

[Transcript] Plain English with Derek Thompson / Econ Megapod: The Debt Ceiling Is Dumb, and the Inflation "Crisis" Might Be Over

Hey there human oids, this is David Chewmaker here with a very exciting announcement. Your favorite wrestling podcast feed, The Ring of Wrestling show is now going daily. And you can hang out with me and Kaz on Mondays and Thursdays for the Masked Man show. And you can join me, Peter Rosenberg alongside stat guy Greg and Dip every Tuesday with she Pete.

And on Fridays, I'll welcome a friend or special guest from the world of wrestling. Now Wednesdays, we have a very special new show called Wednesday Worldwide that you're going to want to check out.

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Today we've got a double barreled podcast for you.

Gina Smilik of the New York Times will join us to break down the debt ceiling showdown that is enveloping Washington and economist Jason Furman is back to talk about his debt ceiling PTSD from the Obama administration and to answer some deeper questions about the U.S. debt trajectory and the state of the economy today.

But first, a new way to think about the debt ceiling and fears of the U.S. government running up the tab.

So every December, I try to catch up on all the best-reviewed films of the previous year.

And that means I recently watched this movie, Banshee's of Inna Sharon, directed by Martin McDonough, which is up for nine awards, including all the major ones, Best Picture, Director, Actor, Supporting Actor and Actress, Editing, Screenplay.

The plot centers around two friends, one of whom decides he doesn't want to be friends anymore.

And this guy tells his friend, I decided I want to work on my music legacy rather than do idle chit-chat with you for the rest of my life.

And if you keep trying to talk to me, I'll chop off my fingers.

People love this movie, and that's great.

It's great that people love movies.

I did not love this movie because this character's motivation struck me as completely idiotic and unrealistic.

Like, yes, I understand movies are heightened reality, there might be some allegory here for the folly of civil war, but I need movies to at least somewhat mimic human psychology and nobody in the real world decides to enforce the end of a friendship by cutting off their fingers, especially when that would deprive them of the very thing they want to do.

In this case, play the fiddle.

And then, just the other day, I thought, actually no, maybe I was wrong.

There are people in the real world who choose to uphold insane self-punishment tactics to enforce arbitrary rules about human affairs.

Because the debt ceiling exists.

The U.S. debt ceiling, as you probably know, is a statutory limit on the amount of money

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the U.S. government can borrow to pay for everything it's already approved spending on, fighter jets, roads, social security, interest on our debt.

No other country except Denmark, by the way, has a legislative limit on their national debt.

They just pass laws and then spend the money required to execute the laws, and if they want to change the laws to spend less money, they just change the laws.

That's how normal people run a state.

The U.S. is not normal people.

Every few years, we have this absurd situation.

The out-of-power party, typically the Republicans, threatens that they won't raise the debt ceiling.

Even though they know that to do so would cause the very catastrophe they seek to avoid.

They say, we're worried that this debt situation is going to create a major crisis, so we're willing to threaten to push the U.S. into default, which will cause a major crisis.

It will cause global markets to have a meltdown.

In order to avoid a future meltdown, the debt ceiling is a mechanism for threatening to chop off our fingers to keep us from getting our fingers chopped off.

Time to be fair to the debt ceiling.

The best argument for the debt ceiling is that it's a kind of pre-commitment device.

It's a way of keeping ourselves from being reckless in the future with spending, like throwing out the Cheetos in the snack drawer.

But as the writer James Surowicki once wrote, the problem with the debt limit is that it's both too weak and too strong.

It's too weak because Congress can just vote to lift it.

We've done so every single time.

We've done it more than 70 times in the last 100 years.

But the debt ceiling is also too strong because the negative consequences are so ludicrously at a proportion to the behavior we're trying to regulate.

The debt ceiling exists, and it persists, not because it's a good political tool nor because it's a good economic tool, but rather because it's a good media tool.

It is entertainment.

This is a movie.

It is a script whereby out-of-power politicians play act caring about the deficit without actually having to make any hard decisions about what to do with it.

It's Banshee is of Washington.

I'm Derek Thompson.

This is Plain English.

Gina Smilik, reporter for The New York Times.

Welcome to the podcast.

Thank you for having me.

So the US has this thing, the debt ceiling.

We have a limit on our ability to borrow money even for spending that Congress has already approved of.

And if we don't increase that limit, if we default on our debt, bad stuff happens.

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So I want to sort of dig into some of the basics here.

First off, why does the US have so much debt?

We have debt because we spend more than we take in on an annual basis.

So the government has a bunch of outlays every year, Medicaid, Medicare, Social Security, defense spending, all the various programs that we're all familiar with.

And those cost more than the government raises in tax receipts.

And so we end up with a deficit that adds up over the years.

We have to borrow in order to fund that deficit.

And that is why we have a big debt pile.

Dozens of countries have deficits.

Dozens of countries have debt, even countries that control their own currency.

The US and Denmark is like the only country in the world that has a debt limit.

So just give us a little history of that.

Why are we so unique in this way?

Yeah.

So the debt limit is something that historically made a lot of sense.

Congress used to be very involved with how the government was funded.

