How Imminent is the US Budget and Debt Crisis?

Simon Johnson discusses the reaction to his call for a 20-year program of fiscal consolidation outlined in his book White House Burning.

Steve Weisman: Simon Johnson, senior fellow at the Peterson Institute and professor at MIT Business School, has written a new book, White House Burning, about the future problems of debt and budget deficits for the United States. This is Steve Weisman with Simon. You've been promoting the book around the country. How are Americans are processing this situation that faces them fiscally and in terms of the debt?

Simon Johnson: The interesting and somewhat encouraging piece, Steve, is that when I give a talk about the book and talk about the history and how we really got to where we are today and what we can do about it, people are very receptive. There's a lot of engagement from people on the right and people on the left. The problem is that, at a later point in my talk, I generally say, "And I think your taxes are going to go up." At that point, I lose people. Nobody wants their taxes to go up and yet they're asking the government to do a lot for them, directly and indirectly. They're mismatched between expectations of what you want the government to do and what you're willing to pay for. That mismatch is quite serious.

Steve Weisman: I think your book forces the reader to confront that mismatch more than anything I've read recently. Is there any understanding that there has to be a mix of spending and revenues?

Simon Johnson: No, actually. I think the problem is that we live in this very magical, as in unreal time. The U.S. can borrow a lot around the world. The 10-year treasury rate just last week was 1.99 percent. Depending on what you think inflation is, that could be almost a zero real interest rate adjusting for inflation. Incredibly easy to borrow. Why would any politician deliver a potentially unpalatable message to you when he or she can borrow an extra billion or two or trillion at 2 percent? That's a problem on the right and on the left. I think that without the politicians working on this and constructing messages and competing around what to do really about deficit and debt, the whole conversation tends to slide away from us. It doesn't break through into people's consciousness and doesn't become a tangible deliverable for the people who get elected.

Steve Weisman: You're suggesting, as many others have, that it's going to take a crisis for us to deal with these problems. How far are we away from such a crisis?

Simon Johnson: I don't think it has to be a full-blown, stomach-churning crisis of let's say fall of 2008, which, of course, was a financial crisis, not a fiscal crisis in the United States. There could be a wakeup call. In the 1980s, bond yields went up a bit and the politicians paid attention. In early 1992 [when] the Clinton administration was coming to power—but actually, before the inauguration—there was a pivotal meeting in Little Rock, when the argument was how much the new administration should push for new spending. The [contrary] view was taken by Robert Rubin and others. James Carville documented this very clearly, that the bond market would not be favorable if the government was perceived to be overspending. As a result, they limited their plans and they were actually rather fiscally responsible, if you look at the broad history of American administrations. So there can be wakeup calls that can be changes in perceptions.

I think part of the reason to write this book is to work on that margin and not to sit back and say, "Don't worry, be happy," until the bond market turns against you. Because the European experience at the moment, the eurozone, is a vivid reminder that if you wait for the market to really slap you in the face, it can be very, very nasty for everyone.

Steve Weisman: In the wake of the first round of the French elections, everybody's now saying that the Europeans are having second thoughts about austerity. How does that affect the United States?

Simon Johnson: The Europeans are in a bind, because it's austerity or bust literally. If you want to stay with a fixed exchange rate system, you're going to have to have some fiscal austerity. The European Central Bank, I don't think, is going to throw a lot of monetary easing into the mix, so if you don't do the fiscal austerity, you're going to have interest rates going up on your bonds. The markets are going to be scared. That's going to make it much more expensive to service your debt, much harder to roll it over. This is exactly the problem that undid Greece, it has put pressure on Portugal and Ireland, and also of course Italy and Spain. If this is now moving on to France through the political process and through whatever messages the French government communicates or the French election throws up. This is going to be very difficult for them, unless they're going to opt out of the euro. But if they opt out of the euro, they have a lot of debt, public and private, in euros.

Steve Weisman: By the same token, don't you also worry that the United States could move too fast or toward austerity, given the precariousness of the current recovery?

Simon Johnson: Certainly it's a theoretical concern. The way American politics works, I would not suggest that is imminent. There's no need for precipitative austerity in the United States. We have time, we have space, in part because the rest of the world is sufficiently disordered and there's a lot of savings from Asia and other places that want to be parked in U.S. securities, particularly in U.S. government debt. So this keeps our interest rates low. It means we have time to make a fiscal adjustment. And if the two sides, the Republicans and Democrats could come together, I would suggest that a path to fiscal consolidation is actually relatively smooth and quite easy to achieve in the United States. But that's not where we are. The two sides are very far apart at this moment.

Steve Weisman: And as the title of your book suggests, White House Burning, it might take some heat. Do you think there's any chance at all that in a lame duck session this year, the Republicans and Democrats could at least take some step toward fiscal consolidation over the long term?

Simon Johnson: They could take a step, but it may well be an unintentional step in the following sense: gridlock, meaning complete noncooperation at the end of this year.

Steve Weisman: Which produces?

Simon Johnson: It would mean that the Bush era tax cuts expire. Now, that's the only instance anywhere on the fiscal and political horizon where gridlock will push you towards fiscal consolidation. Everything else that you can see – refusal to agree on spending or on revenue – is going to keep the fiscal accounts off track. But if the Bush era tax cuts expire, that's a big adjustment and in our book, literally, that's about half of the fiscal adjustment we need to make between now and 2030. Debt to GDP down is now about 73 percent, on its way to 90 percent. We suggest bringing it down to 50 percent or below by 2030, over two decades. You can do a lot of that with the Bush era tax cuts. You may not want to do it all up front, but that's the fiscal cliff that kind of comes with the baggage of gridlock at this point.

Steve Weisman: Simon, thanks very much. Good luck on the book.

Simon Johnson: Thank you.