The US debate over the fiscal stimulus is remarkable in its neglect of the medium term – that is, the budgetary challenges over a period of five to 10 years. Neither the White House nor Congress has offered the public a scenario of how the proposed mega-deficits will affect the budget and government programmes beyond the next 12 to 24 months. Without a sound medium-term fiscal framework, the stimulus package can easily do more harm than good, since the prospect of trillion-dollar-plus deficits as far as the eye can see will weigh heavily on the confidence of consumers and businesses, and thereby undermine even the short-term benefits of the stimulus package.

We are told that we have to rush without thinking lest the entire economy collapse. This is belied by recent events. The spring 2008 stimulus package of $100bn (€76bn, £71bn) in tax rebates was rushed into effect in a similar way and we now know it had little stimulus effect. The rebates were largely saved or used to pay down credit card debt, rather than spent. The $700bn troubled asset relief programme bail-out was also rushed into effect and its results have been notoriously poor.

The Tarp has not revived the banks or their lending, but it has supported a massive transfer of taxpayer wealth to the management and owners of well-connected financial institutions. Some of those transfers – as in the case of Merrill Lynch using its government-financed sale to Bank of America to enable $4bn in bonuses last month – are beyond egregious. Yet the US is now inured to corruption and in such a rush that even billions of dollars of public funds shoehorned into Merrill’s private pockets in broad daylight barely merited a day’s news cycle.

The most obvious problem with the stimulus package is that it has been turned into a fiscal piñata – with a mad scramble for candy on the floor. We seem all too eager to rectify a generation of a nation saving too little by saving even less – this time through expanding government borrowing. First it was former US Federal Reserve chairman Alan Greenspan’s bubble, then Wall Street’s, and now – in the third act – it will be Washington’s.

The White House and Congress have stated an amount – $825bn to be spent mostly over two years – on top of a deficit that is already projected to reach $1,186bn in fiscal year 2009 without the stimulus package. Many of the details of allocating the $825bn are being left to Congress with the aim of reaching a bipartisan consensus. The result is shaping up to be an astounding mish-mash of tax cuts, public investments, transfer payments and special treats for insiders.

What we need is a medium-term fiscal framework, one that lays out an anticipated schedule of taxes and spending consistent with the needs of the economy and government functions. Rather than soundbites about ending pork-barrel projects or scouring the budget for waste, or about the relative multipliers of tax cuts versus spending increases (both of which depend on expectations about the future, a point mostly overlooked in the debate), we should be reflecting on certain basic fiscal facts, the most important of which is that the US government faces huge and potentially debilitating structural deficits as far as the eye can see.

In rough numbers, the US federal tax system collects about 18 per cent of gross national product, while the total of just five categories of public spending –
Social Security (retirement and disability), health (Medicare, Medicaid), veterans’ benefits, defence and homeland security and interest payments – eat up about 18 per cent of GNP. Yet government has more to do – for example, providing the justice system; help for the poor and unemployed; science and technology research; energy systems, transport and other infrastructure; diplomacy and international aid; natural hazards mitigation; training; and the future costs of financial clean-up. Let us add in the fact that state and local governments are broke and need increased federal transfers, and that America’s ageing population, broken healthcare system and growing underclass all require increased fiscal attention. We currently pay for all of this, if we do so at all, by borrowing from China and from the future.

If the present stimulus package is adopted without a medium-term plan, it will go the way of the earlier stimulus package and the Tarp, yet also put the US into a fiscal straitjacket that could paralyse public sector action in critical areas for a decade or more to come. This is especially true if we allow further tax cuts during a time of fiscal haemorrhage, or give into “bipartisan” demands to make the Bush tax cuts permanent, even for the rich, as seems increasingly likely.

There are many valuable things proposed in President Barack Obama’s spending plans – such as the sums to be spent on energy, healthcare and education – but these should be incorporated into medium-term strategies rather than a grab bag of hasty short-run spending. The tax cuts that he is likely to approve in the stimulus package, and the extension of Bush-era tax cuts if that comes to pass, could close the door to these longer-term programmes; haphazard spending on these vital programmes could do the same.

Perhaps Mr Obama should reflect on the fact that the Clinton-era boom began in 1993 with tax rises and a congressional rejection of a fiscal stimulus package. This time, there is certainly a cyclical case for deficit-financed public spending, but accompanied by phased-in tax increases to provide proper financing of crucial government functions in the medium term.

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