

America's *Ungovernable* Budget

A policy at war with itself.

BY JEFFREY D. SACHS

The heart of any government is found in its budget. Politicians can make endless promises, but if the budget doesn't add up, politics is little more than mere words.

The United States is now caught in such a bind. In his recent State of the Union address, President Barack Obama painted a convincing picture of modern, twenty-first-century government. His Republican Party opponents complained that Obama's proposals would bust the budget. But the truth is that both parties are hiding from the reality: without more taxes, a modern, competitive U.S. economy is not possible.

Obama rightly emphasized that competitiveness in the world today depends on an educated workforce and modern infrastructure. That is true for any country, but it is especially relevant for rich countries. The United States and Europe are in direct competition with Brazil, China, India, and other emerging economies, where wage levels are sometimes one-quarter those in high-income countries (if not even lower). America and Europe will keep their high living standards only by basing their competitiveness on advanced skills, cutting-edge technologies, and modern infrastructure.

That is why Obama called for an increase in U.S. public investment in three areas: education, science and technology,

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and infrastructure (including broadband internet, fast rail, and clean energy). He spelled out a vision of future growth in which public and private investment would be complementary, mutually supportive pillars.

Obama emphasized these themes for good reason. Unemployment in the United States now stands at nearly 10 percent of the labor force, in part because more new jobs are being created in the emerging economies, and many of the jobs now being created in the United States pay less than in the past, owing to greater global competition. Unless the United States steps up its investment in education, science, technology, and infrastructure, these adverse trends will continue.

But Obama's message lost touch with reality when he turned his attention to the budget deficit. Acknowledging that recent fiscal policies had put the United States on an unsustainable trajectory of rising public debt, Obama said that moving towards budget balance was now essential for fiscal stability. So he called for a five-year freeze on what the U.S. government calls "discretionary" civilian spending.

The problem is that more than half of such spending is on education, science and technology, and infrastructure—the areas that Obama had just argued should be strengthened. After telling Americans how important government investment is for modern growth, he promised to freeze that spending for the next five years!

Politicians often change their message from one speech to the next, but rarely contradict it so glaringly in the same speech. That contradiction highlights the sad and self-defeating nature of U.S. budget policies over the past twenty-five years, and most likely in the years to come. On the one hand, the U.S. government must invest more to promote economic competitiveness. On the other hand, U.S. taxes are chronically too low to support the level of government investment that is needed.

America's fiscal reality was made painfully clear two days after Obama's speech, in a new study from the Congressional Budget Office, which revealed that the budget deficit this year will reach nearly \$1.5 trillion—a

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sum almost unimaginable even for an economy the size of that of the United States. At nearly 10 percent of GDP, the deficit is resulting in a mountain of debt that threatens America's future.

The CBO study also made clear that December's tax cut agreement between Obama and the Republican opposition willfully and deliberately increased the budget deficit sharply. Various tax cuts initiated by George W. Bush were set to expire at the end of 2010. Obama and the Republicans agreed to continue those tax cuts for at least two years (they will now probably continue beyond that), thereby lowering tax revenue by \$350 billion this year and again in 2012. Tax cuts for the richest Americans were part of the package.

The truth of U.S. politics today is simple. The key policy for the leaders of both political parties is tax cuts, especially for the rich. Both political parties, and the White House, would rather cut taxes than spend more on education, science and technology, and infrastructure. And the explanation is straightforward: the richest households fund political campaigns. Both parties therefore cater to their wishes.

As a result, America's total tax revenues as a share of national income are among the lowest of all high-income countries, roughly 30 percent, compared to around 40 percent in Europe. But 30 percent of GDP is not enough to cover the needs of health, education, science and technology, social security, infrastructure, and other vital government responsibilities.

One budget area can and should be cut: military spending. But even if America's wildly excessive military budget is cut sharply (and politicians in both parties are resisting that), there will still be a need for new taxes.

The economic and social consequences of a generation of tax cutting are clear. America is losing its international competitiveness, neglecting its poor—one in five American children is trapped in poverty—and leaving a mountain of debt to its young. For all of the Obama administration's lofty rhetoric, his fiscal policy proposals make no serious attempt to address these problems. To do so would require calling for higher taxes, and that—as George H. W. Bush learned in 1992—is no way to get re-elected. ◆