

Center for American Progress

Economic Policy Institute and Center for American Progress Action Fund Conference Call

Subject: “Why Raising the Debt Limit is Imperative”

Introduction/Moderator:

**Heather Boushey,
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Speakers:

**Robert M. Solow,
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**Alan Blinder,
Professor of Economics and Public Affairs,
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**Lawrence Mishel,
President,
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**Time: 1:00 p.m. EDT
Date: Wednesday, June 29, 2011**

*Transcript by
Federal News Service
Washington, D.C.*

OPERATOR: Good afternoon. My name is Crystal (sp), and I will be your conference operator today. At this time, I would like to welcome everyone to the Economic Policy Institute and Center for American Progress action call on the debt limit.

All lines have been placed on mute to prevent any background noise, and after the speaker's remarks, there will be a question-and-answer session. (Gives queuing instructions.)

Thank you. Ms. Boushey, you may begin your conference.

HEATHER BOUSHEY: Thank you so much. I'm Heather Boushey, senior economist here at the Center for American Progress, and I'd like to welcome you all to this call. Thank you so much for joining us today.

Now, as tensions around a deal to raise the debt limit continue to rise, some of the world's most respected economists are presenting a letter to Congress, urging them to move forward and act swiftly without sharply cutting federal spending. This letter, which is being released today, has been signed by 235 economists, including six Nobel laureates, four John Bates Clark Award winners; and five past AEA, American Economic Association, presidents. The letter argues that the debt limit must be raised because failure to do so would cause devastating global and domestic economic consequences.

I'd like to introduce our speakers on this call today. First, we have Professor Robert Solow, Nobel laureate and retired professor of economics at MIT. We have joining us as well Professor Alan Blinder, professor of economics and public affairs at Princeton. He's a former vice chairman of the Federal Reserve System's Board of Governors and a former member of the Council of Economic Advisers. We also have with us Dr. Lawrence Mishel, who is currently the president of the Economic Policy Institute.

I would like to remind you all on this call that it is being recorded, and there will be time for questions after each of our speakers has given a short presentation. I would like to turn it over now to Professor Solow.

ROBERT M. SOLOW: Thanks and hello, everybody. As Heather said, what this letter amounts to is a plea that it's important to get the debt limit raised without a cliff-hanger, without – if we haven't already had a cliff-hanger – and the question is why. That's what I want to talk about.

And the answer is that failure to do that is going to simply disrupt ordinary government in the – orderly government in the U.S. Large amounts – dollar amounts of outlays will have to disappear or fiddled and not only federal operations, but state and local operations as well are simply going to be limited and reduced at a time when the economy is weak, is expected by everyone to stay weak for a couple of years, and we really can't afford that sort of thing.

Apart from just the disruption of government activity, a major blow – it would be a major blow to what is already a weak recovery, and we can't afford this. Any kind of mess over the – raising the debt limit will send – if it hasn't already started to send – a very bad message to the

rest of the world that public finance – sensible public finance in the U.S. is very vulnerable to party political tactics. It will certainly create uncertainty about the future status of Treasury debt and will almost certainly induce higher interest rates on Treasuries. And that will inevitably leak into corporate interest rates, into bond rates in the U.S., through the normal market interactions. And this – that sort of thing will hamper the slow recovery in the U.S. over and above the direct effects on expenditures.

So from every point of view, it's really important to get the debt limit raised without idle threats, certainly without real threats, and without cuts in spending at a time when cuts in spending are the wrong thing to do. They will be required later. The odd thing is that the business community knows this. This is not far-out doctrine. And the blackmail about debt limit, which is what it amounts to, is coming from elsewhere. So it's clear what sensible policy wants. I can leave it at that, and we can move on.

MS. BOUSHEY: Thank you, Professor Solow. I'd like to turn it now to Professor Blinder.

