



New Dangers of a Debt Ceiling Confrontation

Simon Johnson says the economy is growing but that another debt ceiling battle later in 2013 would disrupt the progress.

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Steve Weisman: Simon Johnson of the Peterson Institute for International Economics is here with me— Steve Weisman. We just talked about the prospects for implementation of financial reform and further legislation.

Simon, you also recently testified before the Senate Budget Committee, and you've been watching a budget that the deficit in the short term getting under control or shrinking because the economy is perhaps performing better than some expected. What is the immediate outlook?

Simon Johnson: The economy is recovering. Revenues are stronger than expected. This is encouraging. But, I think the big worry is what happens politically. In particular, do we have another damaging and destabilizing fight over the debt ceiling, for example, as we head into the fall?

Steve Weisman: One reads that the Republicans are wary of another such fight. It takes two to fight, but it would be the Republican choice of whether to seek a confrontation. When would such a confrontation come?

Simon Johnson: That's right. There is a range of estimates on when would be the decisive moment for the debt ceiling. Sometime between September and the end of the year is the range, which is pretty wide, but that reflects the fact that the economy is recovering. You don't know exactly how much revenue is going to come in over the next quarter or so.

With regard to the decision to confront, it is definitely a Republican decision. They considered it in January of this year and I think wiser heads prevailed within the party. They decided not to make that an issue front and center. I think that was wise because in summer 2011, when they did have the debt ceiling confrontation, it went very badly from a point of view of impact on the economy. There was a big spike in uncertainty about policy, as far as we can measure, a decline in confidence and a decline in investment and hiring as a result. So, personally, I would keep the debt ceiling completely off the table.

Steve Weisman: If you're going to hold the budget hostage, you have to have a demand that you want the administration to meet. There seems to be a reluctance on the Republican side to come up with a demand. They're not going to use the crisis to privatize Medicare or one of these bold ideas that they've considered in the last couple of years.

Simon Johnson: The Republican [position], as seen, for example, in the House Budget, is definitely more [for] expenditure cuts over the next ten years. There are also ideas perhaps about Medicare and Medicaid, phasing them out or transitioning away from the current funding arrangement, but those are beyond the ten-year horizon in their major impact. So, those expenditure cuts are proposed, and there is something to negotiate over, which is the sequester. Both sides agree that the sequester is fundamentally a bad way to run fiscal policy. And so, the question is, if you replace the sequester with something, what are you going to replace it with? And, I wouldn't say they are negotiating with that; they're making statements about that.

My point is, if you want to have a discussion on those terms, then I guess we have to live with it. But don't go to the debt ceiling, don't talk about default or changing the order in which Treasury pays its creditors or anything that can at all affect how people view the creditworthiness of the US Government. It didn't go well last time. It won't go well this time.

Steve Weisman: In the meantime, there is a budget process for this year. The Senate has, under pressure from the Republicans, produced its budget. Is there any possibility of using the regular budget process to resolve any of this, or are we going to invariably have to have a confrontation?

Simon Johnson: It does seem that we're going to have to have a confrontation, and you can argue both sides of who is responsible for that. I think that it's very regrettable that we run our fiscal policy on this basis. I think it makes us look poorly run in the eyes of the world. I think it undermines the economic recovery and I don't see why at this point, after we've done some tax increases—which is what happened at the end of last year—and some spending cuts—which is what came out of the Budget Control Act including the sequester—why can't we get the two sides together on a budget framework for the next ten years. To me, now will be a good time to do that. But that's not how the political leadership sees it.

Steve Weisman: When you spoke at the Committee, what was your sense of the mood at least on the Senate side to try and cooperate? Is there any sign that the Senate is inclined toward cooperation on budget issues?

Simon Johnson: Not at this moment; and the contrast that was being drawn was exactly with immigration. I think the idea that legislation will be crafted, we'll see how far that goes, but something will be crafted on immigration. That seems quite plausible. On the budget, I'm afraid, I came away discouraged, and I came away feeling that even though the hearing was cordial and people were talking to each other in a very polite way, the debt ceiling is going to be on the table. And, I just think that that's unnecessary, unfortunate, and really an avoidable way in which we'll damage our economy.

Steve Weisman: What is your projection of economic growth in the coming year?

Simon Johnson: I am pretty optimistic about the US economy. Obviously, it's been a very slow, painful recovery. Employment is still about 2 percent below where it was before we went into the recession. It's extraordinary, last half decade really. But, my big worries are outside the U.S. The euro zone is still far from stable, and there may well be slowdowns to come from some parts of the emerging world as well.

Steve Weisman: And, the markets in the emerging world are showing some volatility, aren't they?

Simon Johnson: We should expect volatility. I think we've become a little too accustomed to the idea that central banks can control things. I think the big risk is the euro zone, and that the euro zone policymaking processes don't work well and their financial system is extremely vulnerable. They insist on running their big banks with very, very little capital, little bank equity. And, as a result, even relatively small shocks can have destabilizing effects.

Steve Weisman: Thank you, Simon.

Simon Johnson: Thank you.