It used to be pretty intimately connected to the money-raising process that the Treasury uses.

And that has sort of faded over time, with the dawn of World War I back in the 1910s and then World War II after that, we really saw Treasury exercising a lot of autonomous ability to go ahead and raise debt, sell government bonds in order to raise money to pay for the nation's deficit.

And so it became the kind of situation where the government would authorize spending and Treasury would basically figure out how to fund that spending.

But the debt limit lived on as this vestige from the days when Congress was involved in those decisions.

And so now we regularly have a situation where Congress passes budgets.

Those budgets are clearly going to push us past the debt limit, but we still separately have to go ahead and raise the debt limit in order to authorize the debt issuance that will raise the money for the spending that we're already planning on doing.

What's so confusing to me about this conceptually, like I understand the words that you're saying, I understand the definition of the debt limit, I understand that it's this 106-year-old law.

But what's so bewildering is that the way that we teach kids how a bill becomes a law is we say Congress passes a bill, the president signs the bill, the bill becomes a law, end of story.

But what you're telling me is, and this is true, it's not the end of the story because Congress has to separately approve of the federal government's ability to pay for the things that Congress has already told the federal government to pay for.

It is a weird double step.

Do you have any... When you're trying to explain the logic of this rule to friends or family or even to yourself, is there a metaphor that comes to you?

It's like having to pay off of a credit card and then separately have to tell the bank

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that has the checking account that you're paying off the credit card with, yes, I approve the spending, yes, I approve the spending.

It's a really bizarre sort of two-step here.

I actually often use the credit card metaphor, but I use it a little bit differently than most people do.

A lot of people will say, oh, raising the debt limit is like raising your credit limit.

I actually think that's wrong because that implies that you're going to do all this new spending that you wouldn't otherwise have done because you've raised the debt limit, which could be true to some degree, but that's not what this is fundamentally about.

I think it's more apt to say that raising the debt limit is agreeing to make and raise the money to pay back the bills you've already incurred on your credit card.

You've got that occasional Netflix subscription that's going to, you know, you're just going to hit your credit card at the end of the month and raising the debt limit is like raising the money you need to pay back that Netflix subscription.

This is spending we've already committed to.

That's right.

It's spending you've already committed to and a huge difference between households and the federal government.

Remembering my 101 macroeconomics reporting here, individuals, households do not have a machine at home that prints money.

The federal government has a machine at home that prints money.

It's the federal reserve.

We have the capacity to create more of our own currency.

We control our own currency.

In that case, yes, it's exactly what you said.

It's kind of like me having to approve of a W-2 or 1099 income that's coming in to me.

I have to approve that I can use that money to pay off a credit card.

It's a completely bewildering two-step.

Back to reality here, back out of the world of metaphors.

What does it actually mean to default on our debt?

What are banks afraid of happening if we simply do not raise the debt limit?

I think it's important to think about the two kinds of spending that happen with the debt limit.

There are spending authorizations, money that's just going to flow out of Treasury that just happen on a regular basis, think military salaries, social security payments, etc., etc.

Then there is the Treasury statutory ability to issue more debt, to pay back principal on old debt, and to pay its coupons, which is sort of the interest it owes on the debt it's already issued, so the bonds.

The thing that people are, I would say, most worried about is especially on Wall Street, is the possibility that you could run into a problem with those latter two areas, that we could get to a situation where the government realizes or decides that it can no longer pay back the principal on the bonds that it's issued, or it can no longer pay coupons interest on the bonds that it's issued, because if that were to happen, the government would

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be in financial default.

We would not be paying back on our loans to foreign investors and to everyday people who hold these in their retirement accounts, and that would be catastrophic.

It would suggest that you can no longer trust America's debt markets to be the deepest, the most liquid, the safest in the world, and we would lose a huge benefit that we derive from having these very safe, very secure debt markets, which is, we probably end up paying more for our future borrowing, and so that is what Wall Street is so worried about.

They think it could be just catastrophic if that were to happen.

They are also obviously worried about not being able to pay the other bills.

I think that nobody thinks that it's a good idea to not pay any bill that the US government - the default is seen as sort of the most catastrophic possible scenario, but many people think that if you don't pay Social Security recipients, or you're not paying some of your state and local governments money that is due to them in time, people are still basically going to see that as a default.

So we're in a really tough situation where any mispayment is pretty bad news.

The US technically already hit the debt ceiling on January 19th.

That was like two weeks ago. You're describing a scenario that's like the end of the world, like financial meltdowns, people not receiving Social Security payments.

But all of that hasn't happened yet.

So explain to me how we already technically kissed the debt ceiling, but the world hasn't fallen apart.

Right.

So we use extraordinary measures.

The Treasury employs what is called an extraordinary measure in order to keep us from going over the debt limit.

Basically, that amounts to moving pots of money around using accounting tricks to make sure that they can stay under the borrowing limit.

They're not borrowing more, but they're still paying the bills.

These are used pretty regularly during these debt ceiling episodes.

They're called extraordinary, but they're pretty run-of-the-mill at this stage.

And they usually last a few months.

We're expecting these ones to last at least until early June.

That's what Treasury Secretary Janet Yellen has told us.

