The Policy Budget in Financial Crisis

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Abstract

The Keynesian theory is used by governments to deal with financial crisis. This research shows the main concepts for this theory. The Keynesian theory recommends that government motivates the economy by increasing spending and decreasing the interest rate. The theory proposes that these two actions will increase the purchasing power for the public. As a result, the demand for products will increase, which thus motivates the private sector to hire more employees, leading to economic recovery.

Keywords: Keynesian, financial crisis

Introduction

Governments can use the Keynesian theory to deal with financial crisis. After the Great Depression, John Maynard Keynes published *General Theory of Employment, Interest, and Money*, which became known as the Keynesian theory. This theory is based on three main assumptions: the labor market equilibrium is based on labor demand, supply, and the real wage; the government can motivate the economy by increasing government spending and/or cutting taxes; and the price level is controlled by the central bank's monetary policy. The Keynesian theory assumes that the government has broad tasks in the economy, and the government is thus motivated to control the economy.

As with any theory, the Keynesian theory faces many criticisms. For example, Keynes failed to include some main issues in his theory such as free trade, tax effects, and legislation effects. Furthermore, he assumed that the public are mainly consumers and not savers. The final criticism is that the Keynesian theory has not been tested; therefore, it is just a hypothesis.

Clearly, in dealing with financial crisis, the Keynesian theory has different approaches than other theories. For instance, the Keynesian theory requires governmental intervention during financial crisis to fill the gap between economic potential and the actual economic output, while other economics theories; such as the Austrian Theory of the Business Cycle assumes that any governmental intervention will lead to a huge disaster. In addition, the Keynesian theory assumes that any increase in aggregate demand will lead to economic growth and decrease the unemployment rate. On the other hand, other economic theories such as the Austrian Theory of the Business Cycle believe that this economic incentive may motivate the economy in the short term, but in the long term, it will negatively affect the economy.

This research shows the main components of the Keynesian theory. Furthermore, it explains details the opinions of advocates and skeptics for this theory. The research also focuses on the implementation of the Keynesian theory in the current financial crisis. Finally, the research aims to show why this theory is more effective in dealing with the financial crisis than other theories and why.

Literature Review

At the end of the Great Depression, John Maynard Keynes introduced his economic theory, which has three main aspects. The first aspect is that a labor market equilibrium is based on three main factors: labor demand, supply, and the real wage (Dymski, 2013). The second aspect is that the government can motivate the economy by increasing government spending (fiscal policy) and/or cutting taxes (monetary policy). For instance, Keynesianism assumes that aggregate demand stimulus will do two main things: expand output, and reduce unemployment. At the same time, monetary policy will be guided by output and inflation goals (Dymski, 2013). The third aspect is that the price level is controlled by the central bank's monetary policy (Lehrman, 2014).

All these aspects work together to decrease unemployment by supporting market forces with limited government intervention (Dymski, 2013).

Furthermore, these aspects show that Keynesianism focuses on the macro-economic level more than on the micro-level. For instance, the central point in the Keynesian theory is what governments should do to avoid and solve financial crises (Dymski, 2013). The Keynesian theory aims to support the private sector because it is the main element of the recovery stage. For instance, the Keynesian theory believes that growth of the private sector will decrease the unemployment rate, which is considered the main issue of a financial crisis. Keynes explained that increasing spending would lead to a deficit in the budget (liquidity trap), but that the government should continue to increase spending because any change in this strategy would lead to an even worse situation.

Skeptics of Keynesianism

Opponents of Keynesianism have five main arguments. The first argument is that the Keynesian theory does not mention free trade. For instance, Keynes assumed that the global trade is not a significant factor because it is reciprocal to both countries involved, which creates a balance in its impacts. Unfortunately, in the twenty-first century, the size of global trade has increased significantly, and it has become a significant economics factor. The second argument is the tax system. Taxes changes affect the economy by either increasing or decreasing money in the hands of the public. As a result, it either motivates or hurts the motivation programs for the economy. The third argument involves how legislation affects the economy. The Keynes theory does not introduce any advice for the government about introducing any type of legislation, which the government should either focus on or avoid motivating the economy. The fourth argument is that Keynes assumed that the public consists of consumers, and he eliminated other choices for the public such as saving. Finally, some scholars assume that the Keynesian theory has not been tested, so it is still a hypothesis.