ALAN BLINDER: Thanks, Heather. I'm going to pick up exactly where Bob finished. This should not be controversial. What – and it's not difficult. What to do about the budget, especially the long-run budget, is very difficult with a lot of moving parts and should be controversial, and we should be debating it for some time. And some part of that debate is bound to be partisan; that's what politics is for.

But maintaining the full faith and credit of the United States government should not be controversial, should not be partisan. And that's why this letter urges a clean increase in the debt ceiling without attaching a lot of stuff to it, even though some of that stuff that might get attached to it is necessary for the future.

But there'll be plenty of time to do things like that. The debt ceiling needs to go up just to finance this year's budget. Even if there was no next year – and of course there is a next year – those are decisions that Congress, in its wisdom or lack of wisdom, has already made. And failure to raise the debt ceiling at this point would be declaring – essentially, declaring those decisions illegal, null and void, whatever; not enabling them to be carried out.

Beyond that, the national debt ceiling will have to be raised very substantially to accommodate any budget agreement for the next 10 years, 20 years, 30 years, however many years you want to think ahead. Whatever comes out of the current negotiations, even if it should be exactly the Ryan plan to one extreme – it won't be that, but even if it should be – would require a very large increase in the national debt ceiling.

So it really doesn't matter if you're a Democrat, you're a Republican, you're neither or both. Any kind of sensible budget agreements for the future that you envision will require a very large increase in the national debt ceiling. We're not bringing the deficit to zero next year. And that's why this shouldn't – that's another reason why this shouldn't be controversial.

Finally, elaborating slightly on what Bob was saying two minutes ago, if we don't raise the national debt ceiling, the arithmetic is that in round numbers federal outlays will have to be cut by about 40 percent. It is a sad but true fact that in – again, in round numbers – and the exact numbers don't quite match between the CBO and OMB, so I think that's why it can't be – do better than round numbers – we are only taking in revenues about 60 cents for every dollar that we spend. Now, that's an unsustainable situation for sure, not something we're proud of. But there were reasons for getting there.

That gap, 40 percent, is about 1.6 trillion (dollars) at annual rates – trillion. That number, in turn, is more than 10 percent of GDP. And just incidentally, if we did this calculation for non-interest spending – so to preserve the interest, to make the interest payments on the debt – the cut would have to be even bigger than 40 percent. But let's just think about a number that exceeds 10 percent of GDP.

Bob was saying correctly that we don't need that now. I'd like to be much – and that's true. I'm going to be much stronger than that. I don't see how it's possible to even think that you could cut spending at a rate of approximately 10 percent of GDP and not get a recession – not get a relapse into recession out of that. And we certainly don't need that. And that's even ignoring the financial panic that would likely ensue as investors all over the world concluded that the United States didn't know what it was doing.

So to come back to where I started, this should not be controversial. The arguments for raising the debt ceiling and avoiding a crisis are totally overwhelming. And with that, I'll turn it over.

MS. BOUSHEY: Thank you so much, Professor Blinder. I want to turn it now to Dr. Mishel.

LAWRENCE MISHEL: Thank you very much, Heather.

First, just to reinforce what Alan was saying and what Bob said about it not being controversial and to put some numbers to it, both the Obama budget and the Ryan budget increase the debt by roughly \$6 trillion or more over the next 10 years. So, I mean, who can stand there and say the debt ceiling doesn't have to be raised? Now, the problem is that the American public thinks, somehow, that it's a problem raising the debt ceiling. And that's why elected officials need to educate the public further.

My second point – I want to reinforce what is said in the first sentence of this letter, which is that you need to raise the debt ceiling without attaching drastic and potentially dangerous – (inaudible) – the spending part.

So two points about – (audio break). We cannot get our fiscal situation in a sustainable position with unemployment as high as it. Creating jobs and getting to a fiscally sustainable position are complementary policies, not in opposition with each other. We can never get the deficit under control at 9 percent unemployment or even 8 (percent) or 7 percent.

