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'Years to Come'

Mr. Obama levels with the public about deficits — and sets himself a fiscal challenge.

"FISCAL SPACE" is an economist's term for a country's capacity to borrow and spend its way out of recession without risking exorbitant interest rates and inflation later on. Generally speaking, the more public debt a country already has as a share of its economy, the less new debt it can take on.

As President-elect Barack Obama and Congress contemplate a fiscal stimulus package that could total hundreds of billions of dollars, they still have some fiscal space to work with. At $6.3 trillion, the publicly held national debt is about 45 percent of the $14 trillion economy — not much above the post-World War II average debt-to-GDP ratio of 43 percent. But the space is shrinking rapidly. According to new figures from the Congressional Budget Office, federal debt is rising at the fastest rate since World War II: It is estimated at $1.2 trillion in fiscal 2009, or 8 percent of gross domestic product. This stunning number reflects both the direct effect of the recession on tax revenue and spending and the high cost of measures taken to combat the downturn, such as the financial sector bailout. And it is likely to be matched or exceeded when the Obama stimulus plan kicks in.

Mr. Obama was just leveling with the American people when he noted yesterday that the country faces "trillion-dollar deficits for years to come" unless policymakers "make a change in the way that Washington does business." The question, of course, is how to change. Though Mr. Obama's appointment of an efficiency-minded chief performance officer sent a useful signal, the real answers are legislative. The stimulus package must not bloat the government's permanent financial commitments. According to a recently published International Monetary Fund paper, appropriate measures include increased transfers or temporary tax cuts to consumers at the bottom and middle of the income scale; aid to state and local governments; and repairs and improvements (especially energy-saving ones) to existing infrastructure. The IMF recommends against increasing the federal payroll, cutting corporate tax rates or letting companies deduct their recent losses against past years' profits. The stimulus plan should include a plan for offsetting spending cuts and revenue increases once the economy recovers.

Over the long run, investors will finance the U.S. government at reasonable rates only if it tackles its huge unfunded health-care and pension commitments. Unchecked, the cost of providing Social Security, Medicare and Medicaid to 77 million retiring baby boomers could push the debt-to-GDP ratio up to nearly 300 percent by 2050, according to a December 2007 CBO report.

Ideally, Congress would make the necessary hard choices through the normal legislative process. Its repeated failure to do so, however, may necessitate a commission to recommend reforms for the House and Senate to accept or reject. Reps. Jim Cooper (D-Tenn.) and Frank R. Wolf (R-Va.) and Sens. Kent Conrad (D-N.D.) and Judd Gregg (R-N.H.) have offered proposals for such a panel. Hard as it is, jump-starting the U.S. economy will be easy compared with securing its financial future. But Mr. Obama and the Congress must do both.