Free trade. The Keynesian theory missed many main vital issues. The first issue is free trade. Some scholars show that Keynes intentionally ignored this issue. For instance, Keynes assumed that global trade happens in two directions, which creates equal effects, and the result is that there is no significant impact of free trade (Geoghegan, 2011). However, this global economic situation was different in the 1930s when Keynes introduced his theory than it is today in the 2000s. For instance, the US is importing more products than it exports, which means that global trade is a main problem because increasing the US imports means that the purchasing power of US citizens will support foreign economies more than the US economy. For example, between 1998 and 2008, the US trade deficit with China increased more than 400% (Lind, 2011). Furthermore, global trade in this century exceeds the role of imported or exported products. For instance, many companies outsource jobs outside of the US. This issue is considered a new movement, which started at the end of the twentieth century. In the 2000s, US companies hired 2.4 million employees abroad (Geoghegan, 2011).

In addition, there is a strong relationship between the domestic and international markets, and each one affects the other. Global trade directly affects the competition between the international and domestic products, which reflects on governmental spending in social welfare programs. As a result, scholars show three potential effectsof the relationship between free trade and government spending: positive, negative, and no effect. Social welfare spending requires higher payroll taxes, which increases labor costs. At the same time, competition between domestic and international products requires decreasing the cost of domestic products. Therefore, governments face a pressure to decrease social welfare spending (Rickard, 2012). In addition, labor unions are weak, which eliminates any hesitation from the government to cut social welfare spending.

Global trade also directs government spending. For instance, competition requires decreasing the cost of domestic products, so governments subsidize domestic products. In addition, governments use subsidies programs not only for competition but also for protection of citizens' jobs (Rickard, 2012). However, revenue sources are limited, creating an obstacle to expanding subsidy programs (Rickard, 2012).Government faces additional obstacles to increasing subsidy programs as well. For instance, in developed countries, there are some restrictions, which control intervention by the governments in the private sector (Rickard, 2012).In addition, subsidy programs may face objections from other countries. For instance, the US government has an agreement for free trade with other countries such as the Central American Free Trade Agreement (CAFTA) and the North American Free Trade Agreement (NAFTA).

Moreover, two internal groups reject any restrictions on free trade. The first group consists of interest groups. These groups include companies and investors that receive benefits from free trade (Lind, 2011). At the same time, any restrictions should decrease their profits. The second group consists of liberal citizens who believe that everything should be free, and any governmental intervention leads to a disaster (Lind, 2011). Furthermore, transportation and communication costs increase during depression, which affects the prices of imported products (Epstein, 2010).

The Keynesian theory works to motivate the economy to decrease the unemployment rate and increase the money power for the public. The theory, based on the effects of global trade, gives the government two choices. The first choice is that the government should increase the subsidy programs to protect employees from losing their jobs. Furthermore, the government should increase social welfare spending. Increasing both of these programs will support industries to keep their employees, and they will increase the purchasing power for unemployed citizens.

The second choice, because of limited sources for the government, would entail increasing the subsidy programs while ignoring any increase in social welfare programs. This solution will protect employees in industries. At the same time, the government has spending in other programs, which will create opportunities for unemployment. The government will face rejection from other governments because this support will have effects abroad. With both of these choices for government action, Keynes asked every country for national self-sufficiency (Geoghegan, 2011). National self-sufficiency requires the government to have a plan to decrease the global trade by being able to be better meet its own needs.

On the other hand, some economists assume that the US government should make a policy to restrict the free trade (protectionism). For instance, many countries, such as China, Japan, and South Korea, manipulate trade to support their industries in the face of competition. These countries have three main tools. The first tool is tariffs. For instance, China, prior to become a member ofthe World Trade Organization (WTO) in December 2001, had high tariffs on imports (The Office of the United States Trade Representative). Since then, it has worked to decrease tariffs to followWTO rules. However, China rejects decreasing tariffs in certain industries, such as automotive industries (The Office of the United States Trade Representative).

