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Step Two – Going Backward – Election More Important Than Ever

In one of the least likely outcomes in Supreme Court history, Chief Justice Roberts, who was widely considered a conservative voice on the Court, proved to be the swing vote in one of the largest expansions of US government involvement in the economy ever.

Justice Kennedy, who many feared would be the swing vote in favor of the Affordable Care Act (ACA or Obamacare), joined Justices Scalia, Thomas and Alito in dissenting against the new law. In his oral statement today at the Supreme Court, Kennedy said, "In our view, the entire Act before us is invalid in its entirety." In other words, if Roberts would have joined these four, the entire law would probably have been struck down.

Instead, the Chief Justice "threaded the needle," or "cut the baby in half" and said that while the Commerce Clause would not allow Obamacare, the power of Congress to tax and spend does allow it. In other words, you can be taxed if you don't buy health insurance. As far as we know, this is the only tax in American history that can be levied for not doing something. In other words, you can live in the back of your brother's property, grow your own food, build your own house out of lumber you cut down, but still be forced to pay a tax just because you're a breathing citizen of the United States

The tax is 2.5% of income with a ceiling linked to the average cost of insurance and a floor of \$695 no matter what your income. The ACA described this as a "penalty," which Roberts said was not constitutional under the Commerce Clause. Nonetheless, he argued that "It is not our [the Supreme Court's] job to protect the people from the consequences of their political choices."

As a result, he found a way to make Obamacare constitutional, by using the argument that it is a "tax" not a "penalty." And since Congress has the power to tax, the law will stand. We do not agree with this argument and find it interesting given that Justice Roberts said at his nomination hearing that "Judges are like umpires. Umpires don't make the rules, they apply them. Nobody ever went to a game to see the umpire." It certainly seems he found a way to be at the center of the game.

At the same time, the Supreme Court ruled that the new Medicaid mandates on states cannot be enforced by too heavily penalizing the states. In other words, states either opt in or opt out of the expansion in Medicaid envisioned under Obamacare, but cannot be penalized by taking away monies that have nothing to do with the new expansion of Medicaid.

Some conservative commentators are taking solace in the fact that Roberts' decisions plus the four conservative dissents created a working majority for the most limited interpretation of the Commerce Clause since the 1930s. We agree. However, if the federal government is free to use its taxing authority as expansively as the Court now allows, we don't see the gain for those who support limited government.

A Step Backward

What all of this means is that the US is facing the prospect of looking much more like Europe. Government's size and scope is expanding, taxes are rising, and a single-payer healthcare system is not that far off as long as citizens can be "penalized" for not buying health insurance. Long-term growth prospects are now reduced and the Plow Horse Economy has lost some of its forward momentum.

We do not believe the ruling, in and of itself, will cause a recession. However, it will continue to hold down price-earnings ratios and push off a new high in the stock market until after the election in November, an election that has suddenly become "one of the most important in our lifetimes."

The silver lining in Roberts' decision is that if the "penalty" is now a "tax," it can be repealed with just a simple majority in the US Senate via the budget reconciliation process, with no filibuster allowed. If it had been upheld and still considered a "penalty" it would have needed a 60-vote, filibuster proof majority to turn back. As a result, even more so than yesterday, the direction of the US economy hinges on the election in November. Will the US become more like Europe, with lackluster growth, high unemployment, higher tax rates, and eventually major debt problems, or not?

The bottom-line: we stand by our Plow Horse Economy, but one that will grow at a 2.5% to 3% growth rate for the rest of this year – we had been forecasting 3% to 3.5% growth in the second half – and an 8% or above unemployment rate by November – we had been forecasting a rate at 7.8% or slightly below.

Interest rates will remain at record low levels, while stocks will face a more difficult road. Downside policy risks have increased, but stocks remain seriously undervalued already and could get a lift as the economy improves going into the second half. All of this could change quickly following the elections in November, but the US has now taken a step backward. Taxing "inactivity" is a new chapter in American History. Justice Roberts has made his mark.