

“State and local governments have an extraordinary opportunity to be game-changers.”

Diane Swonk, chief economist at Mesirow Financial in Chicago, is listed among the top economic forecasters in the nation annually and is regularly quoted in consumer and financial media. She addressed the opening session of NCSL’s 2012 Legislative Summit.

State Legislatures: How confident are you that Congress will come to an agreement to avoid the so-called “fiscal cliff”?

Diane Swonk: I am confident we will avert the fiscal cliff. But the hesitation of dealing with it is going to cost the economy and likely keep growth below the 2 percent threshold well into the first quarter of 2013. I don’t think you’re going to see the payroll tax cuts and unemployment insurance extended, which will suppress growth. It’s hard to assess the actual cost of the hesitation we’re seeing. My own estimation is it will probably shave a half to a full percent off growth. That’s the difference between an unemployment rate that’s stable to rising and one that is falling. We have this potential, and to squander it to politics is just mind-boggling. It’s the first time in my career that I’ve had to take into account political brinkmanship ahead of economic fundamentals.

SL: Why should struggling U.S. households be concerned about what’s going on in Europe?

Swonk: Because it could throw us into another recession. We’ve already seen one financial crisis, and we don’t need another. The contagion effect means that if Europe goes down, all bets are off. Although, ironically, the most recent CNBC poll of economists, of which I’m a part, rated the fiscal cliff a greater threat to the U.S. economy than Europe, which is extraordinary.

SL: How have state and local governments been affected by the recession?

Swonk: One of the things we usually see in a recovery is that state and local governments are some of the first to start adding

jobs, hiring up, doing projects, doing infrastructure, as state revenues come back. But we’ve seen the exact opposite. One of the main reasons we have a subpar employment recovery is because of the pain state and local governments have had to endure, and the cutting they’ve had to go through.

SL: Can the states expect help from Washington?

Swonk: The federal government is going to be shifting more and more burden onto the state and local levels. Places that have already cut to the bone will have to start cutting to the limb and deciding which limb goes first. That’s not acceptable to the American public, and it doesn’t have to be. These are self-inflicted pains that can be averted with a little common sense.

SL: How do you see the states’ response?

Swonk: A lot of states have tried very creatively to deal with these issues. I’m so impressed with what’s happened at the state and local levels versus what’s happened at the federal level. It’s because they had no choice, but they still did it facing enormous political opposition and it was tough. State and local governments have an extraordinary opportunity to be game-changers.

SL: Newsweek magazine referred to the 18- to 35-year-olds as the “Screwed Generation.” Do you agree?

Swonk: In 1980, when I started at the University of Michigan, my father said I would never be able to buy a home. As much as I’m worried and concerned now, we have an opportunity to make it right. If we can come up with tax and spending reforms that ultimately make the economy more efficient, we’ve already seen in a decade that the world can change quite dramatically. The ’90s were an incredible decade, but not necessarily because of good economic policy. We had a lot of serendipity, we had globalization and some of it was fake, but we got to the point where even though some people didn’t have skills, we could still make them productive. That’s not something any other economy has ever done. We are still the most flexible economy in the world and the potential is still there. The key is to tap it.



SL: How will the drought this summer affect the economy?

Swonk: It doesn't affect the farmers [who have adequate crop insurance] because they're hedged. But the residual effect to manufacturing is another insult to injury. It really is a tax on people living paycheck to paycheck and trying to put food on their plates. When you have no wage growth and rising food prices you get a lot of substituting. All of a sudden you get people trading down the food chain, trying to buy cheaper food that turns out to be not as healthy.

SL: Could the U.S. economy use a little dose of inflation right now?

Swonk: The Fed certainly thinks so. Part of what the Fed is trying to do is re-inflate a disinflating economy. By holding down both short- and long-term rates—and promising to hold rates low for an extended period of time if conditions don't improve—they are saying we'll make it worth your while to

invest today, we'll make cash repulsive to hold so you make more productive investments in our future. Would the Fed tolerate a little bit of inflation? Highly debatable depending on who the chairman is and who you talk to at the Fed. Frankly, if we suffer inflation of 3 percent for a year or two, we're not going back to double digit inflation, and the Fed would love the opportunity to fight inflation rather than this disinflation and high unemployment.

SL: How do you see the real estate market performing in the future?

Swonk: Much depends on what happens in Washington, D.C.—and I hate saying that. We're at a time that would be opportune for the Fed to do its third round of quantitative easing with mortgage-backed security purchases. It would encourage banks to do more loans because there are no private buyers of mortgage-backed securities. If the Fed would do another mortgage program of significance it would allow banks to provide more mortgages. You always get more bang for your dollar by helping a market that's already healing rather than trying to reverse a trend.

Editor's note: This interview is part of a series of conversations with opinion leaders. It has been edited for length and clarity. The opinions expressed are of those interviewed, and not necessarily NCSL's.

You can read previous interviews at www.ncsl.org/magazine with:



John Boehner,
U.S. House
speaker



Jeb Bush,
former
Florida governor



Cecile Richards,
president,
Planned Parenthood



Grover Norquist,
president, Americans For
Tax Reform



Richard Ravitch,
former New York
lieutenant governor



Donna Brazile,
author and
political analyst



Karl Rove,
author and
political analyst



Jacques Chagnon,
president, Quebec
National Assembly



Charmaine Yoest,
president, Americans
United for Life



Alan Simpson,
former U.S. senator from
Wyoming



Simon Johnson,
former Chief Economist,
International Monetary
Fund



Neil Newhouse,
co-founder of Public
Opinion Strategies



Peter Hart,
chairman of Peter D. Hart
Research Associates



James Guthrie,
superintendent of
public instruction,
Nevada