Economic Downturns and Government Intervention

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Extended economic downturns affect all Americans in a dramatic way, so it is important to determine why these downturns occur. Additionally, it is of interest to study why some downturns are short lived, while some go on for quite some time. That will be achieved in this paper through examining historical examples in the United States economy. With each economic downturn presented, the cause of the downturn, the government reaction to the downturn and the outcome of these actions will be discussed. Special attention will be paid to the downturn of 1920-21 and the Great Depression, as these events provide a useful example to downturns that were close together in time. For foundational purposes, there will be a brief description of the Austrian Business Cycle, as it is the theoretical basis used for the rest of this paper. Economic downturns are part of the boom bust cycle, and are made more lasting through various government interventions in the time of crisis.

The Austrian business cycle is the theory that will be used throughout this paper to explain the actions of the economy. The Austrian business cycle attempts to explain the major question of why we have booms and busts in the economy: why Federal Reserve interventions cause a cluster of business errors. The cycle is brought about by expansion of credit by a central bank usually in control of a fiat currency. This expansion of credit creates false expectations for entrepreneurs. It seems as if people in the public are saving and investing more than they actually are. The false perception of saving and investing causes entrepreneurs to invest in ventures that appear profitable but are in actuality not what the consumer wants. The capital that is being invested is not real, but appears to be real because of the artificial credit expansion. This happens more in the
capital goods markets than in the consumer goods markets. Capital goods markets expand faster in the boom, but then are also hit harder in the bust.¹

Increased ventures by entrepreneurs cause the economy to enter a boom. This is a period of apparent prosperity where the economy is on an upward swing. This continues on for a period of time, but since it is artificial, it has to end eventually. There comes a time when entrepreneurs realize that the projects they have invested in are not profitable. Upon this realization, these projects are left abandoned, wasting the sunk resources that were used to start them. This is the bust. The bust is necessary to the business cycle because it is the readjustment of the economy after the mal-investment in the boom.

Governments are mistaken when they try to fight the boom, because they are keeping the economy from adjusting back to its normal state. This theory of the business cycle suggests that one should look at the actions of the government in reaction to an economic downturn to determine what causes its persistence. Rothbard states it as follows

Since the government and its controlled banking system are wholly responsible for the boom (and thereby generating the subsequent depression), and since the government is largely responsible for aggravating the depression, we must necessarily concentrate on these acts of government intervention in the economy. An unhampered market would not generate booms and depressions, and, if confronted by a depression brought about by prior intervention, it would speedily eliminate the depression and particularly eradicate unemployment. Our concern therefore, is not so much with studying the market, as with studying the actions of the culprit responsible for generating and intensifying the depression - government.²

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² Ibid., 82-83.
The first downturn to be discussed is the Panic of 1819. It is known as “America’s first Great Depression.” The foundation of the crisis can be found in the effects of the War of 1812, which did much to alter America’s economic situation. American producers were not able to trade abroad, decreasing their total trade flows. The boom occurred in the post-war economy. There was a great boom in real estate prices, as there was a great deal of public land for sale that would be bought by speculators. The prosperity of the farmers who were able to work this land carried through to the urban areas because there was still a close connection between the agrarian and urban economies.

The monetary situation leading to the Panic of 1819 was poor. There was a rapid growth in the number of banks in the United States, with an increase from 208 to 246 charted banks in 1815 alone. These banks were also releasing more monetary notes that they were not able to back up with specie. In the same year, 1815, there was an increase in the notes released by these banks from 46 million dollars to 68 million dollars. Not only were these banks releasing an increasing amount of notes, there was no stable value for the notes. Each bank in each state had fluctuating values for their notes, making it difficult to do business. The Second Bank of the United States was chartered to remedy these problems. It first began operation in 1817 with the mission to fix the problem of monetary inflation and the inability of consumers and the government to redeem notes for specie.