The second tool is to subsidize their industries to decrease the cost of their products. As a result, their products will be cheaper than US goods. The WTO agreement emphasizes that all states should eliminate all subsidies under the Subsidize Agreement. Unfortunately, some countries ignore this agreement. For instance, in May 2004, the Chinese government passed the Policy on Development of the Automotive Industry. This policy aimed to prohibit using any imported parts in the assembly of vehicles. It affected imported parts and foreign industries of vehicle parts. As a result, in 2006, the US, the EU, and Canada filed a trade complaint against Chinawith the WTO to stop this policy. In 2009, China canceled this policy (The Office of the United States Trade Representative).

The third tool is manipulated currency. Some countries push down their currencies to be under estimate (Lind, 2011). As a result, their products will be cheaper in the US market. In 2011, the trade gap with China was approximately $296 billion because of manipulating currency (Isidore, 2012).

The US government can effectively address these manipulative tools by either increasing the import tax or pending any free trade agreement such as NAFTA. Opponents of this idea offer two main reasons for their argument against it. The first reason is that any restrictions on free trade will motivate the US to be isolated because other countries, in turn, will make restricted trade rules that affect US products (Lind, 2011). The second reason is that free trade is a political tool. In 1934, Congress passed the Reciprocal Trade Agreement Act, which gives the president the right to set tariffs. Since then, the US government uses free trade as a political tool to affect other countries (Lind, 2011). For instance, in 1963, Kennedy warned that any protection for the US industries would motivate the US trade partners to be allies with the Soviet Union (Lind, 2011).

The tax system. The second issue unaddressed by the Keynesian theory is taxes. The tax system has four main roles. The first role is that the government can use the tax system to increase its revenue. For example, in the 1920s, Andrew Mellon, the Treasury Secretary, worked to decrease the income tax. As a result, the income tax decreased from seventy-three percent to twenty-five percent by 1925 (Rugy, 2003). Consequently, the US economy responded to the tax cut by increasing largely, especially in the stock market. However, in 1929, the US stock market crashed and the economy crashed in the Great Depression.

In 1932, President Hoover worked to increase the tax rates by passing the Revenue Act. For example, this act increased the income tax from twenty-five percent to sixty-three percent and raised government revenues. Furthermore, in the 1930s, the corporate income tax rate raised from twelve percent to twenty-four percent to further increase government revenues. President Hoover and later President Roosevelt aimed to decrease the governmental deficit by increasing the revenue through increased taxation (Epstein, 2010). Unfortunately, during the 1930s, the deficit of the US budget remained high even though the federal tax revenue increased. The reason for this was that increasing the tax rates requires the government to raise spending to keep the economy growing (Rugy, 2003).

The second role is that the tax system can encourage or discourage the public and private sector to save or invest. For instance, when a government makes a tax cut, it increases the amount of money in the hands of the public, which motivates them to spend. However, some scholars look at this issue from a different aspect. For instance, when a government makes a tax cut, citizens will earn more money. As a result, the public's desire for investing will decrease (Gale & Samwick, 2014). Therefore, tax cuts may not encourage small businesses to invest. Furthermore, the tax cut motivates the private sector to invest more because the demand will increase. On the other hand, when a government increases the taxes, it decreases the public's ability to buy, which decreases demand. As a result, the private sector works to save.

The third role is that the tax system can redistribute wealth. For instance, in 1932, Raymond Moley, a professor of law at Columbia University from 1928–1954, and Adolf Berle, the manager of city's fiscal affairs between 1934 and 1938, suggested that the government should undistributed corporate profits. This new tax would encourage the private sector to either distribute profits to the public or invest profits in expanding. Both results would increase the purchasing power for the public, either directly or indirectly. The direct way increases the money in the hands of the stakeholders. The indirect way occurs when the private sector expands as it will hire more people, which increases the purchasing power for the public.

The fourth role of taxes is the ideological aspect. For instance, neoliberalism works to create free markets, so it supports any movement to cut taxes (Prasad 2012, 352). Tax cuts lead to a free market, both directly and indirectly. Directly, a tax cut gives the public and the private sector more space to invest or save. The indirect way is that the tax cut enforces the government to decrease spending (Prasad, 2012). As a result, the intervention of the government will be limited. Furthermore, the tax cut can be used as a political tool. For instance, since 1976 the Republican Party has used the tax cut to attract followers (Prasad, 2012).