Most people in Wall Street think that we could get into July or August, but we won't really know until we get income tax season behind us because that's obviously a very important period for government finance.

And so we definitely have until least early summer before we run out of these extraordinary measures and actually based on that moment where it's possible that we could default on the debt.

So the U.S. has already hit the debt ceiling, but the catastrophic sort of implosion from this event probably won't happen until later this summer if no one has actually voted to raise the debt limit at that time.

The U.S. has had, as we've discussed, the debt limit or the debt ceiling for more than

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100 years, we haven't had the kind of catastrophic debt crisis that you're talking about.

Why is this year different?

Is it something that Republicans in Congress are asking for that isn't typically asked for by an out-of-party Congress?

Yes.

So I think that this year is different just because we have a very different Republican House.

It is often the case that the episodes where we have a debt ceiling issue is an episode in which Congress is divided and Republicans in one chamber of Congress are uncomfortable with passing a new debt limit without attaching some sort of future forward-looking spending restriction to it.

That was certainly the case in 2011, which was the really, really bad episode that everybody probably remembers as being very painful and our credit score got downgraded by S&P. And so that was the really catastrophic example.

Congress feels a lot like that in that House Republicans are very adamant that they do not want a clean debt limit increase, that they want some sort of stipulation attached to it.

The White House is very dug in.

They say, why would we negotiate over this with you?

You have to do this.

This is just your job.

You have to pass this debt limit increase.

And I think that the question is where you find middle ground there.

This episode is particularly complicated by the fact that the Speaker of the House, who is a Republican, Kevin McCarthy, is not particularly powerful.

That person obviously is critical to negotiations, very important in striking these difficult partisan deals.

And this year, because of some of the rules changes we recently saw implemented in the process of electing him as Speaker, it's quite likely that he's going to be less capable of sort of rallying his base and getting everyone to agree to a plan than you might typically see.

The combination of sort of like dug in on both sides and potentially less room for negotiation increases the chance that we actually cross over that threshold and get to a point of making a mistake.

It sounds like 2011 is the right model to look for to predict what's going to happen this summer.

That's really the last time we saw the parties play chicken in this way.

What happened in 2011 that actually got us a deal?

Right.

So back in 2011, we did see some stipulations attached to the delimit increase.

Republicans won some victories, and that helped to get us to a deal.

They weren't particularly toothy, but it helped to score that final goal.

I think that the challenge here is that the White House has shown very little interest

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in negotiating.

It is true that President Biden and Speaker McCarthy are meeting and talking about where both sides sit.

This could change, obviously, we could see more interest in negotiating.

It's just not clear how these things are going to resolve at this stage.

There's some people who think that we can get around the delimit without any vote.

These are people who are part of the Mint the Coin Club.

Mint the Coin is something that originated as a kind of internet meme that is now very much a piece of economic commentary.

It goes back to the idea that there's a quirky 1997 law which technically intended to help the Mint make money from coin collectors, but the law gives the Treasury Secretary the power to mint platinum coins of any denomination.

So if Janet Yellen at the Treasury Department wants to mint a coin that's worth \$4.20 to commemorate the decriminalization of marijuana in D.C., she can do that.

If she wants to mint a coin worth \$1 trillion, she can do that.

And she can take that \$1 trillion coin, deposit that coin at the local bank right down the road called the Federal Reserve, and then draw on that account when meeting the federal government's obligations.

So, ta-da, you've extended the government's borrowing capacity by \$1 trillion.

Gina, Janet Yellen does not seem to want to do this.

Do you have a sense of why, and can you characterize, I guess, the White House and the Democrats' approach to this mint the coin idea?

Yeah.

I'm going to give you the theoretical explanation.

And it actually comes back to rather than something that she specifically said, although she's kind of alluded to what I'm about to say.

And it comes back to something you said earlier, actually, which is this idea that this is not a household, you know, the Federal Reserve can print money, et cetera, et cetera.

That's not actually how we go about government finance in America.

The Fed does not finance government spending.

The way that we do government finance in America is we approve spending.

The Treasury issues debt.

It raises money to try and match that spending, you know?

And we don't try and mix Federal Reserve money printing and Treasury government funding.

The idea is you don't want your central bank to finance your government because when you do, you risk sending a signal to investors that you are just going to pump endless amounts of money into the economy and you risk runaway inflation.

This is a very traditional economic explanation of just like how government finance works.

The problem with mint the coin is you cross over that threshold into monetary finance pretty aggressively.

You know, at that stage, you were basically just having the Treasury hand to the Fed this piece of very valuable, you know, coin, I guess, with that goes a better word, and just pumping that money into the economy.

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And not selling it to foreign investors, not trying to sort of use the traditional bond issuance route of raising money to fund the government.

And so I think that that crossing of that threshold in such an aggressive way is just pretty anathema to people who are involved in government finance.

And I think that that's a big reason that you see basically no appetite for this among any policymaker that I've talked to, certainly.

That answer raises an important point, which is that, you know, I am not a fan of the debt limit.

I'm not a fan of the debt ceiling.

I wish that it just did not exist.

But the best argument for its existence is that it foregrounds conversations about how the federal government spends money.