Two, cutting spending in the next few years, as some people are talking about, is ill-advised policy and will only raise unemployment. There's no convincing case, I think, to the people in this call and to the people who signed this letter that austerity can somehow lead to expansion. Third, this means that there's two dangers. One is not raising the debt ceiling; and two, dangerous, immediate spending reductions.

And in saying this, in closing, I may be in disagreement with what the president just said in his press conference. I wasn't listening, but I saw on the TV screen, CNN said that the president said cutting the deficit creates jobs, and creating jobs cuts the deficit. And I think that is at best half right.

MS. BOUSHEY: Thank you so much, Larry. I'd like to open it now. Operator, I would like to open in now for questions from the callers.

OPERATOR: (Gives queuing instructions.) Your first question comes from the line of Trudy Rubin with the Philadelphia Inq.

Q: Hi. Thanks for doing this. And I'd like to refer to something that Alan Blinder just said, mentioning the financial panic that would likely ensue as investors around the world concluded we didn't know what we were doing. Could you talk to the impact that this impasse is having on the image of the United States abroad and its potential for future leadership in foreign policy or economic policy? And what would be the impact if we defaulted on our leadership role abroad in the future?

MR. BLINDER: Good question, to which nobody really knows the answer. But I think we can think of what are the possible outlines.

So first of all, right now I think what you find is investors – and other governments by the way – around the world are sort of scratching their heads in disbelief, like, this cannot be serious. The American's wouldn't do this, they've never – Alexander Hamilton got us started off on the right track; we don't default on our debt.

And they have a hard time understanding this because other countries don't have a debt ceiling as we have. They all have budgets, and budgets imply how much the debt increases, and sometimes that's too much and you have to cut it back. But they don't have this extraneous debt ceiling. If we actually bump into the debt ceiling and in a worst case start defaulting on the debt, this is going to be a big shock to the financial system on a par, in terms of shock value, maybe beyond with the Lehman Brothers' bankruptcy in September 2008.

Now, I'm not – I don't mean to imply by that that the follow on would be as chaotic and awful as what followed Lehman Brothers. We made a lot of changes in the financial system, a lot of the most dangerous linkages have been taken down, institutions have more capital, and so on. So I don't think we'd be looking at Lehman Two.

But to put it into a perspective on the other side, there is tremendous concern now around the world, not only in Europe, about what might follow on a Greek default, justifiably so.

Greece is a tiny little country whose debt, compared to the United States, is – well, not miniscule, but very small, and who's – coming to exactly to the point you raised – who's – who has – which has no role in the financial leadership of the world and never has had one. And that's got a lot of people very worried, because it's got default premiums going up on debt and so on. It's got interest rates going up.

How much greater, then, would be the impact of the financial world taking seriously the notion that the United States has defaulted on its debt, surprising everyone and also, picking up a point that Bob Solow made early on, laying on the table the notion that for the future, politically induced default may be a standard part of the U.S. political-financial system? That would be a horrible notion to let get into investors' heads.

MR. SOLOW: Let me just add one thing to what Alan just said. Everyone will remember that before the financial crisis and even during it, dollars flowed into the U.S. because the rest of the world regarded Treasuries, U.S. Treasuries, as a safe haven, as a way to find shelter from risk. What any kind of interruption in interest payments or principal payments on Treasury debt would mean to the world is that in the future, you can't regard the U.S. as a safe haven for – in uncertain times. And that – to speak to exactly what the question was about, that would be a terrible blow to the leadership role of the U.S. in the world economy as a nation, when it – who – which, when it speaks, gets listened to. So this is not a trivial matter at all, at all.

Q: Could I just follow up on that point? Many people pooh-pooh this, because they say the euro is in trouble and there's nowhere else for countries like China to put its surplus cash. Is that claim, that the U.S. would remain a safe haven no matter what because there isn't any place else – is that claim overstated, or do you think that the U.S. as safe haven could actually become a thing of the past?