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5 Ibid., 7.
The year 1818 saw a continuation of the boom, as the Bank of the United States failed to act as a limiting force in the economy and became part of the problem through engaging in expansionary measures. The Treasury wanted the Bank to accept all state bank notes, especially when received in payment for public land. The Bank essentially just set an expansionary example for the states at the national level. Between 1816 and 1818, the number of chartered banks in the United States grew from 246 to 392. The boom also continued with more speculation on land in rural and urban areas, causing artificially high property costs. In addition, the Federal government increased spending from 700 thousand dollars in 1816 to 14 million dollars in 1818 on various construction projects. Finally, imports into the United States increased at a rate that allowed them to outstrip exports.

There were various problems that occurred during the boom that are cause for concern for the future bust. People began to lose confidence in the ability of the banks to redeem their bank notes for specie as the redemption became more nominal than real. As people lose confidence in banks, it becomes more likely that bank runs will occur as people feel it is necessary to get their specie while there is still some available. Additionally, the Bank of the United States was responsible for paying back the Louisiana debt, the money that was paid for the Louisiana Purchase. This debt was over four million dollars and included domestic and international banks, making it a big burden for the new Bank.

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7 Ibid., 10.
8 Ibid., 11.
The boom ended when the Bank of the United States realized they could no longer continue to expand, and was forced to enter monetary contraction. In the summer of 1818 the Bank took several deflationary actions. The branches of the Bank in various states were told to redeem balances and notes owed to them by state banks.\(^9\) The contraction helped the Bank to increase their specie reserve from two and a half million dollars in 1818 to eight million dollars in the spring of 1821, a result of the collection of debts, which also made state banks contract. The severe monetary contraction that was taking place throughout the country caused a stream of bankruptcies. Those who had engaged in projects throughout the boom found that they were not able to complete the project with the decreased money supply. Additionally, the contraction led to a scramble for a cash position and an eagerness to sell stocks of goods at very low rates and a rapid and severe decrease in prices.\(^10\)

An important feature of American economics today that came about from the Panic of 1819 is persistent large-scale unemployment in large cities. This occurred because urban workers did not have as much flexibility as farmers living in the country with employment. Farmers could find another product to produce or a way to get more income from their land, a luxury not experienced by those in cities who were at the mercy of employers.\(^11\)

The economy began to recover by 1821, only a few years after the initial panic in 1818 and 1819. President James Monroe’s approach to the Panic was to ignore it. In various speeches throughout this period, he said that the economy was on the right track,

\(^10\) Ibid., 13.
\(^11\) Ibid., 16.
and while there may have been minor setbacks, they were nothing to really worry about. This reaction was effective, because it is better to have a leader who does not want to admit the economic hardships of his countrymen than one who tries to fix the economy through interventionism.\textsuperscript{12}

Many journalists working during this time promoted the idea that a slow but steady recovery was necessary to teach people the dangers that come with spending money that you do not have. The popular idea of the time was that citizens should develop industry and economy. It was thought that promoting these values in the country among individuals would prevent another occurrence like this in the future.\textsuperscript{13} There was a push by some in the public to have government intervention to fix the economy through actions like relief for debtors, and more monetary expansion at both the state and national level.\textsuperscript{14} The government did not choose any of these options, but allowed the economy to return to its normal state in its own time, after the adjustment was completed through the bust, lessening the effects of the downturn on the country through making it less severe and shorter in length.

The Panic of 1893-1894 is another economic downturn in American history that is instructive in examining the thesis. Industrial Black Friday happened on May 5, 1893, starting off the nationwide epidemic of bank failures that ended up totaling 500 by the end of the year. In addition to the bank failures, there were about 16,000 business failures during this time period. The crash eventually turned into an industrial and business depression that affected everyone in the country. A study that looked into

\textsuperscript{13} Ibid., 21-22.
\textsuperscript{14} Ibid., 24.
different indicators of depression found that the economy fluctuated from high to low
about one fourth during this panic, compared to a fluctuation of one half during the Great
Depression.\footnote{Samuel Rezneck, "Unemployment, Unrest and Relief in the United States during the Depression of 1893-97," The Journal of Political Economy 61 (1953): 326.} The winter of 1893 brought a lot of suffering to Americans, as the
depression after the initial downturn set in. Discontent and unrest were characteristic of
this Panic, resulting in events like Coxey’s “Commonweal Army” and the Pullman
strike.\footnote{Ibid., 325.}

