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Top Economists Told Obama that Economic Recovery Required a Reduction In Private Debt

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But Obama and His Economic Team Chose the Big Banks Instead

We've extensively documented that too much private household debt is killing our economy.

While Ben Bernanke and other economists who are running our economic policy literally believe that the amount of private debt doesn't matter and isn't even important to quantify, economists at the "central banks' central bank" – the Bank of International Settlements – and many other leading economists say that high levels of private debt create a tremendous drag on the economy.

And Obama can't plead ignorance.

Business Insider notes today:

> A number of economists privately told Obama that his recovery policies were weak in one key area: They didn't do enough to address the mountain of homeowner debt.

The Washington Post reported yesterday:

> One year and one month before President Obama won reelection, he invited seven of the world's top economists to a private meeting in the Oval Office to hear their advice on what do to fix the ailing economy. "I'm not asking you to consider the political feasibility of things," he told them in the previously unreported meeting.
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> There was a former Federal Reserve vice chairman, a Nobel laureate, one of the world's foremost experts on financial crises and the chief economist of the International Monetary Fund , among others. Nearly all said Obama should introduce a much bigger plan to forgive part of the mortgage debt owed by millions of homeowners who are underwater on their properties.
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> [The Obama administration pooh-poohed the need to reduce homeowner debt.] The meeting highlighted what today is the biggest disagreement between some of the world's top economists and the Obama administration. The economists say the president could have significantly accelerated the slow economic recovery if he had better addressed the overhang of mortgage debt left when housing prices collapsed. Obama's advisers say that they did all they could on the housing front and that other factors better explain why the recovery has been sluggish.

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> Former budget director Peter Orszag has said that "a major policy error" was made. And Christina D. Romer, formerly Obama's top economist, has said that the driving ideas "may have been too limited" and that there needs to be a bigger focus on reducing mortgage debt — a process known as "principal reduction."
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> "The new evidence on the importance of household debt has convinced me that we are likely going to need to help homeowners who are underwater," she said last month. "Many of these troubled loans will need to be renegotiated and the principal reduced if we are going to truly stabilize house prices and get a robust recovery going."
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> Atif Mian, now a Princeton professor, came to focus on how finance can destabilize an economy. He saw how foreign money had flooded Latin America in the 1980s and Southeast Asia in the 1990s, leading to borrowing booms and financial crises.
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> Not long before the U.S. recession, Mian and another young economist, Amir Sufi of the University of Chicago's business school, saw a similar trend here. "The common link to the emerging market crises," Mian said, "is that it all starts with leverage."
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> The two economists compared what happened in U.S. counties where people had amassed huge debts with those where people had borrowed little. It had long been thought that when property values declined in value, homeowners would spend less because they would feel less wealthy.
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> But Mian and Sufi's research showed something more specific and powerful at work: People who owed huge debts when their home values declined cut back dramatically on buying cars, appliances, furniture and groceries. The more they owed, the less they spent. People with little debt hardly slowed spending at all.
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> Historically, Sufi said, "places that have bigger recessions usually have stronger comebacks." But his calculations showed that since the end of the recession, places with high levels of debt have not had robust recoveries.
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> Other economists — from both political parties — were making the same point around the time Obama came to office. Blinder, a Clinton administration official, and MartinFeldstein, a Reagan administration official, developed plans calling on the government to commit hundreds of billions of dollars to restructure millions of mortgages with lower interest rates and principal balances.
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> Said John Geanakoplos, a Yale economist who proposed a plan to reduce principal: "I think the missed opportunity to forgive principal at the end of 2008 and beginning of the 2009 was the biggest mistake the administration made in trying to deal with the crisis."

So why didn't the Obama administration accept the proposals to reduce homeowner debt? The Post notes:

> But despite exploring many proposals, the administration did not see a plan that did not have the potential to cause "effects worse than the cure," he said, such as **cratering the financial system by forcing banks to absorb huge losses**.

In other words, the government chose the big banks over the little guy, dooming both.

The administration – under the false banner of "homeowner relief" – simply threw money at the big banks to "foam the runway" so they wouldn't suffer a crash landing.

As some of the leading modern economists argue, forcing big banks, bondholders and other creditors to write down some of their bad debts is the *only* way out of our economic malaise.   We need a debt jubilee.

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