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The Choices That Pay Us Back

By ROBERT H. FRANK

IT'S been a banner summer for the champions of fiscal austerity.

At the recent Group of 20 conference in Toronto, for example, world leaders solemnly pledged to enact big spending cuts over the next several years. In Washington, deficit hawks in the Senate blocked an extension of benefits for the long-term unemployed. And at the state and local levels, revenue shortfalls have activated balanced-budget requirements, forcing extensive layoffs and spending cuts.

But as the nation struggles to emerge from the most severe downturn since the Great Depression, such cuts are the last thing we need. There is no conflict — absolutely none — between our twin goals of putting the economy back on its feet and reducing long-term deficits. On the contrary, government could take many steps that would serve both goals simultaneously.

For example, it could create a program to restructure consumer debt. Although rates on 10-year Treasury bonds are only about 3 percent, many consumers still carry tens of thousands of dollars of credit card debt at 20 percent or more. This burden has been a continuing drag on spending. The federal government could reduce it by borrowing at 3 percent and lending to consumers at 8 percent under a one-time debt-restructuring plan.

With their debt service payments cut by more than half, consumers could increase spending immediately. And the five-percentage-point spread on money lent under the program would help cover its administrative costs, and maybe even relieve short-run government budget pressure.

(Banks might complain, but because the money owed to them would be repaid in full, and because they insist that their high interest rates barely cover their costs, such complaints would ring hollow.)

Another useful measure would be a carbon tax — or its approximate equivalent, a cap-and-trade system —

scheduled for a gradual phase-in after the economy has again reached full employment. This would stimulate an immediate, huge jump in private investment without the government having to spend a penny.

Why? Investment is currently depressed because companies can already produce much more than people want to buy. But once a carbon tax was announced, the design of nearly every existing machine or structure that uses or produces energy would be rendered suddenly obsolete. Motor vehicle engines, electric power plants, refrigerators, air-conditioners, furnaces — all would have to be redesigned for greater efficiency.

The resulting flood of research and investment would enhance our ability to cope with future energy shortages and would serve another crucial purpose. Taxing carbon could eliminate the catastrophic risk of vastly rising global temperatures by the end of this century; it would be a prudent act, quite apart from its utility as an economic stimulus.

The tax would generate no revenue until its phase-in, so it wouldn't reduce the current deficit. But deficits are a long-run problem, and its enactment alone would increase creditors' confidence that we are committed to solving it.

Another productive measure would be to increase public investment in infrastructure. When road repairs are deferred for just two to three years, total maintenance expenses can more than double — even if we ignore the cost of accidents and vehicle damage caused by potholes. Spending an extra dollar now to save two dollars three years from now is an investment with an annual rate of return of more than 18 percent.

Making that investment with money borrowed at 3 percent would not only put people to work immediately, but would also help balance government budgets. And after decades of infrastructure neglect, there are many other public investment opportunities that promise returns even higher than 18 percent.

Here's a final example, which I've long advocated: The government could enact a progressive surtax on extremely high levels of consumption, with a phase-in beginning once the economy recovers. This would reduce long-run deficits while stimulating extra spending immediately. And, like the other examples, it would be a step worth taking even apart from those effects.

Because incomes of the wealthy have been growing sharply in recent decades, luxury consumption has also been rising rapidly. But beyond a certain point, additional consumption raises the bar that defines what counts as adequate, without any increase in objective measures of well-being. And because savings would be untouched by this surtax, it would help steer resources away from keep-up-with-the-Joneses spending races and into productive investment. That would increase productivity growth.

Under a consumption surtax, people would report their incomes and their annual savings to the I.R.S., as many now do for tax-exempt retirement accounts. A household's annual consumption would be calculated as the difference between its income and savings. Congress might apply the surtax only to annual consumption beyond $500,000.

THE resulting revenue would reduce deficits after the phase-in. In the meantime, just the knowledge that the surtax was on the way would stimulate a temporary surge in consumption, as wealthy families rushed to build additions to their mansions and make other purchases before the tax took effect.

In short, the government could take many steps that immediately bolster spending and employment, while also addressing deficit worries. But that's not where we appear to be headed, as big spending cuts are being proposed in the name of fiscal responsibility.

But as almost 10 percent of the labor force remains unemployed, such cuts would instead be the height of fiscal irresponsibility.

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