It forces us to have these conversations in a very explicit way, because we can have them implicitly when we say, you know, vote to, you know, extend Medicare payments or have some new authorization for Pentagon spending.

But having a separate conversation about our debt focuses everyone's attention on the debt itself.

Is this an argument that you're hearing from both parties or that you have heard from both parties?

Or is this really an argument that the party out of power always tends to use, or maybe just Republicans, tend to use when trying to essentially ransom the White House to make a deal with them?

I think you will often hear this brought up when we are having these episodes, which again tends to be just historically, this is a fact.

I'm not stating an opinion in recent years tends to be when the Congress is split and when Republicans have control of one of the houses.

It tends to be the Republicans who have this conversation.

In 2011 and 2013, that was certainly the case.

I do think that many of the Republicans who raised this, and certainly the Republicans in this episode, do sort of raise it along these lines.

They use it as a moment to say, hey, let's have a conversation about the debt limit.

Let's have a conversation about where this money is all going.

Let's have a conversation about where we're headed going forward.

And I said something earlier, I said that, you know, we don't want to see a mistake.

What I meant by that, I wasn't editorializing.

Most of these Republicans you talk to don't actually want to default on the debt.

Most of them say that would be a bad idea, that that's not what we're going for here, but we just want to have a conversation.

You know, I think that, like I was also saying, the Wall Street analysts I talked to, the government analysts I talked to are quite concerned that we are going to get to a point where we've played chicken with it too long and we crossed that threshold and you could have mistakes.

These things are hard to time perfectly.

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But I think it's worth noting that not 100%, but a lot of Republicans don't actually think defaulting on the debt is a good idea or a good plan.

Yeah.

I won't ask you to editorialize in this point, but I will just say to plant my own flag in the ground, I think the Republicans are opportunistic on this, that when they're out of power, they do tend to say, oh, we need to worry about the debt and deficits.

And then the last time we had a Republican president, President Donald Trump, what happened in the first few years of his presidency, the deficits went up and up and up, we passed a corporate tax cut that absolutely extended the deficit and added to our debt.

So it seems like this is, to the extent that it's any virtue, a virtue that Republicans discover when they're out of power and don't exactly act on when they're in power.

I will not ask you to editorialize in my editorializing, but that is just where I end on this particular issue.

Is there anything stopping Democrats when they have power across government in the executive branch, in the Senate, in Congress, is there anything stopping them from raising the debt ceiling by \$100 trillion when they have full control?

You know, it's really interesting because they could have theoretically done this late last year, and it was not the legislative priority that they chose to take up.

And so we could have potentially forestalled this episode.

It's not clear whether they didn't have the votes.

It's not clear what happened there.

It is clear that it wasn't the thing they chose to do.

And so I think there's some interesting questions around that.

I suppose they could have raised the debt ceiling by \$100 trillion.

They could have ended the debt ceiling entirely, but again, it gets to this fundamental issue of neither party wants to be a party that celebrates its own lack of interest in the debt.

Both parties want to spend money on their initiatives, but they also want to seem like they care about budgeting, like that they're kind of like a typical family that cares about the money coming in and the money coming out and doesn't want to get over its skis on debt overhang.

And to a certain extent, I get that, but it's just funny that this entire issue and all future debt ceiling increases probably could have been fixed if Democrats just got together and raised the limit by \$100 trillion.

I want to ask finally about the bizarre psychology of getting Republicans and Democrats to the negotiating table.

This is a quote from your reporting in the New York Times, quote, the Federal Reserve and Treasury are not publicly speaking about what they could do if an outright default were to happen this time, in part because the mere suggestion they will bail out warring politicians could leave lawmakers with less of an incentive to reach a deal.

End quote.

It's like retreating Congress like children.

The Federal Reserve and the Treasury doesn't want to talk too explicitly about how they

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would try to fix this problem because they want to make it seem as big of a possible problem to encourage people to come to the table to raise this debt ceiling, which by the way is a bomb that we planted.

We don't need to even have a debt ceiling, it's just that we planted it.

Do you ever feel free to answer this with whatever level of editorializing you feel appropriate?

I mean, do you ever just sit back and think like it is remarkable that we created this problem for ourselves and that it is so complicated to solve every few years?

Yes.

So I actually have a fun story about this.

So there, in 2013, there was a lot of talk between Treasury and Fed officials about what to do if there was a disaster, right?

And they sent a lot of emails to each other and they had a lot of meetings and lo and behold, one of the House members later subpoenaed all of these documents so we can now read them.

And so we know in excruciating detail that this was literally what they were talking about.

They were like, here's the plan, here's how we'll try and invert disaster, but please don't tell anyone, basically, I'm paraphrasing, but please don't tell anyone, because it might take pressure off of Congress to do something about this.

And I think that if you really do a careful reading of the totality of the documents from that period, which for better or for worse, I have had to do over the last couple of weeks, the message that comes across pretty clearly, and this is hundreds of pages of documents, is that they don't actually have a good plan, like they can't save us from disaster if we decide to drive off this cliff.

It's like they've got a couple of little tiny parachutes that they're going to send off of the car if we drive off the cliff.