On the other hand, some scholars show that the taxes do not affect economic growth. In 1981, President Ronald Reign signed the Economic Recovery Tax Act of 1981 (ERT) into law. The ERT reduced the individual income tax by five percent on October 1, 1981. Then it would be decreased another ten percent on July 1, 1982. Finally, another ten percent would be reduced by July 1, 1983 (Delaney, 1981).Unfortunately, some researchers find that this act did not result in any economic growth (Gale & Potter, 2002). Furthermore, Fabio Padovano and Emma Galli, assistant professors at University Roma, conducted research that analyzed the impact of taxation on the economic growth for four decades since 1950 for the Organization for Economic Co-operation and Development (OECD) countries, of which the US is a member. The researchers found that there is no significant impact of taxation on the economic growth (2001). For instance, reduction by ten percent in the marginal tax rate will increase the growth rate by 0.11 percent, and this change is considered tiny (Gale & Potter, 2002). Changes in taxes do not affect the economic growth because when a government increases taxes, it decreases the national saving, which then has no impact on the economy (Gale & Potter, 2002).

Other scholars assume that impacts tax changes depend on many factors. For instance, changes in taxes are insignificant in developed countries. At the same time, they have significant impact in undeveloped countries (Gale & Potter, 2002). Furthermore, the impacts tax changes depend on the kind of tax. For instance, a change in income tax has a significant impact on economic growth, while a change in corporate tax is insignificant in terms of affecting economic growth (Engen & Skinner, 1992). In addition, whether the tax cut or increases are permanent or temporary affects the impacts tax changes (Souleles, 2002). A permanent tax changes has more effects than a temporary tax change. Furthermore, the tax cut motivates the public to spend more if it results in a small amount gradually rather than one huge amount (Souleles, 2002). Finally, lower-income people are more likely than high-income people to spend more when they have an opportunity to do so created by a tax cut.

While the Keynesian theory works to increase the buying power for the public through low interest rate. It does not mention the tax policy, which can eliminate any effect of low interest when the government increases taxes. This act passed four years later thanthe Keynesian theory. Therefore, Keynes wrote his book while he was noticing increasing taxes in the US, and he did not incorporate that in his theory.

In addition, the Keynesian theory aims to increase money in the market. Therefore, if Keynes included this factor, he would advise that governments should decrease taxes to expand public spending (Epstein,2010). For instance, in 1933, Keynes sent a letter to President Roosevelt, warning him against increasing taxes (Thorndike, 2010). Furthermore, Keynes might be asking the government to increase income tax for just the rich people. The rich people prefer to save their money more than spend it, and the Keynes theory works to decrease savings in any part of society (Thorndike, 2010; Maggs, 2004). Furthermore, increasing taxes on the rich motivates them to invest, which affects the aggregate demand. Unfortunately, the Revenue Act of 1932 increased the tax for all levels of income because the goal was to address the deficit, but, in 1935, President Roosevelt signed to create higher taxes for the rich (Thorndike, 2010).

On the other hand, many economics experts assume that changing taxes does not have an effect on total demand. They assume that the change will transfer the purchasing power from one to another (Thorndike, 2010). For instance, when the government increases the taxes, it transfers the purchasing power from the public to the government to support the economy. Furthermore, the tax system can redistribute wealth.

New legislations. The third issue is that the Keynesian theory ignores the extensive new legislation that affects the cartelization of industries. For instance, the minimum wage and overtime acts affect the labor market. Furthermore, the Affordable Care Act will affect the labor market by increasing the expenditure for the private sector, which means reduced hiring (Epstein, 2010). Furthermore, increasing or decreasing taxes affect the Keynesian plan to solve the problem. For instance, President Obama increased taxes in 2012 withthe Job Protection, and Recession Prevention Act of 2012, which should affect and motivate the economic plan (McEowen, 2013).

