# Economist says renewed financial crisis looms unless government acts

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Economist Anne Villamil says signs of a renewed financial crisis already have emerged, including tighter lending as financial institutions brace for surging unemployment that will leave people unable to repay mortgages, credit card bills and other debt. Photo by L. Brian Stauffer

(PhysOrg.com) -- Another crippling financial crisis looms unless the U.S. government thaws credit markets that are starting to freeze up amid a lingering and deepening recession, a University of Illinois economist warns.

Anne Villamil says signs of a renewed financial crisis already have emerged, including tighter lending as financial institutions brace for surging unemployment that will leave people unable to repay mortgages, credit card bills and other debt.

“Defaults will lead to more losses at financial institutions and potentially a return of the financial crisis," she said. "Since U.S. debt is also held abroad, renewed financial turmoil also could lead other countries to reduce their exposure to U.S. debt, which would drive up U.S. interest rates, lead to exchange-rate swings and further worsen the U.S. economy."

Villamil says President Obama is trying to jump start the sagging economy and ward off another financial meltdown through a proposed stimulus plan that includes $825 billion in tax cuts and new spending to create jobs.

But she says the new administration has yet to lay out a specific plan to stabilize the financial system, unlike Great Britain, which recently adopted measures to kick-start lending and quell concerns about the health of the nation's banks.

In the U.S., Villamil says likely solutions are bank recapitalizations, potentially including government ownership; government acquisition of "toxic debt"; and federal assistance to homeowners, small businesses and displaced workers to prevent default.

Insolvent banks are a serious threat to the nation's economy, already mired in its deepest downturn since the Great Depression, she said.

Troubled financial institutions may not provide consumer and business loans that are essential for commerce, Villamil said. Alternatively, imprudent loans could be made that effectively gamble bank funds at taxpayer risk in hopes of returning banks to profitability.

"Government intervention to address the financial crisis is essential because the government is the only agency that is big and patient enough to address the problem," she said.

Villamil studies financial contracts and the impact of inflation on public finance. She is co-editor of the Annals of Finance and an associate editor of Economic Theory, the European Economic Review, and the Quarterly Review of Economics and Finance.

Provided by University of Illinois