We're still going to plummet, but they're going to slow it down a little.

And so I think that it's a really interesting thing.

They see this as this all-encompassing disaster.

They're not trying to pretend that it's not going to be a huge, huge issue if we go off the cliff, but they do seem to worry that any degree of cold comfort that they could give lawmakers will stop them from coming to some sort of agreement.

So I think that tells you all you really need to know.

It's unbelievable.

It's like we invented this time bomb that we could always un-invent, but we have to go through the misogas of figuring out how to diffuse it every few years.

And even the Federal Reserve and the Treasury, it's like they have little hints about how we could diffuse it or make it a little bit worse, but they don't even want to save them because that might reduce the incentive to actually diffuse the bomb that we invented.

It is so, so insane.

Gina Smilek, thank you so, so much for talking to us through this.

I really appreciate it.

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Thanks for having me.

That was Gina Smilek, reporter for The New York Times.

Now to talk us through some deeper questions about the U.S. debt burden and get a temperature check on the U.S. economy, the Federal Reserve, we're going to bring back Harvard economist and former Obama administration economic advisor, Jason Furman.

Jason Furman, welcome back to the podcast.

Great to be back.

We just spoke with The New York Times reporter Gina Smilek about the whole debt ceiling fracas. When I reached out to you to ask you if you would come on this show again to talk about the debt ceiling, I got the idea from your response that you were not particularly enthusiastic to talk about the debt ceiling.

Why is that?

So, Derek, I'm always happy to talk to you about anything.

In fact, I'm generally pretty open with reporters.

So I have talked a lot, a lot about the debt limit in the last couple of weeks.

And I hate the topic for two reasons.

One is PTSD.

I was right in the thick of it in 2011.

It was a miserable experience, not the worst consequence for the country, but I was en route with my family to go see the final space shuttle launch.

And I had to cancel that because these knuckleheads couldn't come to closure on the deal any more quickly.

And second, it's not an interesting economic topic.

If we default on our debt, it is bad for the economy.

There's no debate about that.

All the issues at stake are political.

Now, political isn't to belittle them.

They're very important political things.

I'm incredibly grateful that people in the White House are working really hard to resolve this and get this done.

But there aren't really any interesting economic questions on the debt limit.

Can you remind us, I asked Gina this question, but you were literally there inside of it.

What happened at the end?

How did we get over the finish line where Republicans and Democrats said, well, we all know we have to raise the debt limit, but these are the conditions that will have to be met.

These are the deals that have to be struck to actually get us over that limit.

So first of all, like other fiscal negotiations that I was a part of, there were multiple venues.

Originally, it was one group of people negotiating with Vice President Biden, then Vice President Biden sharing it.

Then there was another secret negotiation between the President and Boehner.

And then it moved into the Cabinet Room with all the Democratic and Republican leaders

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in Congress, the President, and the Vice President.

So you tried out different venues, different combinations.

That last one, the people got along the worst.

It was constant bickering in the room.

It was constant leaking out of the room.

But ultimately, probably because they had no choice, because it was the last of the venues, they did strike a deal.

Part of how the deal came together was narrowing the initial ambition.

But President Obama and Speaker Boehner originally started out thinking they were going to raise revenues for forum entitlements.

They had this big grand bargain that to some degree, they were both excited about.

It wasn't just an extortion paradigm.

It was, how do we do something cool here, paradigm?

Almost all the cool stuff dropped out, and the deal ended up with discretionary caps, the formation of a super committee and something called a sequester to back it up.

All stuff that was simpler, I would argue stupider, much of which never really happened or turned into anything successful.

So you said that the debt limit itself is not a particularly interesting economic rule or phenomenon.

It's a political phenomenon.

But it's a political phenomenon behind which there are interesting economic questions, like, does the US have too much debt?

And I want to ask you this question, I guess, in two ways.

Let me ask it this way first.

What does it mean for a country like the US to have too much debt?

Right.

So I think that is a profoundly interesting economic question and one that I don't know the answer to.

I've asked a lot of other economists, and they don't know the answer to it either.

The thing I do know is you can't have debt that rises without bound forever.

If you go from 100% of GDP to 150 to 200 to 400 to 1,000, et cetera, that's unsustainable.

At some point, people won't lend to you, interest rates will go up, you'll have a crisis, et cetera.

So that's sort of the easy thing to answer.

The harder is, is it OK if it's 100% of GDP forever?

Could it be 500% of GDP forever?

Does it need to be 50% of GDP forever?

It's not really a science of precisely answering that question.

There's a few things we do know about it.

If you borrow in your own currency and control your own monetary policy, like the United States does, that gives you more room.

But it doesn't give you infinite room.

The UK, when investors got nervous about the UK, it had a big effect on their economy,

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and there's a lot of emerging market economies that do borrow in their own currency, run their own monetary policy, and have had real debt problems.

So that helps, but it doesn't give you an unlimited room.

I think the level of interest rates matters, too.

The real interest rate in the United States now, the interest rate adjusted for inflation, which is the right one to think about, is a little bit over 1% on 10-year borrowing.

That used to be more like two, three, four percent, so that gives us more room to run higher debt.