MR. SOLOW: I don't think that every foreign-held dollar or asset would be converted to something else within six months. But what – there are other places where other countries can put funds: in Germany, in Switzerland, anywhere in northern Europe. There are – there are other assets and the – what would – what would vanish is the reflex, that here, I've got some – I've got some wealth; I don't know what's going to happen wherever I am; let me move it to New York for safety. Even if what – what's out there now would not be instantly converted, future flows would be much less. There will always be other assets from, as I suggested, Germany, German bonds, or Swiss or other European bonds and even, for all I know, some emerging market bonds.

MR. BLINDER: I think that's exactly right. And I would just add one point, that what you're likely to get in a scenario like that is a lot of people in markets concluding there's really no place to hide. Now they know where to hide. When – after they get panicky, they hide in Treasury bills. If there's no place to hide, I don't know that we can predict what they will do in a – in a panic or a near-panic situation.

MR. SOLOW: But (you ?) know damn well that interest rates will rise.

MR. BLINDER: Yes, you do. And you know damn it will be quite unsettling.

MR. SOLOW: Yeah.

MS. BOUSHEY: Thank you. That's a – can we move on to the – is there another question?

Operator?

OPERATOR: Yes, ma'am. Your next question comes from the line of David Corn with Mother Jones magazine.

Q: Hi. Thanks for doing this. Given that the polls still show that most Americans do not support raising the debt ceiling, for whatever the reason may be, what do you think needs to be done in terms of a, you know, public relations effort or messaging endeavor to make the point that you're making? You know, is the public – does the public have to be kind of scared more?

MR. MISHEL: This is Larry. Listen, we're economists; we're not messaging people. But it seems that the responsibility lies with the people on the call who are in the media to be really clear that all the different plans require raising the debt ceiling, and not doing so would be ill-advised, as we're saying. And that's the only way the American public will change its mind, is if it has further information.

MR. SOLOW: I think that that's –

Q: Excuse me, is this Mr. Blinder?

MR. SOLOW: No, this is Solow, Bob Solow.

Q: Sorry.

MR. SOLOW: I would – I would just add that I think that the secretary of the treasury, maybe even the president and others, should be serious about trying to educate the public about this, make some of the arithmetic part of everyday talk. Alan mentioned a couple of numbers that are not hard to comprehend and would make it clear how unrealistic the current talk is and make it clear to ordinary people that raising the debt limit is not something that you can do if you feel like it or not do if you don't feel like it; it's an absolute necessity to fend off the kinds of near-disasters that we've been talking about.

And the truth of the matter is – this is for, I think, for people in the press who know this, that the sort of discussion about raising the debt limit that's going on now is not serious in the sense that I don't – I think everybody knows that eventually the debt limit must be raised. It's being used as a kind of blackmail, of – I know I have to plug this hole in the boat to keep it from sinking, but I want you to turn over something to me before I'm willing to do it. And the idea is just to scare you.

MR. BLINDER: I'd like to add to the people that need to speak clearly to the public, the bipartisan leadership of Congress. That would be nice. I don't actually expect it, but that would be nice. And I think my answer to your basic question is, sometimes leaders have to do things that go against the polls. You're a hundred percent right, and I find it very disconcerting that the polling on this is quite negative; that is, the polling says, let's not raise the debt ceiling and let's go into default. You know, I don't think people appreciate the consequences of that. Polling, for example, almost always shows people want the budget balanced immediately. Now, our budget deficit is 9.5 percent of GDP. It would be cataclysmic to do it immediately, even if you think it's a good idea to do it in 10 years. But if you just govern by polling, that's what you'd be doing now.

MS. BOUSHEY: I'll just add – this is Heather – I'll add one last point to that. Part of this conversation is about tax revenue, and that – you know, extending the Bush tax cuts for the wealthiest was not something that polled very well. The public does understand that there are choices to be made, and that is certainly something that we need to be seeing more in the conversation from leadership here in Washington and around the country, that that's a part of this debt – this broader debt conversation that is appealing to the public.

