

How America is strangling the state

By Jeffrey D. Sachs

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The American economy reached a watershed 30 years ago when Ronald Reagan came into office. While Europe decided to boost its tax-to-gross domestic product ratio in the 1970s and 1980s to fund an expanded range of education, training, labour market and family support programmes, the US did not. Reagan insisted that less, not more, government was the key to prosperity and growth, and put emphasis on lowering tax rates on top incomes. Federal revenues in the fiscal year 2011 amounted to 15 per cent of GDP, less than the 19 per cent of GDP of 1980.

Outlays on public services and investments other than health care and pensions have been badly squeezed. Non-security discretionary programmes, including education, early childhood development, energy, environment, roads, power, ports, dams, training, science, NASA, technology, the judiciary and much more, have been hard hit. In the late 1970s, 5-6 per cent of national income was directed to these areas. Reagan slashed that to a mere 2-3 per cent of national income. Spending has remained at that lower level ever since, apart from a short-lived blip due to the Obama stimulus.

America is unilaterally ceding its global leadership in education, science, and infrastructure. Much of today's young workforce lacks the education and skills to sustain middle-class living standards, and unemployment rates are high and stuck as a result. Yet in 2008, as a candidate, Mr Obama said that he too would aim for the same tax-GDP ratio as during the Reagan years! Mr Obama's promise of continued low taxation may have helped him to electoral victory, but it also planted the seeds of his policy failures.

Mr Obama speaks of investing in education, infrastructure and technology to restore America's jobs and competitiveness, but lacks the financial space to do it. The result is an utterly dispiriting contradiction between Mr Obama's soaring rhetoric about the role of government and the grinding cuts that he has agreed with Congress. Mr Obama's entire economic programme rests on a fiscal fallacy.

According to the July debt agreement between the White House and Congress, non-security discretionary programmes will be further squeezed to below 2 per cent of GDP by the end of this decade. Other than war and a few transfer programmes, government programmes are being asphyxiated. Republicans claim that America's low taxes and small government have spared it from the European disease. This claim is utterly false. The US is vastly outperformed by the high-tax-and-spend countries of northern Europe: Denmark, Finland, Germany, the Netherlands, Norway and Sweden.

These countries tax heavily but also spend efficiently. They buy superb public health, quality childcare, proficient public education, quality infrastructure, and remarkable social equality. The results are lower unemployment rates, smaller budget deficits, much lower poverty and smaller

trade deficits than in the US. These countries also enjoy higher intergenerational social mobility, life expectancy and life satisfaction than the US.

Nor have they suffered slower growth in per capita incomes. Between 1980 and 2009, US per capita income grew by an average of 1.7 per cent. Northern Europe averaged about the same: Denmark (1.6 per cent), Finland (1.8 per cent), Germany (1.4 per cent), the Netherlands (1.8 per cent), Norway (2.3 per cent) and Sweden (1.6 per cent). In the US, most of the gains accrued to the top of the income distribution. Median male earnings in the US have not risen since 1973.

America's greatest shortcoming – a massive failure both of efficiency and fairness – is the way it treats its poor children. While northern Europe amply helps poorer families to raise their children – through generous income support, paid day care, maternity and paternity leave, public pre-school and uniformly high-quality public schools – America increasingly leaves its poor kids to fend for themselves. Affluent families get their kids through college; poor families do not. America's underclass is bulging, with roughly one third of the population either poor or near poor (defined as household income less than 50 per cent above the poverty line).

The Republicans propose to strangle government once and for all. Obama's policies suffocate federal programmes slowly. His favoured tax measure is to allow the Bush-era tax cut on the top income tax rate to expire, thereby lifting the top marginal rate from 35 per cent to 39.6 per cent. This would boost revenues by around 0.5 per cent of GDP, when the underlying cyclically adjusted deficit is around 6-7 per cent of GDP.

To finance the outlays needed on education, infrastructure, family support and technology, taxes on high incomes will have to rise by several per cent of GDP, far beyond what Obama has dared to acknowledge. America requires a combination of higher personal, corporate, estate, net-worth and financial-transactions taxes, with improved tax enforcement, to collect around 4 per cent of GDP more in federal revenues. A brave presidential candidate, following in the footsteps of Theodore and Franklin Roosevelt, will win office some day soon and put the US back on a path towards high employment and recovery of the middle class.

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