Consumption. Furthermore, Keynesian's theory looks for and considers the public in just one aspect, consumption. For instance, Keynesianism assumes that low interest rate will motivate the public to spend more. This assumption ignores other public choices (Epstein, 2010). For example, the public, when the economy is in recession, is worried because the unemployment rate is high, so they tend to save more money rather than spend it.

Did not test.Finally, some experts see the Keynesian theory as just a hypothesis that has never been tested. For instance, Keynes introduced his theory when the Great Depression was almost finished. The Keynesian theory also did not make any improvements in the1970s recession. At the same time, Keynesianism advocates show that the 1970s recession had a different problem. For example, during the 1970s recession the unemployment rate was high and inflation was high which created a different economic picture than what the Keynesian theory works to solve (Pettinger, 2013). In addition, advocates show that the US and the UK solved the Great Depression by increasing defense spending because of war. Therefore, advocates assume that governments tend to increase spending only in severe situations such as war (Pettinger, 2013).Furthermore; the real experiment for the Keynesian theory is the financial crisis of 2008. At the same time, skeptics of the Keynesian theory assume that if it is tested, it will fail (Kates, 2014).

Implementations of Keynesianism in the Financial Crisis

The government works to build economic growth, which can happen in two ways. First, the government can increase spending. Second, the financial institutions can lend money (Galbraith, 2010). Economic experts who talk about increasing spending are applying the Keynesian theory. The Keynesian theory uses fiscal policy to maintain the economy when it faces recession or inflation. For instance, in the Great Depression, Keynes asked governments to increase spending to support the private sector and to decrease interest rate to support the public purchasing power. Some critics say that Keynes's theory does not introduce a deep analysis to solve the economic problem. For instance, Keynes's theory does not suggest an adequate percentage of increased spending or an adequate decrease of the interest rate. In addition, Keynes did not indicate where the money should be allocated. This is creating a conflict inside the US Congress between Republicans and Democrats.

The US government increased spending to get out of recessions. Increasing government spending with tax cuts is a framework for the government to maintain the economy by way of Keynes's theory. The spending increased approximately fifty percent from 2002 and 2009 (Fraser, 2012).Spending increased from approximately $2500 billion in 2002 to approximately $3700 billion in 2009 (Fraser, 2012). Furthermore, the spending is still in high level.

In 2007, the United States spent more than $650 billion on national defense. This number is the highest number since 1945 (Wilkerson & Williams, 2008). The main point is how the increase in the defense budget motivates economic growth. Spending on defense imposes opportunity costs on a nation. Some researchers find that increasing spending on defense boosts overall economic growth in a short time, especially when the country faces external threats (Wilkerson & Williams 2008). In addition, recent studies find that since 2001, spending on defense has added 0.5 to 1.0 percent to the GDP (Wilkerson & Williams, 2008).

The Keynesian Multiplier

Keynes assumed that when the government spends a dollar, in reality it supports the economy two dollars or more. For instance, when the government spends $100 million on infrastructure, it means that infrastructure companies will increase their revenue and projects. As a result, the companies would hire more employees. Employees would use their salaries to buy goods, which means that they will support other companies. Thus, the government will have helped two or more companies with the same money. Keynes also explained many factors that affect the value of spending. For instance, decreasing the interest rate increases the multiplier for the spending (Cassidy, 2011). In addition, how the central bank reacts to an increase in spending affects the Keynesian multiplier.

Keynesianism mentions that the global trade also affects the multiplier, but the global trade in the 1930s was balanced. On the other hand, there is a big difference between 1936, when Keynes introduced his theory, and 2011. For instance, when the government increases spending, it means more projects for private companies. As a result, companies hire more employees who spend money on goods and services. However, when people buy from Wal-Mart or Target, they are supporting China's economy. Furthermore, the US imports more than export, which means that the free trade for the US negatively affects the multiplayer (Geoghegan, 2011). Therefore, the multiplier theory sends a signal for the government to maintain its free trade with other countries. Furthermore, Keynes assumed that the private sector would increase spending because of increasing its revenue. In reality, the private sector saves money more than investing when it faces uncertainty (Carling, 2012).