If you forced me to pick a number, I would say if you told me our debt would stabilize at 150% of GDP, that would seem to me perfectly fine.

We're a while before we breach that, but if we don't change anything, very likely we will breach that and continue going higher.

When I think about a debt crisis, and what a debt crisis would look like in the US, this is not something that we have experienced as a calamity in recent history.

Looking out, it's like, what would the headlines be?

What would we feel as consumers, as households, as businesses in the US, if it was broadly understood that the US was experiencing a debt crisis?

What would happen?

Right.

So there's sort of the fast version and the slow version.

In Canada in 1994, investors got really nervous.

They had large debt, they had large budget deficits, and interest rates skyrocketed.

They jumped, I don't remember exactly, 200 basis points, 2 percentage points, something like that, and that had big repercussions for people, households in the Canadian economy trying to borrow, trying to get mortgages, jobs, and the like.

They did basically an emergency program to cut government spending, raise taxes, and interest rates went back down again, and the debt came down.

Sweden went through an experience like that about 20 years ago, something like that as well, and then obviously in a much more extreme example, Greece, Argentina, other countries have.

That's the crisis type scenario.

I think that's a possibility here.

I don't think it's that likely.

It's not what I'm that worried about.

I remember one person once said, the most predictable crisis in the United States is a fiscal crisis over government's debt, to which I responded, the most predicted crisis in our country is a fiscal crisis over government debt, and look, in 2005, there were more people warning about a fiscal crisis than there were a financial crisis, so I'm not saying I'm not worried about that at all, but it's not my main worry.

There's a second one, which is the gradual version, and that I think we did have in the mid-80s and early 90s, which is real interest rates went up over a sustained period of time and it was more expensive for businesses to borrow, more expensive for households to get mortgages, tougher to sustain our debt, et cetera, and sort of about eight years' worth

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of deficit reduction from Graham Rudman in the mid-80s through the 1990 deal that George Bush did in the 1993 Clinton Democratic, only one brought the debt down.

That plus a lot of other developments brought interest rates down, so I think the greater concern about debt in the late 80s and early 90s was, in part, not because of a crisis, but because there was this sort of slow-boiling issue with real interest rates that is an issue we don't have now, but I think we will have very likely at some point.

One more question on that, the forthcoming debt crisis, if it happens.

You look at GDP growth, and it's fair to say the U.S. is probably going to grow on a real basis around 2%, 3% for the foreseeable future.

I don't see us entering a permanent recession, I don't see us entering mid-2000s China growth of 5% growth for a sustained period of time future, so we have a general sense of how much the U.S. is going to grow over the next few decades.

We also have a general sense of how much certain entitlement programs are going to grow in the next few decades.

You look at Social Security, you look at Medicare, you look at Medicaid, you look at the fact that Americans are on average living longer, they're spending more time in retirement, which combined with elevated health care costs suggests that there's just going to be necessarily more government spending on these kinds of insurance programs, and it's my understanding, I'm not trying to predict a debt crisis here, I'm just trying to piece together the arithmetic that some people put together to say, all right, if we basically know that the U.S.

is going to grow at this rate, and we know that entitlement spending is going to grow a lot faster than that, then at some point we're going to reach a scenario where there's simply too much debt compared to the size of our economy.

How do we, first of all, tell me if you think that that general outlook is just the wrong way to think about it, and two, how would we even know that we are passing that precipice?

Yeah, so if we stick with current policies, which means we do absolutely nothing except extend the expiring tax cuts and continue to pay Social Security and Medicare benefits after their trust funds are exhausted, so it's not literally no laws, but laws that just continue what we have now and extend things, yes, I think our debt will rise to a point where eventually you need to do something about it.

Because I think that gradual, I don't know if crisis is the wrong word, that gradual chronically growing problem, the one we had in the late 80s and early 90s, I think that's the more likely scenario, so I don't feel we need to deal with this tomorrow.

This doesn't keep me up at night, I don't worry, we're about to have a fiscal crisis, but I think absolutely we are going to have to do more at some point in time.

I also think in an ideal world, if our economics are, it would be much better to do that right now than later.

The cost of dealing with the issue does go up the longer you wait, given that we want, I would argue, different people have different views on this, sort of more contractionary stance for macroeconomic policy right now, I think that's an additional bonus to doing front-loading some of the deficit reduction, so I think it would be better to do it sooner than later, I don't think it's tragic if we wait five years and there's some forcing events out there that could raise the odds of action happening even if they don't force

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it.

I want to pivot to the story of the week, and that is the Federal Reserve, which just voted unanimously to raise interest rates by a quarter point.

What was your takeaway from the Fed's meeting this week?

So, if you follow me on Twitter, you'll see I often have really, really long threads, and now I can follow how many people start, read the first one, and get through all the way to the end.

This one I had a very simple tweet, I just retweeted the Fed's statement with, I agree. I think they have it exactly right, I think they've had it exactly right for some time, and it's important to understand they raised rates today, but that doesn't mean mortgage rates are going to go up by 0.25%, the amount they raise the Fed funds rate.

