Column | July 7, 2013

Private Sector Caused Recession

By Mark Weisbrot

After five years of abnormally high unemployment since the Great Recession began, it is strange to hear people with access to major media still claiming that the solution lies in smaller government for America.

It was not the government that got us into this mess; it was the private sector. An $8 trillion bubble in the real estate market was the cause of the Great Recession, when it burst.

The arithmetic is fairly straightforward: private spending on construction collapsed and homeowners cut back on spending and began borrowing against their homes when their housing wealth disappeared.

And then state and local governments tightened their budgets, laid off teachers and other workers, and added to the downward spiral of output and unemployment.

The federal government actually played a positive role for a while with its stimulus program, saving about 3 million jobs. But the stimulus was much too small — the government stimulus, after subtracting the impact of the states' budget tightening, was only about one-eighth of the private demand lost from the bursting of the real estate bubble.

That is the basic accounting of the Great Recession, as well as the reason for the weak economy and tragically high unemployment from which we continue to suffer.

To the extent that the government has had anything to do with this, the problem has been its doing too little: failure to provide enough stimulus in response to the collapse as well as lax regulation of such financial sector giants as Goldman-Sachs, Merrill-Lynch, Lehman Brothers and others helped inflate the housing bubble with reckless and sometimes fraudulent lending and investment practices.

Also, ironic for the libertarians, one of the most important positive responses to the Great Recession — one that has made the most difference in preserving employment and income — has come from the Federal Reserve.

The Fed has created more than $2.3 trillion since 2008, in addition to lowering short-term interest rates to near zero and keeping them there. This has provided a major boost to the economy, and Ben Bernanke made a mistake last week by giving markets the impression that the Fed might begin to reverse course sooner than expected.

Again the problem is only in the government doing too little, not too much, in response to a weak economy.

Paranoid fantasies that the Fed's money creation (quantitative easing) would cause high inflation and might cause long-term interest rates to rise because of fears of future inflation have proven unfounded.

Consumer price inflation is still extremely low at 1.4 percent over the past year, and even after Bernanke's remarks, 10-year Treasury note rates are at a historically low 2.5 percent.

Interestingly, conservatives who are against the Fed's intervention to promote employment did not complain when the Fed actually caused most of the recessions of the past half-century by raising interest rates. This was done deliberately to raise unemployment, so as to push wages down — with the argument that this is the best way to reduce inflation.

This example is one of many which illustrate that the debate between conservatives and their opponents is not really about governments versus markets. Conservatives support very intrusive intervention against "free markets" when it tends to redistribute income toward the rich: for example, increased enforcement of government-mandated monopolies such as patents and copyrights; helping creditors collect debts when they make bad loans; and negotiating "free trade" agreements that only subject working people—but not highly-paid professionals—to increased global competition.

The real debate is not so much about whether we need more or less government or markets, but whether government or markets, which both play important roles in our economy, will continue to be used to benefit the majority or primarily the richest – as has been the case for more than three decades.

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