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The Costs of Activist Central Banks

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George Osborne, U.K. chancellor of the exchequer, praises "activist central banks" for ending economic malaise in his country and the U.S. ("How to Keep Proving the Economic Pessimists Wrong," op-ed, Dec. 15). He contends that "activist monetary policy must do whatever it takes to sustain sufficient demand in the economy." In doing so, he makes the case for giving "central banks the space and the independence to do their job." He also supports "an ambitious program of supply-side reform."

Mr. Osborne, however, is silent on the costs of monetary activism. Ultralow interest rates have increased risk taking, created asset bubbles, harmed savers and incentivized debt financing. The size and scope of government is now much larger than it was before the 2008 financial crisis, thus endangering long-run real GDP growth.

Central banks are also much more powerful than before the crisis. Quantitative easing has politicized credit allocation and caused malinvestment. Those distortions will eventually need to be corrected as interest rates rise and monetary policy is normalized. Mr. Osborne is silent on how central bankers will exit from their unconventional measures.

The emphasis on aggregate demand ignores Say's Law that supply creates its own demand. The real source of economic growth isn't activist monetary policy but rather the supply-side factors that Mr. Osborne also favors. A non-activist, rule-based monetary policy would reduce uncertainty and promote prosperity.

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