The United State Government's Role in the Great Recession

A classical liberalism perspective

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Macroeconomic Theory

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The Great Recession is a result of inconsistency in our economic system that stems from a mixture of poor expectations and an unpredictable business cycle. It is clear through the great Austrian economists that poor expectations comes from the Federal Government's budget and military spending. The Austrians also clarify that unpredictable business cycles, or booms and busts, come from monetary policy along with irresponsible banking. The government's policy with regards to the budget, military spending, monetary policy and the banking sector is to blame for the economic inconsistency consumers and investors experienced.

With the support of data and economic theory from the Austrian school of economic thought, this economic inconsistency is understood with a classical liberal perspective or libertarian. Professor Engle, a research aid at Harvard Law school and current professor of law at Pericles-ABLE, Moscow, summarizes the libertarian perspective; "They seek to further the natural course of history, the transformation of coercive, hierarchical state power into consensual egalitarian freedom, the formation of a society in which people are free and equal and are not judged by race, sex, gender, or wealth, but only in the basis of their abilities; to create a world without war, starvation, illiteracy, or death from preventable and curable diseases." (Engle 59). This means that a libertarian believes that a perfect society is one of which no coercive, central power is in charge of policy, whether elected or appointed. Instead, states and communities will decide the best system for their environment because no central power will prevail. This allows for a greater efficacy in the economy as emphasis is on the freedom of individuals, permitting citizens to have the choice of what happens with their incomes and restricting the government's control over this income. From this perspective, it is clear that the Great Recession is a result of poor expectations from the unbalanced budget and excessive military spending along with a government-influenced business cycle encouraged through monetary policy and poor control of banks.

To begin, we will address why poor expectations from the unbalanced budget and excessive military spending have contributed to the Great Recession. First, let us define expectations as the view consumers and investors have on the economy that has an influence on economic models and output. In a journal contrasting various view of expectations, it is explained that in the Austrian context, “Individuals’ expectations […] (as “dispositions to act” as in Hayek) and they plans they induce will generate varying degrees of coordination depending on the extent to which the institutional context satisfies certain conditions.” (Butos and Koppl 355) This means that in the Austrian mindset, expectations are views that affect the actions of consumers and investors in a competitive market framework. Although, some may argue that this has no effect on economic models when, in fact, it could largely influence models. An easy counterargument to this is accomplished through the example of September 11. The effect of this event had a huge impact on stock markets through a panicked anticipation of markets. In an article on Investopedia, it is stated that after a market closer, “On the first day of NYSE trading after 9/11, the market fell 684 points, a 7.1% decline, setting a record for the biggest loss in exchange history for one trading day.” (Davis). This shows that expectations play a major role in markets. This means that the policies the government implements with regards to their budget and military spending have a huge impact on the expectations of investors and consumers.

With regards to the US budget, its unbalanced state during the Great Recession had a huge impact on the markets. We will define an unbalanced budget as a financial statement in which the revenue of a firm does not meet the expenditures and must be made up through liabilities or debt. In contrast, “a balanced budget is one where the government’s revenue meets its expenditures." (O'Connor 356). Firms must balance their budgets in order to maintain investors' interest and keep the firm from collapsing. The US needs to do the same as the state of the budget has a huge impact on expectations. An academic journal critiquing state budgets states, "The budget process is imperative to any government because it represents the goals and objectives of government officials and provides a source of public accountability." (O'Connor 356). This means that what is stated on the government's budget reflects on what the government plans to accomplish and gives them accountability. As we now understand how the state of a

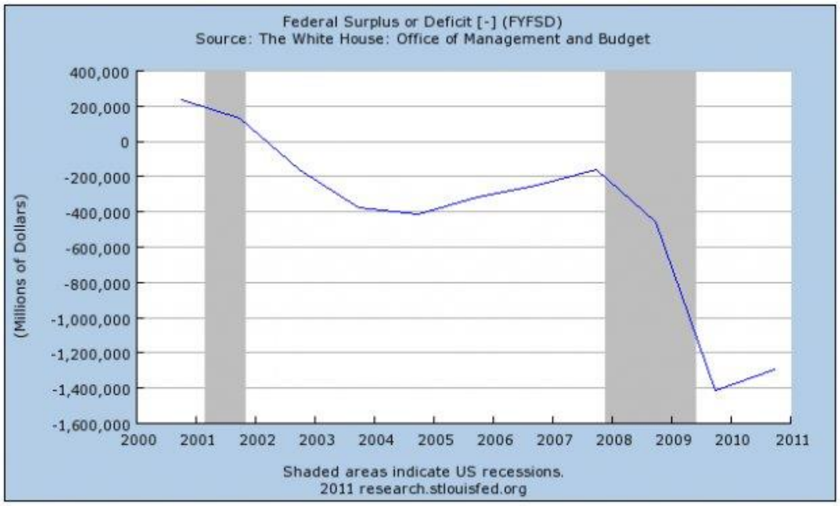

Figure 1: This shows the state of the US government's budget historically. Provided by Business Insider.

government's budget affects investor and consumer expectations, let us apply this to what was happening during the Great Recession with regards to the budget. Figure 1 gives some models regarding the historical state of the US deficit. It shows that during the Great Recession highlighted as the grey area furthest to the right, the government had its budget at a considerable unbalanced state. This was mostly due to borrowing in order to try to stimulate the economy and bail out financial institutes. We notice in Figure 2, a model of the US GDP historically, including

