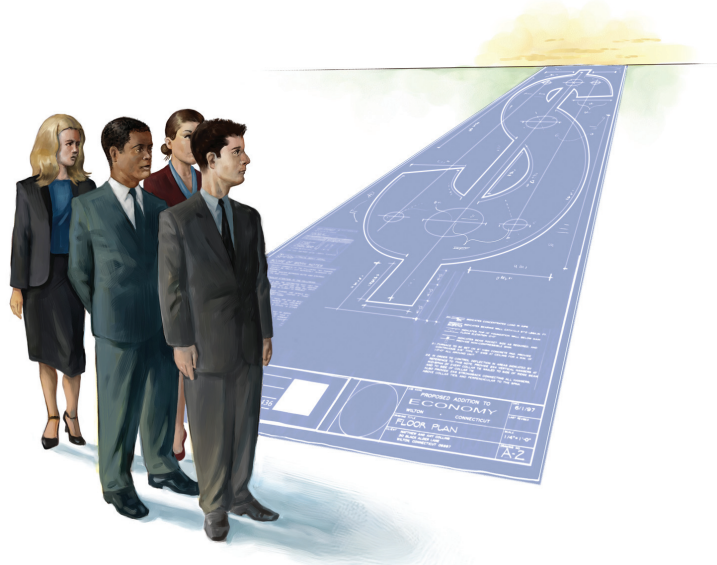
The economic debate in the U.S. regarding the fiscal stimulus package centered on “bang for the buck,” that is, on whether tax cuts or spending increases would produce more jobs. This limited perspective is very misleading, however: the choice of spending versus taxes should turn

first and foremost on the purposes of government, or what economists quaintly call “the allocation of resources.” It’s silly to debate whether investing in a \$100-million bridge creates more jobs than a \$100-million tax cut if we need the bridge! The American Society of Civil Engineers has long documented the crumbling state of U.S. infrastructure and the pressing need for \$2.2 trillion in investments for our well-being and competitiveness.

Government spending and taxation affect the distribution of income demographically and temporally. America ranks 22nd out of 23 high-income countries in public social outlays as a percentage of national income (ahead only of Ireland) for health, pensions, income support and other social services. Our political discourse tends to focus on the middle class and neglect the poor, whereas our tax and spending policies often benefit the wealthy. As a result, the U.S. has the largest poverty rate, income inequality and per-capita prison population of any high-income nation, as well as the worst health conditions.

The timing of tax cuts and spending increases also affects the well-being of today’s generation versus future ones. The U.S. has a chronic fiscal deficit because federal taxation, at around 18 percent of gross national product (GNP), is enough to cover only five types of federal programs: retirement and disability, medical care, veterans’ programs, defense and homeland security, and interest on the public debt. All other federal outlays—for education, diplomacy and international assistance, public administration, science and technology, sustainable energy, water and sanitation, roads, broadband, help for the poor—are in effect funded by borrowing. The chronic deficit problem, now at least 5 percent of GNP, will tend to get much worse as the population ages and health care costs rise, until we finally choose to tax ourselves adequately to pay for the government we need and want (and have committed to by law in many entitlements programs).

Temporary deficits can boost the economy in a recession, although temporary income tax cuts and rebates tend to be saved rather than spent. Prolonged deficit spending, however, would impose future burdens. The most obvious will be the need to service the public debts owed to China and other holders of treasury bills—the U.S. is on a path to multiply its already massive inter-



national debts. Less obviously, the huge budget deficits will crowd out some private investment spending and exports as the economy recovers. Higher taxes needed to cover the service on that debt will not only squeeze consumption but may also distort the economy through disincentives on saving, work or other activities.

There is a sound method to combine the analytical perspectives of macroeconomic stimulus, resource allocation, income distribution, and generational equity and efficiency. It is called a medium-term fiscal framework, which systematically presents the trade-offs of taxation and spending backed up by formal budget projections for at least five to 10 years and in some budgetary processes more than 50 years. Norway, for instance, takes such a long view in the management of its hydrocarbon wealth.

Higher deficits to increase spending on urgently needed public goods such as infrastructure and on transfers to states and cities to help them tackle the pressing needs of the poor and the unemployed can combine desirable macroeconomic stimulus, efficient resource allocation and redistribution. Over time, we will almost surely have to raise taxes to close the deficits and to cover the long-term costs of government. Right now, however, it’s time to think systematically about the long-term role of government and how to pay for it in the coming years. ■

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An extended version of this essay is available at www.SciAm.com/apr2009

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