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CAMBRIDGE – Since assuming the presidency earlier this year, Barack Obama's primary legislative focus has been on reforming the financing of American health care. Yet his proposals are meeting strong opposition from fiscally conservative Democrats as well as from Republicans, owing to their potential impact on future fiscal deficits. Because those deficits are the primary cause of America's current-account deficit – and thus of global imbalances – the health-care debate's outcome will affect governments and investors around the world.

About 85% of all Americans are now covered by some form of health insurance. All individuals over the age of 65 are eligible to be insured by the federal government through the Medicare program. Low-income families (and those whose income and assets are depleted by high medical costs) are covered by the Medicaid program, which is financed jointly by the states and federal government. Many uninsured get free care in emergency rooms of public and private hospitals and receive free care for chronic conditions in those same institutions.

In the most recent budget, the federal government's outlays for Medicare in 2010 are projected to be over $500 billion, while Medicaid will cost taxpayers over $250 billion. Private health insurance is generally provided by employers, which is encouraged by treating employer payments for health insurance as a tax-deductible business expense while not including the value of that insurance as taxable income to employees. That rule reduces income and payroll taxes by more than $200 billion.

In short, an overwhelming majority of Americans are insured, with government a major financer of health care. But there remain about 54 million individuals who are not formally insured, and some insured individuals still face the risk of financially ruinous medical costs if they have very expensive medical treatment.

Obama campaigned on the goals that everyone should have health insurance, that high medical costs should not bankrupt anyone, and that increased efficiency in the production and delivery of care should slow the overall growth of health-care costs. But, rather than producing a specific proposal, he left it to Congress to design the legislation.

Several competing plans emerged from the different Congressional committees that have jurisdiction over the issue. The leading proposal, produced by the Senate Finance Committee, fails to achieve any of Obama's goals. It would cut the number of uninsured roughly in half, but would still leave about 25 million people uninsured – with the threat of ruinously high medical bills deterring them from getting care.

There is also no clear plan to slow the growth of health-care costs. As a sign of their support for the administration's goals, the pharmaceutical industry and the hospital industry have together promised to reduce costs by a total of about $20 billion a year – a token amount, given government health spending of roughly $1 trillion and total health outlays of more than $2 trillion.

The non-partisan Congressional Budget Office (CBO) estimates that the Senate Finance Committee plan would cost about $800 billion between now and 2019. Most of this increased cost would, in principle, be financed by $215 billion of taxes on high-premium insurance policies, and by about $400 billion of cuts in payments to physicians and hospitals that provide services to older patients in the Medicare program.

If the cost and financing estimates are accurate, and if Congress does not change any of these provisions in the future, the CBO's calculations imply that the Senate Finance Committee plan would reduce fiscal deficits between now and 2019 by $49 billion, less than 1% of the projected deficits of more than $7 trillion.

In fact, there is a strong risk that this legislation would ultimately add to the fiscal deficit. Increasing the number of insured by 35 million and broadening protection for some who are now insured implies increased demand for health

care, which could raise the cost of care paid for by the government as well as by private health-care buyers.

In addition, both sources of financing are also uncertain. Taxes on high-premium insurance policies would lead many employees and employers to shift their sources of tax-free income from these health-insurance benefits to other forms of untaxed compensation. If they do this, the government would not collect the additional revenue from the insurance companies, employers, or employees.

Similarly, the proposed cuts in payments to providers of services to Medicare patients are unlikely to receive the necessary Congressional support in future years, especially if it turns out that doing so would reduce the volume of services, rather than just providers' incomes. There is a long history of legislating such spending cuts, only to reverse them in subsequent years.

In considering the fiscal implications of Obama's health proposals, it is important that the current legislation would still leave 25 million individuals without insurance. How much would it cost to insure them if the gross cost is now projected at $800 billion for the easier-to-insure 35 million? And how could that cost be financed if the proposed taxes on existing health policies and the reductions in Medicare outlays have already been used? Closing that gap could add more than $1 trillion to the government's cost over the next 10 years.

It is clear that there is a significant danger that the current legislation would add substantially to future US deficits – and establish a precedent for even more expensive expansions of health care in the future. This would come on top of the currently projected fiscal deficits in both the near term and over the coming decade – and before America's demographic shift substantially raises the cost of Social Security and Medicare.

Surprisingly, the bond market still seems almost oblivious to this risk. But holders of US debt worldwide have every reason to be concerned.

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