Keynes's Opinion about Deficit

Keynes talked about the deficit in the budget of the government as a normal situation for increasing spending. Furthermore, he said that the deficit has a purpose. As a result, he warned against spending cuts, and he said the consequences would be very harmful for the economy. On the other hand, some scholars assume that Keynes was talking about the period when the US was the biggest creditor in the world. Therefore, he was not worried about the US deficit budget. Furthermore, Keynes was asking the US to help other countries to get out of their deficit (Geoghegan, 2011).

Criticism of Increased Spending

There are many reasons that economic experts would oppose an increase in spending. First, citizens would pay the deficit bill in the future (Lee, 2012). For instance, the current deficit means that interest rates would increase in the future, which would have a negative effect on the citizens' lives. Second, when the government spends more money with the aim to hire citizens, it decreases productivity. The government's goal is to decrease unemployment but that encourages public and private organizations to hire unproductive people, which would lead to a decrease in the productivity of employees in the country (Lee, 2012). Third, some critics assume that the government increases spending to support specific companies because the big winner for increasing spending is private organizations.

Unfortunately, economic experts have not found any significant improvement. For instance, the unemployment rate is still high. According to the Bureau of Labor Statistics, the unemployment rate is still higher than the rate in 2007. Furthermore, the unemployment rate has increased since 2008, and it is still high. Furthermore, the GDP growth rate is still struggling (Haubrich & Waiwood, 2012). It growth rate is still below the expectations, and it is still near zero. In the first quarter of 2013, the GDP rate was 2.5.

This percentage is not bad, but it is still less than expected. In addition, the US import prices are still high, and it almost equals those in 2008. For instance, the US trade deficit increased from $84 billion to $324 billion between 2001 and 2013 (Boselovic, 2014). Looking at these economic statistics, economic experts indicate that increased spending has not been efficient.

To achieve the Keynesian theory goals, some scholars believe that the government should include two main aspects in its implementations for the Keynesian theory. The first aspect is taxes. For instance, some scholars show that some taxes cuts do not always motivate the economy. One of the main groups is rich people. Many researches show that rich people tend to save money more than spend when they have a tax cut. Furthermore, firms in the private sector in financial crisis focus on saving than investing when they have tax cut. The second aspect is global trade. The US should fix the deficit in the external trade.

The US government can make some restrictions, or it can subsidy the local products.

Taxes

In the 1990s, the US had a budget surplus. Furthermore, in 2001, the US economy was in recession. As a result, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The EGTRRA added a new tax brackets, and it decreased the income tax for almost all tax brackets. Changes have been implemented in both the percentage of the income tax and the number of brackets. Furthermore, the EGTRRA changed the division of tax brackets. For instance, the first tax bracket for single citizens was divided to two tax brackets in 2002. The first tax bracket in EGTRRA was for people with income below $6,001, and the income tax decreased to be ten percent for this bracket (Gale and Potter 2002, 136). The second tax bracket was for citizens who earn between $6,000 and $27,951, and the income tax did not change from fifteen percent. The third tax bracket encompasses people who earn between $27,949 and $67,701, and the income tax decreased from 27.5% to 27%. The fourth tax bracket was for people who receive between $67,699 and $141,251, and they should pay 30%instead of 30.5%. The fifth tax bracket is for people who earn between $141,249 and $307,051, and the income tax decreased by a half percent to be 35%. The last tax bracket is for citizens who earn more than $307,050, and they should pay a tax of 38.6% instead of 39.1%. Furthermore, there were more tax cuts in 2002 and 2003 (Maggs, 2004).

Furthermore, the EGTRRA provided numerous education subsidies. For instance, citizens who earn less than $130,000 could have education expenses up to $3,000 in 2002-2003 and up to $4,000 in 2004-2005 (Gale & Potter, 2002). Citizens who earn between $130,000 and $160,000 could take a deduction up to $2,500 in 2004-2005. Furthermore, the contribution limit on education IRAs increased to $2,000 instead of $500, and it included elementary and secondary schools.

