Debt Ceiling 'SmackDown'

A staged crisis ends with a bad deal, say Duke faculty

TOPICS FOR THIS STORY: FACULTY, BUSINESS, FINANCE, POLITICS & PUBLIC POLICY

August 1, 2011 | *Steve Hartsoe*

Editor's Note: *Camille Jackson contributed to this story.*

Political theater and "a big fat loss" is how a sampling of Duke faculty on Monday characterized Congress' and the White House's handling of the debt ceiling issue.

A deal is anticipated by Tuesday, but "I think that a default would have been a far better outcome," said Campbell Harvey, the J. Paul Sticht Professor of International Business at Duke's Fuqua School of Business.

"The entire crisis was staged, no more real than a WWE 'SmackDown' in Las Vegas," added Michael Munger, professor of political science. "The difference is that it matters for our nation and the world economy. But financial indicators clearly showed that no one believed there would be anything but a last-minute agreement."

The legislation Congress was dissecting on Monday would cut more than $2 trillion from federal spending over a decade. The deal also would permit the United States to raise by $2.4 trillion its borrowing limit of $14.3 trillion. News reports said that was enough to keep the federal government operating through the 2012 elections.

Harvey said a crisis -- the likely outcome if no deal were reached before Aug. 2 -- was necessary to get U.S. spending on a solid track.

"The Congressional Budget Office (CBO) estimates the federal government deficit in 2011 will be close to $1.5 trillion, about 10 percent of GDP. Read the fine print of the Budget Control Act of 2011. The CBO estimates the impact in 2011 will be only $25 billion of savings in discretionary spending. Big deal. The deficit goes from $1.5 trillion to $1.475 trillion.

"We need a crisis like a default to force our politicians to put our house in order. A win for the economy and budget discipline'? No, it is a loss -- a big, fat loss."

News of a pending deal caused some relief Monday in global financial markets. That was a modest prize from the pending deal, said Connel Fullenkamp, director of undergraduate studies and professor of the practice in Duke's Department of Economics.

"The markets are heaving a sigh of relief that we avoided default, but this is still a disappointing deal," he said. "Cutting deficits by only $2.4 trillion over 10 years isn't enough to convince the markets that the U.S. is truly serious about getting its borrowing under control. Unless the economy experiences a surge of growth -- and where that would come from is anybody's guess -- we'll have to face the same problem again in one or two years. Congress still hasn't addressed the underlying causes of the deficit problem."

On the bright side, Fullenkamp said the debate put serious tax reform back on the agenda.

"A simpler tax system with lower rates would help support economic growth, and should be part of the overall deficit solution," he said. "But the only lasting solution is for Congress to recognize that there's a limit to the revenues it can take in, about 20 percent of GDP. We have to live within that limit."

Donald Taylor, associate professor of public policy at the Sanford School of Public Policy, called for the elimination of the debt ceiling altogether.

"Since World War II, the debt ceiling has been raised dozens of times," Taylor said. "Typically the out-of-power party laments our nation's indebtedness, blaming all the debt since 1790 on the current president and voting against the raising of the debt ceiling -- after making sure that it would pass without their vote. After all, raising the debt ceiling does nothing more than say that we will pay for the spending that Congress and the president already agreed to.

"This time, the Republican Party successfully used brinksmanship and the potential economic suicide that not raising the ceiling would portend to obtain a policy outcome they would not otherwise have been able to achieve. The first thing the super committee should do is end the debt ceiling."

President Obama has been damaged by the debate, added David Schanzer, associate professor of the practice for public policy at Sanford.

"Obama has the sense to know that his standing with independents will plummet if he is seen as a bitter partisan," Schanzer said. "But his problem right now is that his luster as an outsider ready to take on the establishment has been tarnished since 2008. And over the past year he has been unable to break away from the rolling set of crises the Tea Party conservatives have been triggering on the budget.

"This is probably what made increasing the debt limit past the election Obama's highest priority in these negotiations. But he is hardly out of the woods. The fiscal year ends on Sept. 30 and Congress has not enacted a single appropriations bill to fund the government beyond that date."

MORE INFORMATION

CONTACT: Steve Hartsoe **AFFILIATION:** News and Communications **PHONE:** (919) 681-4515
EMAIL: steve.hartsoe@duke.edu

615 Chapel Drive, Box 90563, Durham, NC 27708-0563
(919) 684-2823; After-hours phone (for reporters on deadline): (919) 812-6603