The slow recovery inspired citizens to take action. Coxey’s “Commonweal
Army” was made up of unemployed workers from all over the country. They marched
from Ohio to Washington, D.C. in the spring of 1894. The march ended on May Day
with a conflict on the grounds of the Capital where several of the leaders were arrested
for trespassing. The Pullman strike came in July of 1894. The American Railway Union,
representing workers upset with persistent wage cuts, faced off with the General
Managers’ Association. The conflict was centered in Chicago, where the federal
government intervened by prohibiting the union from interrupting the delivery of mail.
To control the violence, the federal government sent in federal troops. The result of the
strike and subsequent violence was more than twenty people dead and the destruction of
over 2000 railroad cars.\footnote{Ibid., 333-335.}

There was more debate over the federal government’s role in recovery during this
Panic than there had been in past panics. It was not only the worst downturn in American
history to that point, but it also brought about the violence discussed above. The
American Federation of Labor called for setting a legal eight hour workday and a
government issue of five million dollars to fund public works projects. In 1893 New York Governor Flower rejected a demand for special public works funding rejecting the argument that it is ultimately the responsibility of the government to bring about relief from unemployment through public works projects. He worried about the precedent it might set, “…In America the people support the government; it is not the province of the government to support the people…”

Finally, the economic downturn that took place between 1920 and 1921 is an excellent example of a severe downturn that was not followed by an extended depression due to the government response. Before the First World War, the world economy was ruled by the free market to a great extent. There were some protective tariffs, private monopolies and international cartels, but these were not large enough to effect the functioning of the economy. During the War, there was a drastic increase in government control on the economy. Every belligerent nation and some of the non-belligerent nations imposed controls on prices, production and the allocation of labor. This brought about artificial stimulation of the regulated sectors of the economy and artificially restricted other sectors. Though most of these restrictions were lifted at the end of the War, it was not easy to regain the prewar economic balance. An additional problem with the war period is it damaged international trade when all the belligerents, with the exception of the United States, went off the gold standard. This brought about inflation in those countries which made the prices between countries quite disparate.

19 Ibid., 332.
Another factor in bringing about the recession in 1920 was problems with the Peace of Paris, the treaties that ended World War One. Some of these problems include the growth of economic nationalism which was exemplified through new protective measures. The United States took part in this to levels that had never been seen before. The Emergency Tariff Act, passed in 1921, introduced an absolute embargo on German dyestuffs to protect the American dyestuffs industry. The United States only had this industry to protect because they confiscated German patents for the goods during the War. In 1922, the United States passed the Fordney-McCumber Act which brought about the greatest tariff rates in American history. Various monetary and financial problems from the provisions of the treaty were also problems in the post-war economy.21

The economy was in the boom phase of the business cycle in the years leading up to the bust. The banking system brought about a massive increase in the supply of money when the Federal Reserve cut the reserve requirements in half. Banks also went through a good amount of credit expansion that caused the boom to progress further. Between the time the Federal Reserve opened in 1914 and January of 1920, total bank deposits more than doubled. The bust was set into motion by the Federal Reserve. Throughout the First World War and for a few years after the end of the war, the discount rate was kept low. The discount rate is the rate at which the Federal Reserve lends money to banks directly. In 1919, the Federal Reserve recognized that the discount rate could not be kept artificially low any longer and raised the rate. This caused the economy to slow from the boom and readjust into the bust.22

The downturn in 1920 was severe. Between mid-1919 and mid-1920, production in the United States had fallen over 21 percent. This caused conditions to be worse than they were in 1930, after the first year of the Great Depression.\(^{23}\) Deflation rates in the downturn are between 18 percent and 13 percent, depending upon the dataset used. In comparison to the Great Depression, which had the highest deflation in the third year at 11.5 percent, this downturn was more severe.\(^{24}\)