Mortgage rates already built in that increase, in fact mortgage rates have come down in the last few months, and what are called financial conditions more broadly, all the ways in which the Fed affects the economy, that's actually eased in the last few months.

So the Fed right now is largely doing what it already told people it would do, it's following through on what it said, and in that sense, it didn't really tighten policy in terms of its impact on the economy, it just sort of locked in what was already there.

All right, you mentioned that you basically just retweeted the FOMC statement and said, yep, I agree.

There are two key questions that I feel like I have right now.

Number one is how much higher will rates go, and number two is how long will they stay there?

Did the Fed give us any more clarity on those two questions in the statement it released today that you so dramatically and briefly agree with?

They didn't give us much of a clue, and there wasn't much of a clue given in the press conference, they did say that they expect there to be further rate increases, they used plural.

So that implied two more, that would be consistent with the terminal rate that they forecast for themselves in their so-called dot plot back in December.

They'll have another so-called dot plot after the March meeting where they'll outline a path, so they didn't say that.

I think what's tricky right now is two things are true in terms of inflation.

Number one, price inflation and wage growth have both come down really quickly, more quickly than I expected, more quickly than you'd expect given how low the unemployment rate is and other measures of labor market tightness are tight, but they also remain much higher than what the Fed would like them to be.

And so do you expect the progress to continue?

Go from six to five to four to three to two, or do you think it went from six to five to four?

It's going to get stuck at four, and that's obviously not something anyone knows.

I think some of the short run indications indicate that inflation is going to be up in the first quarter relative to what it was last quarter, that some of the things that happened last quarter that were good were transitory, like dramatically falling used car prices.

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Because wage growth slowed a lot, but it's still a point and a half or two points higher than it was prior to the pandemic.

So that's the big question, is how much do you wait and hope the immaculate slowdown in inflation continues versus you need to do something to push it even further?

There's some people who I'm reading who would probably consider themselves doves or liberals who say inflation for the last six months has been a lot closer to 2% than 8%.

And now we have a rate increase, which isn't 75 basis points or 50, it's 25.

Do you think it's fair to say as a framework, as a headline, that to a certain extent the inflation crisis is over?

We are past the acute emergency phase, and we're into something else, like the moderate chronic pain mitigation phase of inflation.

But we're in just a different moment now than we were in when we were getting month after month headline inflation prints at 6%, 7%, 8% annualized.

Yeah, I think that's certainly true.

I get more calls from people in your profession about the debt limit now than I do about inflation. Which is its own signals.

Yes.

It was certainly the reverse a year ago.

I think we're past it.

I think we might not be quite as past it in reality as people think we are.

So for example, the headline inflation number for December was negative.

Prices on average fell in the month of December, but that was because gasoline prices plummeted. No one, no matter how dovish they are in the debate, thinks that we're going to see falling prices of sustained month after month.

So I think some of the relief has been a little bit temporary.

But yeah, I think we were never in as high an inflation world as we thought.

I always was saying an inflation numbers were six or nine.

I was always saying I thought underlying inflation was four, four and a half percent.

I now think underlying inflation is probably more like three and a half percent.

So my number has come down to the news has been better.

But yeah, it's certainly a lot better than it was.

You mentioned a few things that have made me think about certain aspects of the economy.

It's a kind of yo-yo effect.

There was a period where gas prices were clearly driving overall inflation and gas inflation goes way up and then it goes way down into negative territory.

This happened with used cars as well.

Used car inflation was a key driver of the early inflation prince and then used car inflation I think briefly went negative.

I don't know if it's now sort of hovering around zero, but that's another up and down.

Durable goods for a while were clearly driving.

Off was driving the rise of inflation, like the rising cost of furniture, the rising cost of these kind of durable goods.

That went up.

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That came down.

You saw the same thing with shipping costs.

Now the same effect is happening with leisure and hospitality wages.

I don't know if I saw this on your feed or someone else's, but leisure and hospitality wages absolutely spiked as you saw this great resignation with someone leaving a job at Harveys that pays \$12.50 an hour and going to TGIF Fridays because they pay \$13.50 an hour.

So you saw wage, inflation happened there.

That now has gone up and come down.

It does seem to me, one of the things that makes me optimistic about our possibility of having a soft landing is that these yo-yo effects seem to be going in the right direction. I'm not trying to make any prediction about the near future, but it does seem heartening that the yo-yo economy is moving in the right direction, correct?

I agree with everything you said in fact.

Saying the fact that you said makes a soft landing possible and makes me hopeful that it's possible.

And if it happens, it will be because of those yo-yos.

I still don't think it's probable.

I still don't think it's the most likely scenario because the thing where you've seen less of a yo-yo, oh.

Let me just jump in and say, when we say soft landing, I mean, this is like a sort of kind of vague term of art among economic nerds.

Soft landing, at least as I use it, means we get back to a place of stable, two-ish, 3% inflation without an official NBER recession.

Is that your definition of soft landing?

That is the definition I use.

And when I put numbers on it, which are my own arbitrary numbers, I say the unemployment rate does not rise above 4.5% and the inflation rate in the second half of the year is below 3%.

So I even allow some increase in unemployment and inflation still away from 2.

So I take a pretty expensive definition.

