Budget Outlook after the State of the Union: Part I

David J. Stockton says the United States should seek more than the $1.5 trillion in new budget savings proposed by President Obama in order to stabilize its debt.

Transcript of interview recorded February 13, 2013.

Steve Weisman: Following President Obama's State of the Union message, many questions remain unanswered about the prospects for a fiscal deal between the White House and the Republican leadership in Congress. Here with me, Steve Weisman, is David Stockton, senior fellow at the Peterson Institute for International Economics, to see if we can answer some of those questions.

David, first, how much did you learn from the President's speech about what is on offer to the Congress to close the budget deficits over the next ten years and reduce the debt? Was there progress?

David Stockton: I don't think we really heard very much new in the way of major initiatives that would be directed towards putting our fiscal house in better order and getting us on a more sustainable path over the longer term. Obviously the President had a long list of policy proposals that he wishes to pursue for economic development, income support, but in terms of the overall longer term fiscal outlook, I don't think I learned very much.

Steve Weisman: Let's start with the figure of $4 trillion, which seems to be the target that President Obama says is the appropriate one. He said many neutral economists have said this target would put us on a sustainable path. Is that a reasonable figure?

David Stockton: It's a reasonable figure for stabilizing debt-to-GDP, at least over the next half a decade or thereabouts. It's something in the high 70s in terms of the ratio of federal debt to our gross national product. But I don't think that's going to be sufficient. I think what we need is going to be a larger deficit reduction package if we're really going to put that debt to GDP ratio on a more discernible downtrend. As the President noted, maybe $2.5 trillion has already been put in place. The President is proposing, with interest savings accounted for, another $1.5 trillion. But I think it's really going to require in addition to that another $1 to $3 trillion to put our debt to GDP ratio on a more discernible and less risky downtrend.

Steve Weisman: You said that he's counting interest savings. Is that fair bookkeeping?

David Stockton: I think that's fine. If we're really looking at the overall debt to GDP ratio, you want to include the interest savings in there as well.

Steve Weisman: Congress will be debating the $1.5 trillion in the next few weeks in the context of deciding what to do about the pending cuts on the sequester. Remind us what's looming on the sequester.

David Stockton: At the end of this month, on March 1, without any further actions, the sequester will go into effect. That will cut $85 billion from this year's budget, split roughly half between domestic discretionary and a little bit of mandatory spending, and on the defense side. Those cuts are pretty much across the board. They were designed in some sense to inflict considerable pain. They are not good public policy, and I would have some concerns as well about the size of those cuts occurring in an economy that is just now feeling like its getting its legs back. It would seem that having that degree of fiscal restraint at this time would probably be an unwise situation.

Steve Weisman: You would recommend that the sequester be replaced by a more stretched out deficit reduction plan?

David Stockton: Yes, I think it would be a mistake to continue to kick the can down the road. I do think we need to put in place, as I think many people already recognize, the ultimate or longer run solution: a combination of seriously tackling the issues surrounding our entitlement programs and putting them on a firmer fiscal footing.

As the President said, I think quite correctly, last night, if you care about those programs, we ought to be responsible enough to put them on firmer fiscal footing to ensure their long term viability. The other big piece of the project is that we're going to need to raise additional revenue. I think many economists would agree that a package of comprehensive tax reforms could both raise revenues and improve economic incentives in a way that at least would be favorable to our longer term economic outlook.

Steve Weisman: Before we go to Part II, let me ask you what the sequester, if it took place, would do to the economic growth.

David Stockton: My current best estimate for growth in 2013 would be something like 2.25 percent. That's a little better than it was last year. I do think, as I said earlier, we are seeing some signs of firming it overall activity, although just modestly so. I think if the sequester went into effect and remained in effect, and those cuts fed through to economic activity fully, we'd be talking about maybe reducing that estimate of growth in 2013 by three-quarters of a percentage point. That would be something on the order of knocking growth down to 1.5 percent. With that relatively meager pace of growth, I think we would be risking a weakening in the labor market and maybe even some uptrend in the unemployment rate over the course of this year.

Steve Weisman: Thanks. We're going to Part II now.