In 2003, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) was signed by President Bush. The JGTRRA accelerated many parts of the EGTRRA (Bell and Entman, 2011).The JGTRRA affected the all income tax brackets except the first two brackets. For instance, the third income tax bracket decreased to be 25%.instead of 27%. In addition, the fourth and fifth income tax brackets gradually decreased by two percent to be 28% and 33% gradually. The sixth income tax bracket decreased to be 35% rather than 38.6%. These two acts, the EGTRRA and the JGTRRA, are called the Bush Tax Cuts, and these acts were implemented until the end of 2010.

The Bush tax cuts increased the money in consumers' hands by $621 billion, and the consumer spending increased to be 2.5 percent, which is considered a good percentage during a recession (Maggs, 2004). This percent increased to 3.1 in 2004, but this percent was lower than usual, which should be four to five percent in recovery years. Scholars give two reasons for that. The first reason is that the majority of the cuts belong to the high-income taxpayers whom prefer to save more than spend it (Bell & Entman, 2011; Sloan, et al. 2004). For instance, in 2002, approximately the half of the beneficiaries was people who earned more than $75,000 a year. The second reason is that the US government ignored the deficit in the budget that would happen because of two programs: Social Security and Medicare. Instead, it based its decision on the surplus in the 1990s budgets (Gale & Potter, 2002).

The EGTRRA was planned to be implemented in up to nine years. As a result, the money increased in the hands of businesses and investors, which motivated firms to expand and hire more employees.

Furthermore, the Bush Tax Cuts supported investment in another way by focusing on dividend and capital gains (Gale & Samwick, 2014). On the other hand, supporting investments were focusing on housing and finance (Gale & Samwick, 2014). As a result, the impacts of the tax cut were not significant.

At the same time, the US government revenue decreased as a result of the tax cuts. For instance, taxable returns decreased four percent, and the total income tax decreased 10.4 percent in 2001 (Campbell & Parisi, 2001). At the same time, the US government increased spending. Reducing the taxes and increasing the spending led to a deficit in the US budget in 2002.Governments have limited time to cut taxes because they will face a problem of deficit. Therefore, economists assume that when a government makes a tax cut, in the future it should either increase taxes or decrease spending (Gale & Samwick, 2014). Therefore, The Bush tax cuts expired at the end of 2010, which motivated the Obama administration to increase the taxes again with the Job Protection and Recession Prevention Act of 2012.

On January 1, 2013, the act passed the Senate as the American Taxpayer Relief Act of 2012. On January 2, 2013, President Obama signed the act into law (McEowen, 2013). The desire to save or invest varies based on income. For instance, some scholars believe that rich people aspire to save money more than invest it. As a result, economists suggest that the government should increase the income tax on rich people. As a result, the American Taxpayer Relief Act of 2012 made two main changes. The first change is that it made a new tax bracket for people whom earn more than $400,000. The second change is that the marginal tax rate for the new tax bracket is 39.6 percent. Furthermore, this law increased the tax on long-term capital gains from fifteen percent to twenty percent. In addition, it increased the tax on dividends from fifteen percent to twenty percent as well. Moreover, this act aimed to end the tax deductions gradually for individuals who earn more than $250,000 or couples who earn over $300,000.

Facing the Global Trade Problems

To face the global trade problems, the US government has focused on maintenance of the foreign trade scale. It works in two main roles: fighting unfair practices, and attracting foreign factories. For instance, some countries subsidize their products to be cheaper in international markets. Furthermore, the US government can motivate foreign industries to be inside the US, which increases hiring unemployment.

As the research previously mentioned, foreign countries can use three main tools to support their products: tariffs, subsidization, and undervalued currency. These tools lead to unfair competition with local products. On February 28, 2012, President Obama created the Interagency Trade Enforcement Center. This center was created within the Office of the United States Trade Representative (USTR), and it includes the Department of State, the Department of the Treasury, the Department of Justice, the Department of Agriculture, the Department of Commerce, the Department of Homeland Security, and the Office of the Director of National Intelligence (Executive Order, 2012). Furthermore, the main goal of the center is to investigate unfair trade practice (Isidore, 2012).

The US government can use the same tools to face these problems. For instance, the Chinese government subsided solar factories at a rate between 2.90 and 4.73 percent (Clayton, 2012). Furthermore, dumping is considered a violation based on the WTO rules. As a result, more than twelve solar factories in the US laid off employees, shut down plants, or filed for bankruptcy. Therefore, in 2012, the US government imposed antidumping tariffs of more than thirty-one percent on imported solar cells from China because of the subsidy (Koch, 2012; Bradsher & Cardwell, 2012).

