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WITHOUT FISCAL POLICIES THAT SUPPORT GROWTH, EUROPEAN SOVEREIGN DEBT AND U.S. SUBPRIME MORTGAGE CRISES ARE FAR FROM OVER, STUDY FROM LEVY ECONOMICS INSTITUTE SAYS

ANNANDALE-ON-HUDSON, N.Y.— In a new study from the Levy Economics Institute of Bard College, Senior Scholar Jan Kregel analyzes the recent private sector financial crisis in the United States and the sovereign debt crisis in the eurozone, and sees a similar trend in how losses are distributed between borrowers and lenders. Creditors—“too big to fail” banks in the United States and surplus countries such as Germany and France in the eurozone—have been protected or bailed out, leaving the burden of repaying the bad loans and bailout funds to the public, specifically, homeowners with negative equity mortgages in the United States and countries carrying large debt burdens in the eurozone, such as Greece, Portugal, and Italy. By placing all of the responsibility on borrowers, Kregel argues, U.S. and eurozone policymakers have overlooked the role that the lending practices of U.S. financial institutions and the fiscal policies of eurozone creditor nations played in creating the crises, and are preventing borrowers from repaying their debts by imposing deflationary austerity policies.

In his new Public Policy Brief, *Debtors' Crisis or Creditors' Crisis? Who Pays for the European Sovereign and Subprime Mortgage Losses?* Kregel contends that, in the case of the Greek debt crisis, there is an implication that the “profligate” Greeks need to work more and spend less so that the creditors at risk—the “sober” Germans, who spend little and save much—are protected. But the austerity policies imposed on debtor nations ignore the impact of German domestic policy—encouraging investment and saving while discouraging consumption—during the runup to the eurozone crisis and, today, on the ability of Greece and other countries to repay their debt. “There must be an increase in net

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foreign demand sufficient to offset the carry of existing debt and provide an increase in incomes that will serve as a base for higher government revenues and debt redemption,” writes Kregel. “If this is not the case, there may be no way that borrowers can shoulder the losses by attempting to behave more like creditors, unless the creditors become more like borrowers. Successful repayment of the debt would then require Germans to behave like Greeks! . . . The bottom line is that Greece cannot repay its outstanding debt without a debt restructuring or a change in domestic policies in Germany. The solution to the euro crisis depends on German economic policy, not the character of the Greek people.”

Kregel sees a similar situation in the U.S. government’s failure to provide any relief to households that have negative net value in their homes, or that cannot meet the interest service on their mortgages. To meet their payment commitments, he writes, these households are forced to reduce consumption in an attempt to increase saving. But, with the private business sector, at the same time cutting costs to increase profits, the entire private sector is attempting to run a surplus. Meanwhile, if Congress insists that the government debt created to bail out the insolvent financial institutions must be repaid by running a budget surplus, then both public and private sectors can achieve this result only if there is an offsetting external surplus. Given current international conditions, argues Kregel, the external account will remain negative, making current U.S. policy implausible. “Either the public sector or the private sector will fail to achieve their objectives. If the public sector manages to introduce a budget that produces a surplus, then the private sector will face falling profits, falling employment, and falling incomes,” he writes. “This will make it even more difficult for households to meet their debt commitments, since more and more of them will not have incomes at all, making it impossible to save. The debt crisis clearly is not over, within either the US private sector or the EU public sector.”

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Public Policy Brief No. 121: *Debtors’ Crisis or Creditors’ Crisis? Who Pays for the European Sovereign and Subprime Mortgage Losses?*

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