By the end of 1920, industrial production had fallen 25.6 percent below the highest recorded rate for January of that year. In July of 1921, industrial production reached its lowest level at 32.6 percent below the January level. In just 18 months, industrial production fell 32.6 percent. Part of this decrease was a decline in automobile production by 60 percent. At that same time, wholesale prices for goods were 42.9 percent the May 1920 level. In 14 months, wholesale prices fell a total of 42.9 percent. The prices of wholesale goods had risen drastically in the First World War, and this bust eliminated more than 70 percent of that rise, which is a good reflection of the adjustment power of the bust.\(^{25}\)

President Harding responded to this downturn with a great deal of restraint. In his speech accepting the 1920 presidential nomination he said:

> There hasn't been a recovery from the waste and abnormalities of war since the story of mankind was first written, except through work and saving, through industry and denial, while needless spending and heedless extravagance have marked every decay in the history of nations.\(^{26}\)


\(^{25}\) Ibid.

Though he was advised by his Secretary of Commerce, future President Herbert Hoover, to use government interventions to turn the economy around, Harding allowed it to go through the adjustment process. Some aspects of Harding’s approach include reducing the government’s budget by more than half between 1920 and 1922, rather than spending his way out of the crisis. Additionally, Harding cut tax rates for citizens in all income groups and reduced the national debt by one third. The government also cleaned up credit weakness, reduced the cost of production and allowed a private enterprise free reign. The Federal Reserve really played no role in the economy in this time, and did not respond to the crisis.²⁷

President Harding’s choice to respond to the downturn in a laissez-faire manner kept this temporary adjustment from turning into an extended depression like the one that occurred just a decade later. The market was allowed to make the necessary corrections. A process that was painful, but short-lived for the people of the United States. The economy was able to recover in just a matter of a few years. The turnaround of the economy took place around August of 1921. After the recession was over, production was able to quickly get back on an upward track. Industrial production was back to the rates it had been at before the recession in October of 1922. By 1923, full employment was regained, with an unemployment rate of only 2.3 percent.

The next great contraction in the United States is the Great Depression. The boom of the roaring 1920s brought about the Great Depression. There are many theories on what brought about the Great Depression, but Burton Folsom identifies three main causes of the Great Depression in his book New Deal or Raw Deal. The first is the

negative consequences which were discussed above. Second is the Smoot-Hawley tariff which was passed in 1930. This brought about the highest tariff rates the United States had experienced. This is part of the economic nationalism discussed above. This act put tariffs on 3,218 goods that had not had tariffs in the past, while also increasing tariffs on 887 goods. The Smoot-Hawley tariff not only crippled international trade, but made domestic production more difficult through imposing on tariffs for goods used in production. This whipsawed the producers, because they not only sold fewer of their goods overseas, but also had to raise prices domestically, causing them to sell fewer goods. The third cause of the Great Depression provided by Folsom is the actions of the Federal Reserve. Throughout the 1920s, the Federal Reserve pursued inflationary policies. They did this through raising interest rates four times between 1928 and 1929, which amounted to an increase of two and a half percent.28

Other indicators of the impending depression include that while there were substantial increases in production in various sectors between 1922 and 1927, prices did not fall. Additionally, the money supply increased about 55 percent between July 1921, the end of the 1920-1921 downturn to July 1929, months before the start of the Great Depression. Most of that inflation was caused by businesses taking out loans from banks. (Woods 2009, 96-97) Mises commented on this time period as follows:

> It is clear that the crisis must come sooner or later. It is also clear that the crisis must always be caused, primarily and directly, by the change in the conduct of the banks. If we speak of error on the part of the banks, however, we must point to the wrong they do in encouraging the upswing. The fault lies, not with the policy of raising the interest rate, but only with the fact that it was raised too late.29

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It became clear that the Great Depression when Black Friday and Black Tuesday hit in October of 1929, when worried investors sold off their assets in a frenzy, causing the stock market to crash. From a high in September 1929 to a low in November, rails and industrials fell 47.3 percent and industrial stocks fell 52.9 percent.\textsuperscript{30} Once this initial shock hit, the Federal Reserve responded quickly and assertively. The Federal Reserve expanded credit a total of $312,000,000. That equaled a 23.3 percent expansion in total bills and securities, from $1,337,000,000 to $1,649,000,000. The Federal Reserve also purchased $150 million in government securities during the week following the panic.\textsuperscript{31} This swift action by the Federal Reserve only served to make an already dire situation even worse.