While tariffs aim to protect local factories from any unfair practices, there are some citizens against tariffs because of the resulting job losses. For instance, the tariffs on imported solar panels would increase the price of these products. As a result, citizens would face difficulty in buying them. Therefore, demands would go down, and the employees who work as solar panel installers would lose their jobs. In 2011, approximately 100,000 employees were in the solar panel field, and half of them were in installation (Bradsher & Cardwell, 2012). Thus, tariffs affect the employees who will be at risk of losing their jobs because of decreasing demands.

To face these tariffs, Chinese factories have two solutions. The first solution is that they can assemble their solar panels out of China because the tariffs would be on the solar cell, which was assembled in China. The second solution is that the government of China can directly create a subsidy program to face the tariffs.

Scholars believe that the Chinese currency is undervalued. In June 2010, the Chinese government allowed the yuan to rise, and it increased in value about eight percent. At the same time, scholars believe that the yuan is still undervalued more than eighty percent its real value (Isidore, 2012). To face undervalued currency, in October 2011, the Senate passed a bill to create tariffs on imported products from any country, which manipulates its currency (Isidore, 2012). Unfortunately, this bill did not arrive in the House, and thus, was never passed into law.

Furthermore, the US government has worked to create a balance between imports and exports by attracting foreign industries. For instance, in June 2011, President Obama created the Select USA Initiative, which aims to promote and retain investments in the United States (Morrison, 2014). The Select USA Initiative focuses on Chinese firms. The trade deficit between the US and China had increased even though the US government has taken steps to solve this problem. For instance, the trade deficit was more than $295 billion in 2011, and in 2013, it increased to $318 billion.

Conclusion

Based on how the Keynesian theory deal with the financial crisis, the Keynesian theory introduces tools to motivate the economy to get out of the crisis quickly. Furthermore, Keynes believed that the government has tools to both hurt the economy and fix it. In addition, the Keynesian theory is more effective in mitigating the financial crisis for many reasons. The first reason is that the Keynesian theory introduces a model based on economic analysis. For instance, Keynes believes that to recover markets after any crisis, a government should focus on two main strategies. The first strategy is increasing the money in the hands of the public. To achieve this goal, a government should increase spending on infrastructure projects, which lead to overall growth among companies. As a result, more employees are hired in the country, so the amount of money in the hands of the public increases. This change motivates the public to buy goods, which fosters growth in all kinds of companies in the state. The second strategy is to decrease the interest rate, which encourages the public to take out loans. As a result, money will increase in the hands of the public.

The second point is that the Keynesian theory mentions the problems that governments may face in this model, such as increasing deficits, and it introduces successful ways to solve them. In liquidity trap cases, the Keynesian theory suggests continuous spending because any decrease in spending would cause companies to decrease or stop hiring. As a result, the unemployment rate would rise. When the unemployment rate is high, the public moves toward austerity. As a result, small companies, especially in the accessories sector, close down, further increasing the unemployment rate.

The third point is that when other theories ask governments to stay away from any intervention in the economy, they ignore the truth of economic competition between states. They especially ignore the development, so no state wants to keep seeing its economy going down while competitor countries' economies go up. Therefore, the governmental intervention in this century is a significant factor to ensure that the state keeps in the top ranking of world economies.

On the other hand, the Keynesian theory ignored some main issues. For instance, Keynesianism does not show global trade as a main part in the theory because it was produced in the time when the global trade did not have a major impact on the local economy. Furthermore, the Keynesian theory shows general ideas. For instance, one of the main parts of Keynesian is that a government should increase spending to motivate the economy. The main question here is that all governments have limited resources, so which kind of spending should the government increase and by how much? In addition, the Keynesian theory is based on assumptions, which are not always true. For instance, the Keynesian theory ignores any desire by the public to save, so it assumes that increasing the money in hands of the public leads to increase spending. In some cases, especially during crisis, the public worry about the future and increasing taxes later, so they tend to save more money and spend less.

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