With that, is there – I'm going to turn over the operator for another question.

Q: Can I follow up though for a second?

MS. BOUSHEY: Certainly.

Q: Particularly to Mr. Blinder – you know, you've been at this game a while; you've worked with Republicans, although you served in a Democratic administration. Do you see anything substantively different about how Republican political leadership is approaching this issue now, as opposed to years in the past?

MR. BLINDER: Well, yes. What a – yes. Two things: First of all –

Q: And that wasn't a leading question. (Laughter.)

MR. BLINDER: Sounded like a leading question.

MR. : That's funny.

MR. BLINDER: First of all, the history of raising – raising the national debt ceiling is never popular with the public. It always sounds bad. And the history of it is the majority party gets stuck with the task of doing it and a bunch of members of the minority party cast a harmless – they think – vote against it.

That's bipartisan, because who's the majority, who's the minority does change. So during the Bush years, it was the Republicans that were voting to raise the national debt ceiling, and a bunch of Democrats, including Senator Barack Obama, voted against it symbolically. They knew it would pass, but they voted against it.

So what's different now is that this is not symbolic; that if Speaker Boehner doesn't muster a majority of the House of Representatives, this is going to fail. And that's more serious. The other thing that seems to me – I'm now playing amateur politician – different is that Speaker Boehner has got a faction of his party – you can call it the tea party faction if you like – that seems dead set against this.

And it's not at all obvious that he can control it, unlike other rounds where it was always clear that the speaker of the House and the majority leader of the Senate would be able to get enough votes to pass it, and the only question was who was going to get the free pass to vote against it and make a symbolic gesture, when everybody knew it would pass. I don't think that's the situation we're living in right now.

Q: Thank you.

MS. BOUSHLEY: OK. Operator, can we go onto the next question? Thank you.

OPERATOR: (Gives queuing instructions.)

MS. BOUSHLEY: OK. Thank you. I want to make a note that the letter is available on both the Center for American Progress and the Economic Policy Institute webpages. And we can make sure that you get the URL for that. As there are no other questions, we'll conclude this call.

OPERATOR: We do have a question.

MS. BOUSHLEY: Oh, thank you. So we'll take that last question.

OPERATOR: OK. Your question comes from the line of Trudy Rubin with the Philadelphia Inq.

Q: Hi. Just one more point. The Republicans keep talking about just paying the interest. Can you give a graphic example – first of all, is that even possible? And secondly, if you kept paying the interest, what would that mean? You pay the interest on the Treasury bills and then you decimate the government?

MR. SOLOW: That's – it would mean – it would mean diverting what revenue there is that was intended for some other purpose – would be diverted to paying interest on the debt. And that would surely be done, if by some awful chance the Congress falls flat on its face in this. Yes, it would – the Treasury would certainly pay the interest on its debt as long as it could by diverting – by not paying other bills. It cannot pay all its bills.

As Alan has been telling you, the current deficit, the deficit that has already been voted, is 10 percent of GDP, plus or minus. And those bills have to be paid. And if the interest is to be paid to pacify the foreign holders of Treasury debt, then other obligations of the federal government – salaries or whatever – will not be paid – or bills to defense – from defense

contractors will not be paid. Something will have to not be paid in order to meet those interest payments.

Q: And just one other thing: At what point, even if we don't reach this August 2nd deadline, does – do the markets start, you know, panicking over this? At what point is the damage to the U.S. government's credibility and capability so severe that it would have long-standing repercussions even if at the 11th hour they raised the debt ceiling?

MR. BLINDER: Well, that is the \$64 trillion question. I don't believe it's happened yet. And I think nobody can actually know when it happens. As I mentioned a few minutes ago, markets around the world and even Wall Street here in the United States, when you talk to people, are just in total disbelief that this could happen because it's so beyond the pall. At some point – (chuckles) – I don't know when that is; maybe it's August 1st; I mean, who knows when it comes – markets are going to start to say, oh my God, maybe this actually would happen, and then you'll see them start moving. But it's, it – to me and, I think, to everybody, it's totally unpredictable.

