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FOR IMMEDIATE RELEASE

AUSTERITY PLANS WILL NOT PREVENT COLLAPSE OF EUROPEAN MONETARY UNION, LEVY SCHOLARS SAY

ANNANDALE-ON-HUDSON, N.Y.— A widespread failure to understand the nature of the debt crisis in Europe is dooming the future of the European Monetary Union (EMU), a new paper from the Levy Economics Institute of Bard College says. In their paper "Confusion in Euroland," Levy President Dimitri B. Papadimitriou and Senior Scholar L. Randall Wray argue that two significant causes of soaring debt levels are being overlooked: the explosion of private debt in many Western countries prior to the financial crisis, and the decision by Germany to carry a large external account surplus.

"Calling this a 'sovereign debt crisis' misses the point," write Papadimitriou and Wray, who show that, taking the West as a whole, government debt grew from 40 percent of GDP in 1980 to 90 percent today, while private debt grew from over 100 percent to roughly 230 percent of GDP. "Government spending did not cause this crisis, and fiscal austerity for the periphery will not solve it."

The authors contend that another overlooked reason for the growth in debt-to-GDP ratios in the developed world as a whole is the rise in current account surpluses in Brazil, Russia, India, and China. Likewise, current account deficits in Greece and the rest of Europe are the mirror image of current account surpluses in Germany. "Any attempt at debt resolution must take these balances into account," they write. "In the eurozone, the only way to pursue austerity while avoiding a crippling slowdown—which would cause a rise in private sector indebtedness—is to facilitate a corresponding reduction in current account deficits in the periphery. But this will only be possible if Germany reduces its external surplus. We cannot sensibly lecture Greece about reducing its debt ratios without asking Germany to move toward a current account deficit."

Papadimitriou and Wray conclude that the refusal of political authorities to consider expansionary policies for creditor nations like Germany leaves deflation on the periphery as the only means to restore competitive balance: "Deflation itself imposes huge costs on debtor nations. It increases the value of their nominally denominated debts, making default, and an EMU breakup, more likely. Until policymakers see these facts clearly, no amount of austerity will prevent the collapse of the European project in its present form."

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One-Pager No. 20: *Confusion in Euroland*

To read the full text of this policy paper or to learn more about the Levy Economics Institute of Bard College, please visit www.levyinstitute.org.

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