That was no cliff. It was a kids’ playground

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January 2, 2013

There is almost no way for a non-American to understand the context and nature of the ongoing US budget wars. They seem to have no rhyme or reason, even to an American, but especially in comparison with the budget debates in the UK. In the upside-down world of American politics, the Democrat Barack Obama has proven to be the best friend of Republican George W. Bush, championing the permanent extension of Bush’s tax cuts. This is not a sign of bipartisanship, but of incoherence.

Unlike the UK process, there is no budget process in the US. Sure, we have a budget law (passed in 1921) that directs the President to submit an annual budget to Congress. And yes, that will be done in February. But it has nothing any more to do with what gets spent or taxed. Spending lurches from stop-gap to stop-gap, not based on a budget plan. Taxes are dealt with in a scrum, like the one over new year on Capitol Hill. There is, of course, no government in the US. We have a President and 535 members of Congress, nominally members of two parties (with a sprinkling of independents), but in fact 535 geographic fiefdoms each representing local interests and vested corporate interests: oil, coal, Wall Street, healthcare, Hollywood, information technology, arms manufacturers, you name it. The only way to gain coherence in this process is through strong and clear presidential leadership, but more often than not Mr Obama defers to Congress.

There are a few dominating truths in this scrum. First, only the views of the rich count any more. Formal social science research confirms this hunch. The poor are not asked, not consulted and not addressed by policies. The rich pay the campaign and lobbying bills, and hire the family, friends, and staff of the Congress and White House.

Second, the rich want low taxes. America’s taxes of government (at all levels) are 32 per cent of GDP (compared with 37 per cent in the UK, 38 per cent in Canada, and 49 per cent in Sweden). Sure, we have no social safety net. Sure, we have an underclass. Sure, we have crumbling infrastructure. Sure, we emit 17 tonnes of carbon dioxide per American. Sure, around two thirds of our kids don’t finish a bachelor’s degree. But hey, we have low taxes, and that’s what our revolution was about.

Third, the Congress and White House do not do arithmetic. There is no evident linkage between spending and taxation, except in think-tanks and opinion pieces (like this one).

In the agreement signed yesterday, the White House and Senate Republicans agreed to extend the Bush era tax cuts that were set to expire on January 1. Extending the expiring tax cuts costs 2.5 per cent of national income in reduced revenues in future years (a fact not yet mentioned to the American people, I kid you not). You might think that Congress would care about that loss of revenue in view of a budget deficit of around 7 per cent of GDP. You would be wrong. Congress is happy to vote for the tax cuts, leaving to a future date the spending decisions.
So what exactly is going on here? The US needs at least 23 per cent of GDP at the federal level to make the society function even at a minimum standard but collects only 16 per cent in revenues at the federal level. We should be spending around 2 per cent of GDP less on the military but 2 per cent of GDP more on other things, notably clean energy, infrastructure and education.

Our federal deficit is therefore stuck at around 7 per cent of GDP. Yet the two parties just ran the most populist campaigns this side of a banana republic, and I do a grave disservice to banana republics these days to say so. The Republicans wanted to extend the Bush-era tax cuts for 100 per cent of the population, especially for the rich, whom they call “job creators”. The Democrats wanted to extend the Bush-era tax cuts for 98 per cent of the population, whom they call the “worthy, hard-working middle class”.

Yesterday, these two incisive political forces made a mighty compromise. The Bush-era tax cuts will be extended permanently for 99 per cent of the population. This was a difficult compromise. The Republicans had to swallow a marginal tax rise of 4.6 percentage points for households with income above $450,000. The Democrats had to swallow hard to endear themselves to households between $250,000 and $450,000 in income, who got more of a break than Mr Obama had pledged during the campaign. To sweeten the deal further, many other tax breaks and temporary spending measures were extended for somewhere between one and five years.

What does it add up to? Who knows? These packages are voted without budget forecasts attached. There is not even a minimal standard of transparency or accountability. The new agreement has not yet been “scored” by the Congressional Budget Office, at least so far as the public is aware.

What comes next? One showdown after another, with chronic $1 trillion-per-year deficits. We were not at a cliff, but in a playground, with one contraption after the next to climb or descend. We will have another debt ceiling debate starting just about now and coming to a boil in February. We will soon have the expiration of the “Continuing Resolution” that keeps federal spending programmes nominally legal. We will have the President’s February budget.

This would all be entertaining if there were not more serious things to do. The federal Government is a $3.8 trillion enterprise, the largest in the world. The US is the largest economy in the world. It is the second largest emitter of greenhouse gases and the largest in per capita terms of any major economy. Yet it is run without long-term plans, budgets, or strategies.

The American people want their meagre services and rickety infrastructure; the rich want their tax cuts; the military wants its $700 billion in annual spending; and the politicians want to win re-election. And with their remarkable performance for the local and vested interests, 91 per cent of them did. In the meantime, the debt-GDP ratio has doubled from 36 per cent to 74 per cent since 2007.

For the rest of the world, I can only say, hold on tight. US incoherence and unpredictability have a long way to run.
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