Sustainable Developments

# Paying for What Government Should Do

**Obama's reexpansion of the government's economic role is vital—and we will have to pay for it**

BY JEFFREY D. SACHS

**The 10-year budget framework that President** Barack Obama released in February, called "A New Era of Responsibility," is as much a philosophy of government as a fiscal action plan. Gone is the Ronald Reagan view that "government is not the solution to our problem; government is the problem." Obama rightly sees an expanded role for government as vital to meeting the 21st-century challenge of sustainable development.

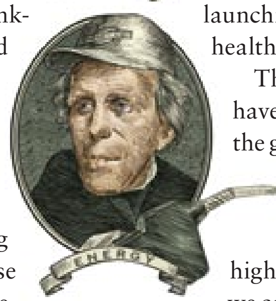
The scientific discipline known as public economics describes why government is needed alongside markets to allocate resources. These reasons include the protection of the poor through a social safety net; the correction of externalities such as greenhouse gas emissions; the provision of "merit goods" such as health care and education that society deems to be essential for all its members; and the financing of scientific and technological research that cannot be efficiently captured by private investors. In all these circumstances, the free-market system tends to underprovide the resource in question.

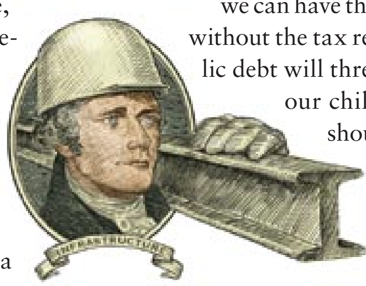
Reagan came to office in 1981 on a platform of shrinking the public sector to free resources for market-based resource allocation. Federal revenues and outlays remained relatively unchanged as a share of national income from 1981 to 2008, at around 18 percent of gross domestic product (GDP) for revenues and around 21 percent of GDP for outlays. The U.S. ran budget deficits during most of that period, with a long and chronic stalemate between those who would raise taxes and those who would cut spending. By and large, the public resisted cuts to spending programs but also resisted calls for tax increases.

The result is in strong contrast with Europe. Federal, state and local government revenues in the U.S. are about 33 percent of gross domestic product, compared with 45 percent in Europe; spending stands at 39 percent of GDP in the U.S. and 46 percent in Europe. Yet because U.S. taxes are even lower than spending as a share of GDP, U.S. deficits are chronically higher.

Obama's budget plan properly focuses on areas that public economics identifies as priorities: health, education, public infrastructure, and research and development, especially sustainable energy—all areas where the U.S. lags discernibly behind many parts of Europe. The president's vision of an expanded federal role is on target and transformative, but the financing will be tricky. This year's deficit will reach an astounding $1.75 trillion, or 12 percent of GDP. In the plan, the government debt held by the public will balloon from 40.8 percent of GDP in 2008 to 65.8 percent in 2013, a level that will weigh heavily on the budget for years.






Obama's budget plan aims to reduce the deficit to 3 percent of GDP by 2013 and then to level it off until 2019. This deficit is relatively large, but even that target will be very difficult to achieve and sustain. With significant increases in entitlements spending and higher interest payments on the rising public debt, the plan is to cut the deficit mainly through higher taxes on the rich, reduced military outlays for Iraq and Afghanistan, new revenues from auctioning carbon emissions permits, and finally a squeeze on nondefense discretionary spending as a share of GDP (which is set to decline from 4.7 percent in 2010 to 3.3 percent in 2019). Such a squeeze on nondefense spending seems unlikely—and indeed undesirable—at a time when government is launching several much needed programs in education, health, energy and infrastructure.

The truth is that the U.S., like Europe, will probably have to raise new revenues by a few percent of GDP if the government is to carry out its expanded role. Within a few years we will probably see the need for new broad-based taxes: perhaps a national sales or value-added tax such as those common in other high-income countries. If we continue to assume that we can have the expanded government that we need but without the tax revenues to pay for it, the buildup of public debt will threaten the well-being of our children and our children's children. No parent, or citizen, should find such an approach acceptable. ■

*Jeffrey D. Sachs is director of the Earth Institute at Columbia University (www.earth.columbia.edu).*

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