Though Hoover is often remembered as a lassiez-faire president, his actions upon the onset of the Great Depression were anything but lassiez-faire. He claimed to believe in limited government, but his actions suggested otherwise. He took actions after the market crashed in 1929 to the extent that no other president had before him. The only way in which his actions were limited was that he did not intend all of them to remain after the crisis was over. Some argue that the labor market failed because of Hoover and his industrial labor program. He held White House Conferences where he advised employers to not cut wages and to use labor sharing programs when employment needed to be reduced. He also banned immigration, increased deportations and issued propaganda to discourage new workers from entering the workforce. Without the

\textsuperscript{31} Ibid., 222.
implementation of these policies by Hoover, the Great Depression likely would have been something like three times less severe and would also have been shorter.\textsuperscript{32}

Andrew Mellon, Hoover’s Secretary of the Treasury, had been through a similar situation in the 1920-1921 downturn and had seen how effective the lassiez-faire approach had been. He advocated the same kind of do-nothing liquidation plan for the 1929 downturn, but Hoover chose to pursue his interventionist policies instead. He attempted to stimulate the economy through government spending and protecting jobs. He thought he could prevent the bust through propping up wages. He thought that high wages were the cause of prosperity, when in fact prosperity causes high wages.\textsuperscript{33}

Further, Hoover launched public works projects, raised taxes, extended emergency loans to firms that were failing rather than letting them fail, hurt international trade through the Smoot-Hawley tariff and lent money to states for various relief programs such as the Emergency Relief and Construction Act. He reflected on the decision to intervene in the economy saying, “…Two courses were open. We might have done nothing. That would have been utter ruin. Instead, we met the situation with proposals to private business and the Congress of the most gigantic program of economic defense and counterattack ever evolved in the history of the Republic.”\textsuperscript{34}

After Hoover’s policies proved unsuccessful, Franklin Roosevelt was elected by the American as the man they wanted to lead them through one of the toughest times in American history. Rather than see the results of Hoover’s actions, and trying the alternative option, doing nothing, Roosevelt decided to take Hoover’s basic ideas even

\textsuperscript{33} Ibid.
\textsuperscript{34} Ibid.
further through implementing the New Deal and all the programs and agencies that came with it. First, President Roosevelt sought to help agriculture though increasing farm prices and propping up the prices of agricultural products. He did this through the Agricultural Adjustment Act (AAA). Essentially farmers were paid to not produce on their land in a time where hunger was a prevalent problem. The thought behind this was that if there was increased scarcity for food, the prices would stay higher. The government also kept food in warehouses and destroyed crops that were “overproduced.” The Secretary of Agriculture was the person who was to make decisions regarding how much of a good should be produced. Additionally, farm prices were pegged to their 1910 values.35

President Roosevelt also allowed businesses to organize into cartels through suspending antitrust laws. The government also established minimum prices for many goods and limited output. The NRA, National Recovery Act, had each industry write a code of fair competition for their industry, with both companies and the government working together to determine what the code would be. Laborers were also given more power to organize and act in a way that had a great effect on employers. One entrepreneur that refused to sign the code of fair competition for his industry was Henry Ford. He did not think the program was right, and went as far as to call it “un-American.”36

Another action taken by Roosevelt to attempt to remedy the Great Depression was raising taxes. Hoover had set the precedent for taxes in the Depression decade by

36 Ibid., 43-59.
implementing a revenue bill that increased tax rates to near wartime levels. First, he continued increases in excise taxes that had originated with Hoover. Originally, excise taxes had been primarily on vice goods, such as tobacco. Hoover added taxes on luxury goods that affected upper class citizens, as well as on everyday necessities that affected middle and lower income groups. Roosevelt chose to keep the majority of these taxes in place throughout the Great Depression. Though excise taxes were an effective way to raise income, they are a regressive tax and hit the poor the hardest. In a time of depression when the poor are out of work and hungry, a regressive tax is not the best way to aid them.

