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Health Care Reform and the Threat to the Dollar

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The U.S. dollar is falling steadily against the Euro and many other major currencies. If this trend continues, the repercussions for the U.S. economy would be significant: higher inflation, higher interest rates, and a lower standard of living. It could also lead to the rapid dethroning of the dollar as the world's primary reserve currency. Perhaps most worrisome, the slide in the dollar risks becoming a rout that could trigger another global financial crisis.

The Obama Administration has advanced a broad slate of policies sharing the consistent side effect that they would weaken the economy soon and indefinitely. For example, the health care reforms working through Congress would mean more government spending, more taxes, and quite possibly higher budget deficits. This is a prescription for a weaker economy. For workers and families, such reform would mean fewer choices and higher health care prices, but it would also mean fewer jobs and lower wages.

Exchange markets have a different vantage. They see the U.S. economy quickly becoming a less attractive place to invest, and so as the odds of the public option's passage increases, the dollar sinks further.

The Decline and Decline of the Dollar. As of October 28, the U.S. dollar had declined from about 1.24 dollars to the Euro in March to about 1.50 dollars to the Euro—a 28 percent decline on an annualized basis. The Obama Administration has responded by repeating the traditional government mantra in support of a "strong dollar," but market participants have good reason to believe that the Administration is privately delighted at the dollar's decline. For one thing, it appeals politically to the Administration's supporters in the industrial labor unions. For another, and not coincidentally, the Administration's policies from soup to nuts would weaken the U.S. economy.

Exchange rates are subject to a multitude of domestic and foreign influences. In the short run, if the Federal Reserve holds down short-term interest rates while rates abroad are higher or rising, then capital will move toward the higher interest rates and the dollar will face downward pressure. Longer term, the dollar will trend lower if the U.S. maintains a higher rate of inflation than does Europe, for example.

The exchange value of the dollar is also heavily influenced by the market's perception of the U.S. economy as a place to invest. If foreign and domestic investors view U.S. prospects as promising, they tend to move savings into the United States, providing upward strength to the dollar. However, as concerns grow about the future of the U.S. economy, especially in comparison to high-growth markets abroad, then savings will flow to the better opportunities, bringing downward pressure on the dollar.

Federal policies can have substantial long-term consequences for the U.S. economy and thereby

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have a powerful influence on forward-looking investors as they evaluate the strength of the dollar. In the fiscal year that just ended, the federal government ran a budget deficit of $1.4 trillion, more than the deficits of the previous four years combined. As the dollar continues to fall, Congress is pressed by the Administration to raise the debt limit in anticipation of another $1.5 trillion in deficit spending expected for 2010.

Market participants are understandably worried about U.S. fiscal policies broadly and the Administration's own rosy projection of $9 trillion in deficit spending over the next 10 years as the nation builds a bridge of debt to its unaffordable entitlement programs. This kind of gross fiscal irresponsibility casts a shadow over the U.S. economy to an extent rarely seen outside of collapsing third-world countries.

At the moment, financial markets appear to be giving the Obama Administration and Congress the benefit of the doubt that a significant fiscal policy correction is imminent. The only apparent basis for this supposition is the presumption that policymakers must know that the projected deficits cannot come to pass. Even voices on the left are stating publicly that a course change is critical: The nation is on an unsustainable fiscal course, facing unprecedented deficits that, if left unaddressed, will seriously weaken America's economy.[1]

Against this fiscal train wreck of a background, the Administration is pushing numerous anti-growth policies, such as higher individual income tax rates, higher tax rates on capital income, and a growth-killing tax- and regulation-heavy environmental policy. If these or related policies appear close to enactment, markets will take notice, assess their harmful effects on the economy, anticipate the shift of global investment away from the U.S. economy, and bring further immediate downward pressure on the dollar.

Health Care and the Dollar. Before these other policies are queued up, the Administration is pushing Congress to pass health care reform to create a path to a government health care monopoly. No denials, no talk of competition, and a public option distract from this fundamental point. For Americans, this would mean fewer choices and higher costs for health care. Superficially, health care reform and the exchange value of the dollar appear to be unrelated issues. In reality, though, health care reform is very relevant to the strength of the dollar, or lack thereof.

Suppose health care reform is deficit neutral as President Obama promises, so that all the tax hikes raise the expected funds, all the spending cuts take place as written, and it all adds up. This legislation would still represent a massive increase in the role of government in the U.S. economy and would still present the economy with a huge tax hike. More government and higher taxes mean a smaller economy. Politicians may argue the contrary, but markets know better, and market participants invest their own money. The health care reform moving through Congress will result in fewer jobs and lower wages and fewer investment opportunities for businesses operating in the United States. Even deficit-neutral health care reform will add to the downward pressures on the dollar.

Supposing health care reform is deficit neutral requires an Olympian leap of faith, however, given past experience. Congress has demonstrated its willingness in principle to offset part of the costs of health care legislation through a huge tax increase. Raising taxes in principle is not their problem. Finding acceptable tax increases in detail is a huge problem they would rather avoid.

The balance of the reform is to be offset with spending cuts of dubious probability. Some years ago, Congress put in place modest reductions to Medicare spending. Congress has waived those spending reductions almost every year through what is colloquially known as "doc fix" legislation.

Just recently, the Senate attempted to waive these reductions permanently, adding $247 billion to the budget deficits over the next 10 years. The vote in the Senate failed when a handful of responsible Democrats joined with a united Republican front worried about the deficit consequences. There is little reason to believe the new spending cuts as part of

1. See Robert Greenstein, "On the Deficit: Don't Make Matters Worse," *Washington Times*, October 27, 2009.

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health care reform will go into effect when the congressional leadership works tirelessly to void past spending cuts.

The Wrong Prescription for a Sickly Dollar. Health care reform as currently constructed will either weaken the economy or balloon the deficit while it weakens the economy. In either case, the net result will be to discourage investment into the U.S. economy by foreigner and American alike and add to the multitude of downward pressures on the dollar.

President Obama and the Democratic Congress are playing with fire if they neglect the effects of their actions on the dollar. A sudden rout of the dollar in exchange markets could trigger another far-reaching crisis in global credit markets and snuff out the nascent recovery in the U.S. economy. The nation needs real health care reform. It does not need a government monopoly on health care. It does not need higher taxes. It does not need an Administration hostile to the dollar.

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