Going Over the Cliff Is the Only Way to Save the Government

March 26, 2013

Everyone is confused about the Fiscal Cliffhanger. Obama is struggling to make a deal to prolong most of the Bush-era tax cuts. The Republicans are holding back. Yet if a deal is reached, the federal government and the long-term purpose of the Democratic Party are both likely to be ruined for years to come. If the deal fails, the Democratic Party can at long last return to what should be its core purpose: using government to promote the public wellbeing.

The main point is this. If no deal is reached, the Bush tax cuts end. We would return roughly to the tax schedule of the end of the 1990s, when the macro-economy performed reasonably well and the budget was near balance. Federal government revenues would rise by around 2.5 percent of GDP per year compared with the current tax schedule. According to the CBO, the federal tax system would collect 20-21 percent of GDP in the second half of this decade. This is a bare minimum of what's needed for effective government.

The Bush tax cuts were never affordable, not then; not now; not for the "bottom 98 percent" as Obama wants; and certainly not for everybody, including the rich, as the Republicans want.

If a deal is reached along the lines that Obama and the Republicans are now discussing (to make the Bush tax cuts permanent for around 99 percent of the population, say for households below $400,000), then the federal tax system would collect around 18.5 percent of GDP in the second half of the decade, roughly 2.5 percent of GDP less than if the Bush tax cuts expire.

Let's be clear. In an ideal world, there are better and more progressive ways to get to 21 percent of GDP in federal tax revenues than by personal income taxes alone. A partial list would include: a wealth tax on large fortunes (e.g. 1 percent on net worth above $5 million); an end to tolerating tax havens like the Cayman Islands; an end to the tax deferral of overseas corporate income; a crackdown on abusive transfer pricing; and a tax on carbon emissions). The problem is that neither the Administration nor the Congress is proposing these measures, and in the meantime, a deal now that extends the Bush tax cuts will be a severe loss of revenues for years to come without any offsetting gains.

If the deal is reached, therefore, the Republicans have won: they have locked in a federal tax system that collects so little total federal revenue that government can afford almost nothing aside from the military, interest payments, retirement programs and health care. Say goodbye to the rest: science, technology, education, job training, infrastructure, a functioning justice system, community development, renewable energy, environment, and more.

How would we divide up 18.5 percent of GDP while bringing the budget deficit under control? The current mandatory programs are around 13 percent of GDP, and because of population aging will rise to around 13.5 percent of GDP in the second half of this decade. Interest payments will be around 2.5 percent of GDP. Military outlays are currently around 4.5 percent of GDP. The discretionary civilian programs are currently around 3.5 percent of GDP, already a wholly inadequate level.

To bring spending down from this point, even to 20.5 percent of GDP (leaving a deficit of 2 percent of GDP), would require very deep cuts somewhere. Suppose that military spending could be cut to 3 percent of GDP, with the military-industrial complex kicking and screaming in objection. That sum plus interest payments of 2.5 percent of GDP would leave around 15 percent of GDP for mandatory programs and civilian discretionary programs. If the mandatory programs were left unchanged, civilian discretionary programs would fall to around 1 percent of GDP, an absurdly low level. Yet if those programs were protected (as they should be), something else would have to give: vital support for the poor, or any hope of getting the deficit under control.

In short, something terrible would have to give. Either we'd have to gut life-sustaining programs for the poor (Medicaid, Food Stamps, etc.), or gut civilian government (education, science, environment), or bust the budget with trillions of dollars more in public debt.

The point is that prolonging the Bush-era tax cuts, whether it's for everybody (as the Republicans want) or "only" for the bottom 98 percent as Obama wants, or someplace in between, would leave the government without the federal revenues needed for basic services, support for the poor, and public investments for training, education, infrastructure, science, and the environment. So, if a deal is struck, we likely face a decade of shrinking civilian programs, more suffering of the poor, and mounting public debt.

That's what is called "successful" deal making in Washington these days.

So why is Obama pushing so hard for a deal? There are two purported reasons, with anybody's guess on their relative importance.
First, he has continually promised continued tax cuts for 98 percent of households, going all the way back to promises in the 2008 campaign and repeated until today. This promise was probably necessary for his election and reelection given the populist bent of our politics, though it’s devastating from a budgetary and economic point of view in the long term. Second, he is worried about the short-term aggregate demand consequences of a sudden rise in tax rates. If it’s the latter reason, Obama is ready to squander long-term budgetary needs to avoid a little short-term pain. Either way, the budgetary consequences are terrible.

For the sake of our long-term future, I am therefore hoping that the current negotiations fail, and that we end once and for all the unaffordable tax cuts of the Bush era. It is time to awake from the fiscal fantasy that Bush and Cheney pushed on us during 2001-2003 and that both parties have continued until now.

Follow Jeffrey Sachs on Twitter: [www.twitter.com/JeffDSachs](http://www.twitter.com/JeffDSachs)