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COMMENT
OPINION

America should also look to its fiscal health

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America desperately needs a better framework for providing healthcare and Barack Obama's administration is right to press on for change, even as the economy remains frail in (it is to be hoped) the aftermath of the financial crisis. Yet given the explosion of the federal debt, it is extremely important to craft a plan that will not excessively risk the government's own fiscal health. The risks cannot easily be overstated.

The US government is already entering a prolonged period where it is extremely vulnerable to a loss in investor confidence from the Chinese and other main holders of its Treasury securities. Foreign investors are rightly concerned about the deeply ingrained reluctance of Americans to tax themselves. The last thing the US needs is to be viewed as one giant California, rich but unwilling to pay enough taxes to fund the services its citizens demand. A sharp rise in taxes to pay for healthcare initiatives could potentially weaken the credibility of the government's promise to raise taxes as needed to pay off debtors.

It is true many people are claiming that a new healthcare package can be a big part of the cure for US budget problems. They argue that standard measures of national debt are far too narrow and do not take into account a country's huge commitment to future expenditures such as old age pensions and, especially, healthcare programmes. Given generous benefits, increasing life expectancy and adverse demographics, old age benefit programmes have actuarial debts that are many times the conventionally measured national debt, even as conventional measures rise to levels last seen after the second world war.

According to this logic, finding a way to contain rising healthcare costs would help more than almost anything to reduce the broadly defined government budget debt. Lower healthcare costs would also help the private sector, presumably raising investment, growth and, of course, future tax revenues. It would also be helpful, of course, to have a healthier and happier workforce.

Thus, in principle, fixing the imbalances in the Social Security and, especially, the Medicare programmes could provide a powerful offset to the huge increase in debt burdens visited by the financial crisis.

Unfortunately, the idea that healthcare reform will alleviate debt problems rather than exacerbate them is far-fetched. As the US Congressional Budget Office warned this week, many proposed healthcare reforms are more likely to worsen the government's budgetary health than to improve it. This should hardly be surprising, given that a main purpose of reform is to help provide better care for Americans who cannot afford insurance.

Higher taxes to pay for healthcare are also likely to reduce US growth, making it far more difficult to escape the debt trap. This comes at a time when other policy initiatives, such as tackling environmental degradation and income inequality, are also likely to imply higher tax burdens (the taxes are implicit in the case of cap and trade legislation to protect the environment). In addition, the continuing weakness of the financial sector weighs on growth, and it is by no means clear yet when and how some semblance of normality will be restored. This is particularly the case as the government struggles to reform regulation of the financial sector, with many political and economic puzzles to solve, not least the international dimensions of the problem.

All of these considerations appear to underscore the importance of finding ways to keep the new health plan from being overly burdensome, and to avoid unduly optimistic projections on efficiency savings. Healthcare reform is no substitute for finding a credible path to fiscal sustainability. If badly handled, it could prove the straw that breaks the camel's back.

Make no mistake, the US and much of the developed world is in a frighteningly precarious fiscal state. Exploding debt levels have remained manageable in no small part thanks to the extraordinarily low level of global real interest rates. Should the general level of global interest rates rise substantially, perhaps owing to a pick-up in emerging market growth over the next few years, a number of developed countries, including the US, may have to tighten their belts sharply in order to maintain stable debt ratios. Countries that fail to do so will suffer severe consequences, including spiralling interest rates and, ultimately, default by direct means or through high inflation.

It is a disgrace that the world's richest country cannot provide reliable basic care for its poorest citizens. But if the politics of reform produces too extravagant a plan when the nation's fiscal health is already so weak, the US may experience a form of financial crisis even more virulent than the one it is recovering from. Any healthcare plan would then be dead on arrival.

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