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Larry Summers: U.S. Economy in Deep Trouble.

Lawrence Summers, former U.S. Treasury Secretary under Bill Clinton, warned in an op-ed this week that the U.S. economy is in far deeper trouble than most people understand.

The subprime crisis, he wrote in *The Financial Times*, has moved from being a financial system issue to a potentially recession-inducing “threat” to growth, one that will affect the entire world and last for years.

“Even if necessary changes in policy are implemented, the odds now favor a U.S. recession that slows growth significantly on a global basis,” Summers wrote.

“Without stronger policy responses than have been observed to date, moreover, there is the risk that the adverse impacts will be felt for the rest of this decade and beyond,” he wrote.

Summers cited several statistics, including a housing market that is in “free fall” from prices that seemed to be at “basement levels a few months ago.” One forecast sees house prices declining as much as 25 percent over previous highs.

Foreclosure rates will accelerate, he pointed out. Adjustable-rate mortgages will soon begin to reset to higher rates, forcing the pain to spread to other credit markets, like credit card and auto loans.

Banks simply won’t be in a position, in that case, to keep ahead of the steam on the economy. New lending will wither, and even “good” borrowers will encounter trouble, pushing prices down even harder as the number of buyers dries up, Summers warned.

Add to that a weakening dollar, high energy costs and problems in the Middle East.

The U.S. government must quickly enunciate a clear public policy regarding the financial system or face the consequences of a crisis that feeds on itself and will likely continue to do so for longer than is necessary, Summers urged.

The government must own up to the reality of the problem — and do it quickly.

“In the U.S. today, as in many other countries in the past, confidence will return the first day an official statement about the economy proves to have been too pessimistic,” Summers wrote.

Is there a way out? Yes, says Summers, and he prescribes three steps: Lower the federal funds rate to stimulate the economy, and potentially offer low- and

middle-income families tax breaks or add spending to foster confidence; establish a clear policy on declining credit availability; and keep up demand for housing, perhaps through direct government loans to home buyers.

Existing adjustable-rate loans likely to default should be automatically converted to lower, fixed rates in many cases, Summers contends.

- “All of this may not be enough to avert a recession. But it is much more than is under way right now,” Summers wrote.