PREPARED TESTIMONY FOR HEARING OF THE HOUSE APPROPRIATIONS SUBCOMMITTEE ON LABOR, HEALTH, AND HUMAN SERVICES, MARCH 25, 2009

Paul Krugman

As everyone is aware, this hearing is being held at a time of economic crisis. Unemployment is rising steeply, and the outlook for working Americans is the grimmest it has been since the Great Depression. Two years ago, few imagined that things could get this bad, this fast.

We all hope that President Obama's policies can pull the economy out of its tailspin. But even if he does succeed in that goal, that will not be enough. For the U.S. economy was failing to serve the needs of the American people even during the "good" years of the current business cycle.

I find it instructive (and depressing) to consider the state of the economy for ordinary Americans in 2007 – which was as good as it got in recent years. By almost any measure, the economy was worse for most families in 2007 than it had been in 2000, the previous business cycle peak. And there was, if you believe the numbers, surprisingly little progress even over a longer period, reaching back three decades.

Thus, median family income, adjusted for inflation, was slightly lower in 2007 than it had been in 2000. And if we go back several business cycles, to 1979, we find that median income rose only 15 percent over a period of almost 30 years – less than half a percent annually. Virtually all of that rise, by the way, took place during the Clinton years. That compares with sustained income growth at more than 2 percent a year during the postwar generation.

The poverty rate in 2007, an alleged boom year, was 12.5 percent, not only higher than the 11.3 percent rate in 2000, but higher than the 11.7 percent rate in 1979. If one believes the numbers, none – none – of America's economic growth over the past generation has trickled down to the poor.

And the health insurance situation worsened substantially. The percentage of the American population without insurance rose sharply in the late 1980s and the early 1990s, sparking an unfortunately failed effort at health reform. The situation then improved somewhat thanks to cost control and a booming economy. But since 2000 health care costs have once again risen much faster than wages, leading to a growing problem of uninsured Americans even when the economy is growing. It's almost certain that the current crisis will soon present us with a major crisis of lost coverage.

Why has a growing economy failed to deliver for ordinary Americans? One major reason is growing income inequality: many of the gains in income went to a small minority of very well-off people, with most workers seeing little rise in real wages. Even using Census data, which miss the growth in the highest incomes, *average* household income rose twice as fast over the past 30 years as *median* income – that is, income growth would have been at least twice as fast if it had not been for growing inequality.

There is also a secondary reason for the failure of economic growth to help many Americans: our dysfunctional health care system. We are unique among advanced countries in not having some form of universal coverage, yet we spend far more to cover 85 percent of our population than our counterparts spend to cover everyone – with no evidence that we receive correspondingly better care.

For both these reasons there has been a remarkable disconnect between the state of the economy, as measured by the growth of GDP, and the experience of most Americans. And if that disconnect continues, recovering from the current recession, urgent though it is, will still leave major economic problems unsolved.

So what can we do to end the disconnect?

Reducing income inequality is a difficult task – the truth is that while we have some ideas about what might work, there is little reason to be confident about the efficacy of whatever measures we try. The "Great Compression" of the New Deal, which created the middle-class society of the postwar era, is an inspiring role model. But in honesty, I can't promise that we can repeat that experience.

Health care reform, on the other hand, is something we know can work. Study after study has demonstrated that the U.S. health care system isn't just harsh and unfair, it's highly inefficient. We have extremely high administrative costs, largely because insurers work so hard *not* to cover the people who need insurance most. We lag in the use of information technology. We have a combination of inadequate care for many Americans and vast spending on dubiously effective care for many other Americans.

I might also note that our health care system underinvests in preventive measures that could save money as well as lives.

A reasonable estimate is that successful health reform could eventually save several percent of GDP while substantially improving the majority of Americans' lives. As anyone who has studied proposals to promote economic growth knows, that's huge; even a drastic increase in private investment would be highly unlikely to yield that big a result.

But can we afford health care reform in the face of projected large fiscal deficits? Yes, we can. In fact, we must.

First of all, there is no reason to be concerned about the level of deficits, per se, in the near term – by which I mean the period, likely to extend for at least three or four years, before the economy recovers.

In normal times there is reason to worry that deficits will "crowd out" private investment and raise interest rates. In the current situation, however, the world economy is in effect suffering from an excess of desired saving: even at a zero interest rate, businesses aren't willing or able to invest all the savings the private sector wants to undertake. As a result, government deficits stimulate economic activity by giving those savings a place to do; they do not crowd out private investment, in fact they may well crowd it in.

What we do need to worry about is government debt: there are real concerns about the sustainability of very high levels of debt in the future. However, we need to realize, striking though it sounds, that a trillion dollars more or less of debt over the next decade is virtually irrelevant to America's long-run fiscal position; that position is instead dominated by the rising projected costs of our entitlement programs, mainly Medicare and Medicaid.

And the only way to rein in Medicare and Medicaid costs is via a thorough reform of our health care system. To put off health-care reform out of fear of deficits would be a monstrous case of being penny-wise and pound-foolish – sacrificing the nation's long-run fiscal prospects for the sake of holding current numbers below some artificial threshold.

In dealing with the deficit, and also in dealing with health care, we need to take the long view. And that long view says that we should proceed with massive reform, now.

Thank you.