To your last point, I think that if this – even if this gets to an 11th hour or 13th hour solution, it is certainly possible – certainly believable, though we can't know for sure, that in the future, a political risk premium against politically induced default will get built into U.S. borrowing rates. And it probably wouldn't be much, but at – given the amounts that we borrow, even 10 or 20 basis points added to the interest bill is an awful lot of money to make a political point.

Q: Yeah. So –

MR. SOLOW: Let me just one thing to what Alan said. He's absolutely right that the reason why it's unpredictable at what point exactly markets begin to behave badly on this account is that it doesn't – it's not the sagest, wisest investors in the market that matter. It's the ones at the fringe. It's the – it's the first few people who say, fire, let's run for the exit that start the stampede. And the same thing might happen here. When any significant holder of dollar assets abroad starts a little panic selling, that will spread. And that can happen at any time, just as anyone in the theater can holler: Fire, let's run.

Q: Thank you.

MS. BOUSHLEY: I think there was one more – there was one more question on the line.

Q: Was it Dr. Mishel who was just speaking?

MR. SOLOW: That was – no, this was Bob Solow.

Q: Oh, Bob Solow, sorry.

MS. BOUSHLEY: Thank you. Operator, we have information that there is another question on the line?

OPERATOR: Yes, ma'am. Your final question comes from Don Lee with the L.A. Times.

Q: Hi. Thanks for doing the call. I think my question was partly answered by you just – by your latest remarks. But how firm do you regard the August 2nd deadline? And you've talked about – you know, laid out the possible, you know, scenario if we do get to that without breaking the impasse. But how much on the upside, how much benefit to the economy do you see if we can reach an agreement on this and raise the debt limit?

MR. BLINDER: Well, I think it's not so much agreement as avoiding the disagreement and the consequences of that which are hard to calculate but could be severe. As to the August – this is Alan Blinder speaking, by the way – as to the August 2nd deadline – I want to preface what I'm about to say by saying I'm not privy to any insider information from the Treasury; I have not had conversations with Tim Geithner about this – but I'd be surprised if he can't wiggle past August 2nd somewhat.

There are many things that the secretary of the treasury can do that he really doesn't want to do and that would be damaging in a variety of ways to a variety of people, such as not paying some of the government's bills that don't count towards the national debt ceiling – that's just one example – that can squeeze by August 2nd. But you run out of these pretty quickly when you're short 1.6 – when you're short about 40 percent of what you have to pay, you need a lot of tricks up your sleeve to keep going very long.

Q: Do you have any idea how long it could –

MR. BLINDER: I do not.

MR. SOLOW: It's impossible know.

MR. MISHEL: This is Larry. Basically, there's no reason to test that.

MR. : (Off mic) – yeah.

MR. MISHEL: We're saying that, you know, this is a – there's no good economic reason to test Tim Geithner's ability to wiggle past – you said August 2nd. That seems to be a good time to – they should be able to – if they're going to do a deal, do it; if they don't actually need to do a deal, to raise the debt ceiling. And they should not mess around with August 2nd. That's my view.

MS. BOUSHEY: And that seems like a good note to end on. Thank you all so much for joining us on this call, and especially thank you to our three presenters this morning – or afternoon, as the case may be. And of course, again, the letter is available both at the Economic Policy Institute and Center for American Progress web pages. That's epi.org and americanprogress.org. And if you have any follow-up questions, do not hesitate to contact us. Thank you so much.

MR. SOLOW: Pleasure to do business with you guys.

MR. BLINDER: Thank you.

MS. BOUSHEY: Thank you.

MR. MISHEL: Thanks, Bob. Thanks, Alan. Buh-bye.

(END)