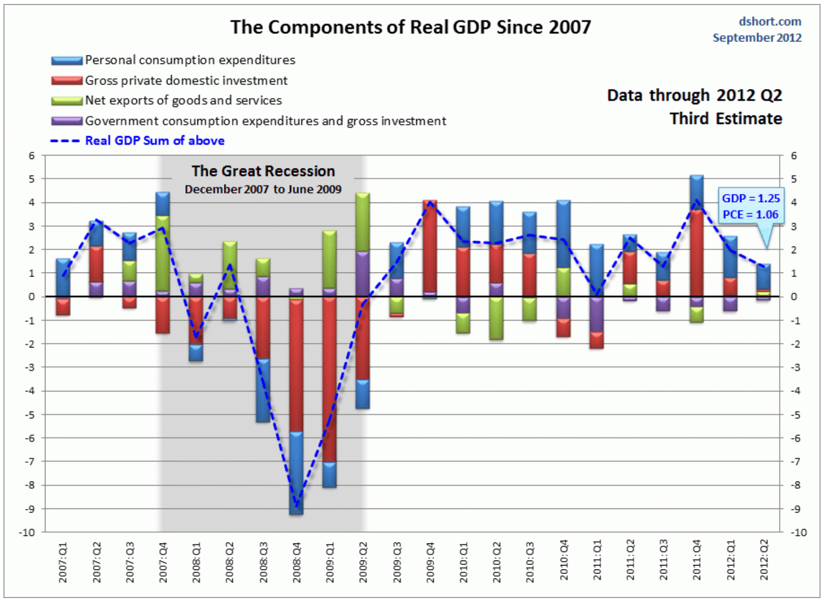

Figure 2: This shows the state of the US GDP historically. Provided by Business Insider

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gross private domestic investment and personal consumption expenditures. Comparing the two models, we notice that during the Great Recession, the large amount of government deficit correlate to an unusual decrease in investment and consumption. Therefore, during the Great Recession, the unbalanced state of the US budget contributed to a lowering of expectations which contributed to a huge decrease of investment and consumption, lowering GDP.

In addition to poor expectation during the Great Recession stemming from an unbalanced budget, we notice the state of military spending having a large impact on expectations. From a libertarian perspective, war is frowned upon because it destroys the individual freedom of others. A common rhetoric: how can we be free when we are preventing other countries from achieving their freedom? In addition to the war being a complete moral hazard, the war on terrorism contributed to poor expectations on the economy during the Great Recession as well. A professor of law at Pericles-ABLE, Moscow, Russian Federation, Dr. Eric Engle states that “War is the ultimate dysfunction, the inability to resolve conflict rationally. Wars may be easy to start but are always unpredictable and difficult to terminate.” (Eric) This is an example of a scholarly source agreeing through his research that wars can lower expectations because the outcome is uncertain. We notice in Figure 3 that Since the September eleven attacks, US military activity and spending has increased significantly. We can correlate this to Figure 2 and notice that this has an impact on GDP as well. The war in the Middle East has significantly lowered expectations and contributes to the decrease in investment and consumption during the Great Recession. In Summary, we have shown that the war on terror along with the state of the US budget have

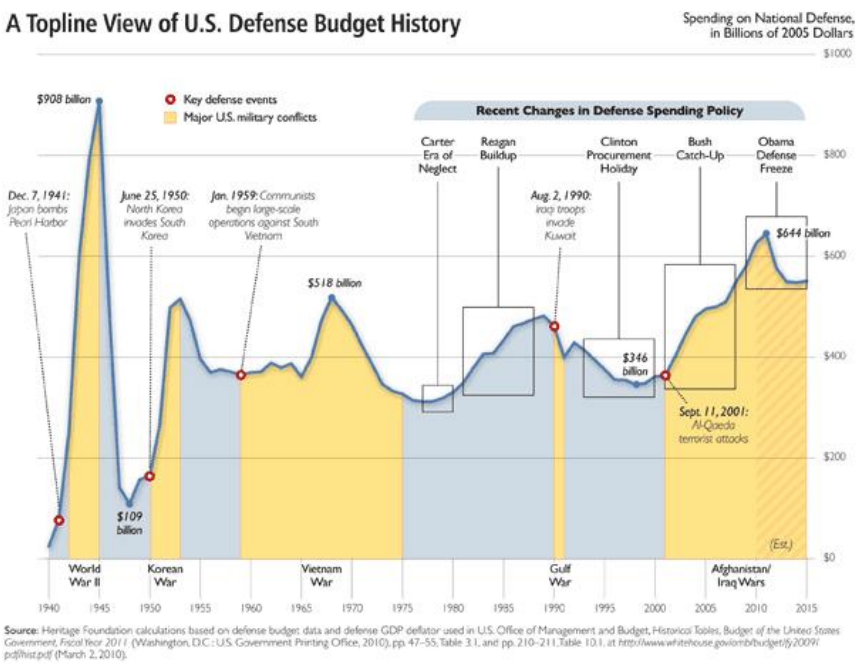

Figure 3: This shows the US defense spending and we will focus on the rise in spending since September 11

contributed to poor consumer and investor expectations which has been a major cause of the Great Recession.

In addition to expectations being a major cause in the Great Recession, we notice the business cycle outlined by the Austrian school of economics was a cause of the Great Recession.

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