In addition to increasing excise taxes, the New Deal increased income taxes dramatically. While excise taxes paid for most of the New Deal programs, Roosevelt wanted to tax the rich. In 1935, the income tax for the top segment of earners was 79 percent. This removed incentive for the highest earners to want to continue to earn more since such a great percentage went right back to the government. Roosevelt also put a variety of nuisance taxes into place. These included an indirect sales tax and a tax on all manufacturers.

Roosevelt thought that a public works program was necessary to employ workers and stimulate aggregate demand until the economy picked up again. These public works programs were heavily in infrastructure development. These relief programs were expensive, especially in a time when government revenues were decreased. In 1927, total

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38 Burton Folsom Jr., *New Deal or Raw Deal*, (New York: Threshold Editions, 2008), 122-123.
39 Ibid., 131-132.
government expenditure at all levels of government was 12.8 percent of GDP, a number that increased to 17.86 in 1940.\textsuperscript{41} At first, Roosevelt’s administration gave out direct aid to the states through the Federal Emergency Relief Administration. Roosevelt then came to the conclusion that it was bad for people’s moral and work ethic to simply give out money, so he created the Works Progress Administration that was tasked with creating jobs for the unemployed. Most of the jobs performed by the WPA were not necessary tasks. Performing these jobs was more of a waste of capital in a time where it was hard to come by.\textsuperscript{42}

Similar in some ways to the Great Depression, the inflationary recession of the 1970s is another example of a downturn that persisted due to government intervention. A common view of the cause of the recession is that it was caused by oil shocks. These shocks were caused by OPEC countries forming a cartel and taking deliberate actions to increase the price of crude oil, a good that was widely used by consumers around the world. The price increase was quite severe, as in 1973 the cost was three dollars a barrel and by 1980 it was $30 a barrel. The reasoning for this argument is the inflationary cycle begins with expectations by people of continuous increases in goods. From there, more is bought in the short term, which created higher demand, leading to a demand for higher wages, pushing prices higher yet again.\textsuperscript{43} While this cycle could cause prices to increase, it cannot be blamed for the entire recession.

The real cause of the downturn and the depression was monetary expansion. There were mistakes made in monetary policy in the time period of 1968 to 1971. These

\textsuperscript{41} Elliot A. Rosen, \textit{Roosevelt and the Great Depression and the Economics of Depression}, (Charlottesville: University of Virginia Press, 2005), 152.
\textsuperscript{42} Burton Folsom Jr., \textit{New Deal or Raw Deal}, (New York: Threshold Editions, 2008), 83-84.
\textsuperscript{43} Rondo Cameron, \textit{A Concise Economic History of the World}, (New York: Oxford University Press, 1997)
mistakes include decreasing reserves of gold to cover the paper dollar and printing more paper money. Additionally errors made in the period of the recession, from 1971-1974, led to more rapid inflation in 1978. The decade of the 1970s started with a generally poor economy that was made worse by wars in the Middle East and problems with the supply of oil.

Throughout the 1970s, there were various periods of inflation, recession and high unemployment. In the 1970s, the price of gold spiked to over $800. Additionally inflation rates increased to over fourteen percent. In this time period, the cost of oil inflated, though it was not necessarily reflected in the price of oil. In the time prior to the Arab Oil Embargo in 1973, the United States had pegged oil process at three dollars a barrel. In the second half of the decade, the civilian rate of change and the rate of change in consumer prices decreased. Changes in the unemployment rate and the consumer price index indicate the nature of the decade as well. In the first half of the decade, 1971-1974, the unemployment rate was 5.4 percent while the consumer price index was 6.6 percent. Those figures can be looked at in comparison to the statistics for the second half of the decade, 1974-1979. In this time period the unemployment rate was 7.9 percent and the consumer price index 8.1 percent. These figures illustrate how the

