



A Gloomy Outlook in Europe: Part II

Adam S. Posen says that while the threat of a European crisis disrupting the US economy has eased, Europe's economic woes continue to cast a shadow over the struggling US recovery.

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Steve Weisman: This is Steve Weisman with Adam Posen at the Peterson Institute for International Economics. Adam is taking over as President of the Institute in January. We just discussed the grim outlook in Europe, which is perhaps grimmer than it needs to be in your view. Yet you were suggesting that the U.S. can breathe a little easier compared to a year or two ago. How so?

Adam Posen: It's pretty straightforward, Steve. The steps that have been taken by the European Central Bank, particularly some steps they announced at the end of August, and some other things done by the governments there, have meant that what financial markets and Congress call the tail risk, the likelihood of a really bad event, a euro breakup, an expulsion of Greece, a panic in markets, has been hugely diminished.

This hasn't improved the prospects for Europe on average in any meaningful sense. It's not like this matters for day to day. But what's happened is they've convinced the markets that they won't let a panic take place or they won't let a crash take place, which is helpful, constructive. And so for the U.S, there isn't as much uncertainty about what happens in Europe. It's still a drag for us that this bunch of very rich countries who normally buy a lot of our stuff and sell us a lot of stuff and invest here and generally are part of our commercial world, are not growing or in fact are contracting. That's not great, but that's pretty straightforward to deal with. The panic scenario, the breakup scenario, those are things where our banking system becomes at risk. There are gyrations in our currency. There are potential weird things happening to interest rates, and thankfully, I think at least for the next couple of years, those are unlikely.

Steve Weisman: Let's talk about the U.S. leadership and what they should be saying to Europe. Over the last couple of years, it's been obvious that at Treasury, especially there has been frustration with European policy making. Do you think that's eased some and what do you make of that?

Adam Posen: It's eased a little for basically the reason I just said. So they're not setting fire to our house right next door, so that's nice, but their house is still a smoldering wreck, which isn't so nice if they're your next door neighbor. Getting out of the imagery into frustration—I mean this is a current theme for the U.S. government and sometimes for other governments with the U.S.—which is, you have a rich country. It's not like some small, poor country. It's not a Haiti. It's not a Lithuania, which pretty much has control over its own destiny and things might go well, things might go badly, but they end up going down a path that just doesn't make any sense. It seems to be self-destructive. And what can you do about it? And the answer is, if it's Haiti or if it's Lithuania, they run out of money. They're desperate to have you for aid or desperate to have a U.S. military base or they want to be on somebody's good side or they need to go to the IMF and then you have leverage.

If it's Spain, Italy, or Spain and Italy with the collusion of Germany doing this, it's like Japan in the '90s. It's a country which you have no leverage over, except to say, "Come on guys. We

really wish you wouldn't do this." I'm being a little facetious here, but I've lived through and worked on the U.S.–Japan relations when Japan was the smoldering house next door.

Steve Weisman: Right, you mentioned in the early '90s, when the U.S. —despite its lack of leverage -- did manage to encourage favorable developments in Japan.

Adam Posen: It was very frustrating throughout the Clinton Administration. People were extremely frustrated with Japan and then -- not having anything having to do with the change of presidents -- there came an opportunity in Japan that there was a new piece of the ruling party coming up, a new Prime Minister potentially in [Junichiro] Koizumi, with a really good economic minister named [Heizo] Takenaka who was making sense. And the people in charge at the White House then—this is the early 2000's—Glenn Hubbard was in charge of this from the CEA [Council of Economic Advisers] and I tried to help. We supported and nudged and encouraged what Takenaka and Koizumi were doing, which meant we were not lobbying, but the U.S. was taking a pretty strong position in a domestic political issue in Japan.

Now it turned out in that situation to be helpful, although it had to be done a bit carefully. I think there is a challenge. This is what diplomacy is about. This is when we talk about economic diplomacy, what the State Department has to do, what the president and the NEC [National Economic Council] has to think about.

Steve Weisman: And the Treasury.

Adam Posen: And the Treasury. What arguments can you make that will be persuasive to influentials within these countries? How far can you go in backing somebody who you think is doing more reasonable policies without it backfiring on you?

Steve Weisman: And presumably you have to do this discretely and even secretly.

Adam Posen: Some of it discretely and secretly, but it's not like I'm saying you make hush, hush high campaign contributions. That's not what we're talking about.

Steve Weisman: No, I understand.

Adam Posen: Just to be clear. In Japan's case, at one point we published —and I think it was 2001 or 2002—with a very high then Bush administration official [an essay] in the Japanese papers saying, "You know, it really makes more sense to do what Takenaka's doing and we hope he gets backing." And now maybe there's some room for doing that somewhere in the German press or the Spanish press. But it's not so much about secret, but the word you used, I think that's right, is discretion. You have to be a little careful about this. If we just start lecturing, it's not going to work.

Steve Weisman: Three or four years ago when everyone in Europe thought the U.S. was in no position to lecture anybody because [they thought] "you caused this global meltdown." That has changed to some degree, hasn't it?

Adam Posen: It has, but it's not like we've come all the way back up to where we were in '06 when everyone thought we had pretty much the golden ticket.

Steve Weisman: Right.

Adam Posen: And I think that's justified. Nobody should think, given the U.S. economic behavior of the last 10 years, that we do. But that's the other piece and you're very astute to bring it up, Steve because part of what we're doing in these persuasive meetings between international officials in the press and the public sphere that talks about these things, is trying to say to people, "Look, I know you think I'm a spendthrift too—I being the U.S. here—or I messed up looking at bubbles, so I'm always too easy." You have to somehow get past them. And in this sense it is like talking to somebody you know. It's like, "Yes, I've had a bad record dating, but I still can tell you that that guy isn't right for you." And one defensive thing is to say, "Oh God, who the hell are you to tell me?" And the other thing is to say, "Really, you think so?" And think about it. Again that's why it's called diplomacy. It actually requires engagement, knowing the people who are there, engagement in a different sense.

Steve Weisman: We'll have a new team in Washington to pick up the ball. We'll have a new treasury secretary, so it'll be interesting to watch.

Adam Poser: Yes. I don't want to get into individual personalities. There are a number of good possible candidates to succeed [Treasury] Secretary [Timothy] Geithner. Secretary Geithner is, at this point, a historical figure. One thing that has to be said about him that's very good is he had a very great international awareness, in part, because that's where he came up in his career. I think one thing I hope is that even though the first priority of the Obama Administration, both because they wanted to be and also because it should be, is dealing with the domestic budget deal. That whoever they pick for treasury secretary either has some international awareness as well or knows that they have to delegate to the people who work for them who do, because I'm predicting bad going for Europe for two years, but if we have two years of bad going, things may be pretty ugly in three years' time.

Steve Weisman: Thank you, Adam.

Adam Poser: Thank you, Steve.