Even with that relatively expensive definition, I still don't think it's probable.

If it happens, it'll be because of the yo-yo that you described.

But the thing that has done less of a yo-yo and Chair Powell emphasizes this a lot is if you look at prices for services, not counting housing, that's more steadily increased. Just wiggles up and down has been a little bit of a wiggle down lately, but that's more dependent on wages that has generally increased.

Wages are growing at a pace that would make you think that part of inflation is going to be elevated enough that you get to the 3.5% underlying inflation rate.

And could wage growth slow all on its own without unemployment going up?

It certainly could.

It's what happened over the course of the year.

Will a lot more of it happen?

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I don't think it's probable, it's possible.

Could we have slower price growth even with fast wage growth?

Absolutely.

If we get more productivity, if we get a decline in the profit share and an increase in the labor share, but again, I do want to not bet on that all the happy things will work together. And I want to place more probability on what I think is the patterns we've seen in the past.

Questioner at the labor market, we gained 4.5 million jobs in 2022.

The unemployment rate at 3.5% is basically at a half-century low.

But real wages are lower today than they were in December 2019 for every industry in the economy except retail, trade, and leisure and hospitality, as you recently pointed out.

So we have a labor market with more jobs, more growth, lots of job openings, but also poorer workers.

How does this make sense to you?

It seems like there's certain aspects of the labor market right now that are really breaking economists' brains or at least breaking certain models of how we expect the economy to work.

How do you tell yourself a coherent story about what's happening in the jobs market?

Yeah.

This one is actually a place where there's a disconnect between what academic macroeconomists have thought and what has been more common in policy circles in DC and think tanks even in the way that FOMC members and the FOMC chair have spoken.

If you look at economic research, the issue you just discussed comes under the heading of, is the real wage procyclical or counter-cyclical?

When the economy booms, does the real wage go up or does the real wage go down?

John Maynard Keynes actually thought economic booms resulted in prices going up and wages going up, but he thought the prices went up even more than the wages went up and so they actually hurt real wages.

That was sort of a key part of Keynesian economics.

Then it wasn't clear that was true in the data and part of what's called new Keynesian economics was to explain this puzzle that maybe in booms real wages went up, but maybe they went up just a little bit, were mildly procyclical, and then you look at Europe and you've generally seen, you haven't even seen any mild procyclicality of real wages.

So the religious, the sort of doctrinal view that a hot economy raises wages more than prices is not obvious in theory.

It raises both, which one goes up more is ambiguous, and it's not obvious in practice.

So my head is exploding a little bit less.

Now why did people come to be so convinced of this?

Partly, it's what happened in the late 1990s in the United States, low unemployment, high real wage growth, and it happened again in the couple years before COVID hit.

The late 1990s, that might have been faster productivity growth that was driving wages up, not demand, and the time before COVID, it was just sort of a year, two or three years.

Maybe that was something random, maybe that was productivity, maybe it was something else.

So I think it requires more of a revolution in popular thought about the economy than

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academic thought.

I heard we had you on the show, I think in the first half of last year, where the most interesting economic mystery in the world, at least to me, was that GDP seemed to be declining, flatter declining, but unemployment was low and jobs were growing like crazy. So we were in this situation where we're adding more and more workers, more work was being done, but less product was being produced, which there's a few ways you can sort of square that, one of which is just workers are getting less productive, but it was just a very strange phenomenon to see those two numbers going in different directions. Do you have a similar sort of big economic mystery of the moment, another way in which there are two data points or a handful of data points that seem to be pointing in entirely opposite directions, and you're like, this might be academically or substantively the most interesting and weird thing that's happening in this economy right now.

Yes.

So first of all, let me just say a year later, I still don't have a better understanding as to why in the first half of last year, GDP was falling and jobs were rising so strongly, a year of data and thinking has not cleared that one up.

Somebody else would give the following answer to your question, but I wouldn't.

They would say, oh, labor markets have basically stayed equally tight or gotten tighter over the course of 2022, but wage growth fell.

How do you get falling wage growth with tighter labor markets?

I don't find that that surprising.

I don't think the theory of the Phillips curve is supposed to work exactly each and every quarter.

What's the Phillips curve?

The theory that low unemployment means faster wage growth or faster price growth.

I don't think that theory is supposed to hold exactly each and every month within every month.

I think there are certain reasons why we're having more inflation a year ago above and beyond labor tightness that have gone away.

So I'd say on most people's mystery list right now, I think on mine is, this one isn't really a mystery either.

It's just consumer spending has been really strong while everything else in GDP has been really weak.

And how much longer can consumers hang on, continue to have low savings and spend?

That's not much of a puzzle, but it's a big question, 70% of the economy question, in fact.

Right.

Not like an existential mystery, but a really important question to be able to predict because it probably speaks to the future of GDP growth and possibly unemployment growth and also possibly inflation.

Yeah.

That'd be a big one.

But if I could shake a crystal ball and have the exact consumer spending numbers for the

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next five quarters, that would be pretty nice for both my investment strategy and my general sense of a future thinking about the economy.

Jason Furman, thank you very, very much.

Thanks for having me.

Thank you for listening.

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