

The deficit and health care

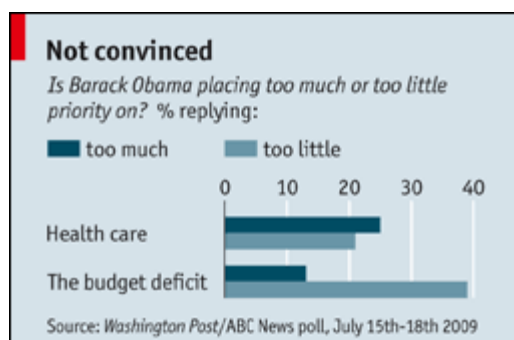
## Falls the shadow

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### The enormous deficit is complicating the president's ambitious plans

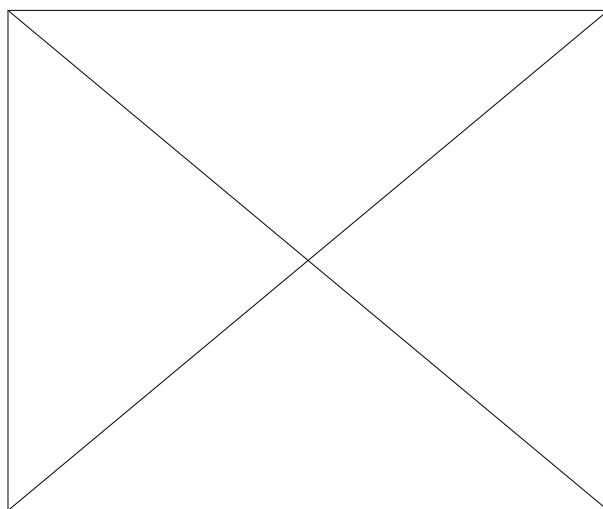
**IT WAS** a rare victory for fiscal rectitude. On July 21st the Senate stripped the funding for seven more F-22 fighter jets from a big spending bill, bowing to Barack Obama's threat to veto the aircraft.

But it was overshadowed by the much bigger setback Mr Obama had suffered a few days earlier. Three committees in the House of Representatives had presented a plan to provide health cover for the uninsured with the help of hefty tax increases on the rich. On July 16th Douglas Elmendorf, Congress's chief budget scorekeeper, stunned Washington when he said the bill would not only fail to tame health-care costs, but would permanently shift them higher. It would add \$239 billion to the deficit in the next decade and far more thereafter. The next day conservative Democrats joined Republicans on two committees in voting against the bill, though it still passed.



That Mr Elmendorf's comments made such an impact signifies the growing political potency of the deficit. By a big margin, Americans think Mr Obama is paying too little attention to it, according to one recent poll (see chart). The proportion who consider it the most important issue facing the country has risen from 12% last December to 24% in June, according to another poll by the *Wall Street Journal* and NBC News. That is unusually rapid, says William Galston, a scholar at the Brookings Institution: "That's now part of the political reality Obama has to reckon with."

Many presidents have seen their ambitions frustrated by the realities of red ink. Ronald Reagan cut taxes shortly after taking office, but soon had to reverse course and raise them. George Bush senior promised “no new taxes” and then had to break the pledge, scarring his party for years. Bill Clinton campaigned for a middle-class tax cut, but abandoned the idea shortly after he was elected. The second George Bush managed to escape this fate because he inherited a surplus. But by the time he left office, his profligate combination of serial tax cuts and unrestrained spending guaranteed the deficit would again loom over his successor.



The severity of the recession spared Mr Obama, at first, from confronting the deficit. Indeed, with the economy spiralling downward and the Federal Reserve’s monetary ammunition all but spent, he rightly chose to boost the deficit in the short term through hefty fiscal stimulus.

But the recession has inflicted horrific damage on the government’s accounts. Mr Elmendorf’s Congressional Budget Office (CBO) predicts the deficit will be \$1.8 trillion this year. This is bearable given the scale of the recession; the real problem is that it will decline only to \$1.2 trillion by 2019, still a horrendous 5.5% of GDP. On July 21st Ben Bernanke, the Fed chairman, suggested that a deficit of no more than 3% was sustainable—a figure that would arrest the growth in debt as a share of GDP.

Most of the red ink results from the enormous hole the recession has punched in GDP and consequently in tax revenue, the cost of bailing out the financial system, and interest on the mounting debt. Only a small part of it comes from America’s big and growing entitlements, Medicare and Medicaid (health care for the elderly and poor, respectively) and Social Security (public pensions), whose worst fiscal problems lie beyond 2019. “Unless we demonstrate a strong commitment to fiscal sustainability,” Mr Bernanke remarked, “we risk having neither financial stability nor durable economic growth.”

Mr Obama knows all this: he promises repeatedly not to leave the problem to his successors. Yet he has done little to back up the rhetoric. His willingness to veto more F-22 spending is admirable, but the \$1.75 billion at stake is immaterial. He will release an updated budget outlook in mid-August, but it is unlikely to contain any notable new initiatives. There is still no sign of a path towards fiscal tightening over the medium term as the economy recovers. Quite the opposite; Mr Obama has not wavered from his position that taxes on those earning less than \$250,000 will not go up. In fact, they've been temporarily cut. He did say in an interview this week that he might set up a commission that could look at ways of reducing entitlements spending once the recession is over.

The president has promised that health-care reform will be deficit-neutral, but this is a slippery concept. A plan may be deficit-neutral over ten years, but add significantly to it thereafter by front-loading revenue and backloading costs. The CBO figures show that this is a big problem with the House plan, whose shortfall will balloon beyond the ten-year horizon.

Jim Cooper, one of the Democrats' most fiscally hawkish congressmen, fears that if push comes to shove, his party will not long remain stalwart on deficit-neutrality. "Health care has been such an impossible dream for so many decades that a lot of today's Congress would overlook the deficit problems. I hear it all the time from colleagues in leadership: 'We always find enough money for defence. We'll find enough for health care'." Mr Galston, though, thinks that the public's worries about the deficit will reinforce Mr Obama's commitment that health reform should not boost the deficit over the medium or long term. This could mean that he ends up with a plan that covers fewer of the uninsured than many had hoped.

None of this deals with the still-gaping hole in the budget. Indeed, a truly deficit-neutral health-care plan may make it tougher to fill that hole: if the rich are already being taxed more to pay for health reform, that makes it harder to use them to address the wider deficit. There are other ways to reduce the deficit, including getting rid of the mortgage-interest deduction, raising the age of eligibility for Medicare and Social Security, altering the inflation-indexation formula, or proposing some sort of tax reform that raises additional revenue. These ideas need not be implemented immediately; that would contradict the purposes of stimulus. But the knowledge that they are in the works would help reassure the public and investors that the federal debt—forecast on current policies to explode from a net \$5.8 trillion last year to a net \$11.7 trillion in 2019—may be tamed.