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decade played out. In addition, there were a number of highly publicized and well known labor disputes throughout the decade.\footnote{Albert E. Schwenk, “Compensation in the 1970s,” \textit{Bureau of Labor Statistics}, accessed January 23, 2011 \url{http://www.bls.gov/opub/cwc/cm20030124ar05p1.htm}.}

The government responded to this downturn in an active manner. Initially, the government attempted to remedy the crisis through comprehensive wage and price controls. This was done because of lingering memories of the Great Depression and the results of restrictive monetary and fiscal policies used to contain inflation during that time. Policy makers did not want to increase unemployment through these policies. Starting in August of 1971, the federal government began to use wage and price controls to respond to high inflation.\footnote{Ibid.}

The Nixon administration put his New Economic Policy into place, even though it went against his stated economic principles, which were more in the free market vein. He said, "Philosophically, however, I was still against wage-price controls, even though I was convinced that the objective reality of the economic situation forced me to impose them."\footnote{Daniel Yergin and Joseph Stanislaw, “Nixon Tried Price Controls,” \textit{The Commanding Heights}, accessed December 14, 2010 \url{http://www.pbs.org/wgbh/commandingheights/shared/minitextlo/ess_nixongold.html}.} The New Economic Policy froze wages and prices for 90 days in an attempt to reduce the rate of inflation. When considering this policy, not much thought was given to what would happen after the 90 day period was over. The goal was to be able to pursue a more expansive monetary policy. The Quality of Life Council was appointed to watch over and determine these price controls. After these policies were put into place there
was a net decline in unemployment, leading the policy makers to believe they had made the correct decision.\textsuperscript{51}

The Nixon administration then pursued inflationary fiscal policy. Inflation then began to increase again, due to dominate wage and price pressures, synchronized the international economic boom, and crop failure in the Soviet Union. After inflation increased again, Nixon reimposed the freeze in 1973, but this time it became apparent right away that it was not effective.\textsuperscript{52}

Finally, it is instructive to examine the current economic bust and examine how it came about and what has been done about it. The interest rate was lowered to one percent by the Federal Reserve after the dotcom bust in 2001 in an effort to provide an easier transition. In 2004, the Federal Reserve forced the interest rate back up in an effort to avoid inflation.\textsuperscript{53}

An interesting comparison can be done between President Hoover and President Bush and how they reacted to an economic crisis. One trait these presidents had in common was they both stated free market beliefs before entering office are remembered that way by history. The facts do not support this, as while Bush was in office he increased government spending by over a trillion dollars, as well as increasing spending as a percentage of GDP by almost three percent, the highest level since 1994. When he

\textsuperscript{52} Ibid.
came into office there was a budget surplus, but he left the budget at a deficit over three percent of GDP.\(^5^4\)

The second bubble burst near the end of Bush’s second term in office. The first thing they did was the typical response of having the Federal Reserve cut the interest rate. The federal government then started to put into place a set of programs to correct the economy. The first of these was the Term Auction Facility, which the Federal Reserve enacted to auction off loans. In 2008, Bush signed the Economic Stimulus Act, which gave $150 billion in tax rebates. Then the government took over Fannie Mae and Freddie Mac. TARP (Troubled Asset Relief Program) increased insurance on deposits. Finally, the Treasury Department got involved too through purchasing $125 billion in stock from various United States banks.\(^5^5\)

Government intervention in economic downturn only serves to extend the downturn. Economic downturns are a natural and necessary part of the boom-bust cycle. Actions taken by the government to intervene and try to fix the economy is what exacerbates the downturn and can then turn it into a depression. The Panic of 1819, the Panic of 1893 and the economic downturn of 1920 are all examples of economic crises where the government practiced restraint and brought about recovery sooner. The Great Depression, the 1970s, and the current downturn are examples of times when the government has made a significant effort to fix the economy, and it resulted in extending the time of financial hardship for Americans to an unnecessary level. This information is very instructive for the future, hopefully the government can learn to allow the economy to work on its own rather than interfering with it.

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\(^{55}\) Ibid.
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