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The Invisibility of Market Monetarism

Nick Gillespie rounds up the leading explanations for the slowness of the economic recovery:

> Gentle reader, do you think lack of counter-cyclical spending is mostly to blame for the slow recovery? Or is that very spending (read: borrowing), compounded by regulatory and political uncertainty ushered in by a "transformative" health plan, a massive financial-regulation bill, the inability to pass a budget and create a clear path on tax rates is a larger cause here?

Gillespie doesn't mention a third option: the market monetarist view that the slowness of the recovery stems from tight monetary policy. Standard economic theory says that if inflation is projected to be below the Fed's 2 percent target and unemployment is way above the economy's natural rate of 4 or 5 percent, that's a sign monetary policy is too tight.

Too-tight monetary policy would produce exactly the kind of slow recovery we're currently experiencing. But a lot of people have fallen into the trapMilton Friedman warned us about: of taking low interest rates as a sign of loose money. In reality, low interest rates can be a sign of extremely tight money, as with Japan over the last two decades.

Unfortunately, Gillespie's two-sided framing of the debate is pretty much the conventional wisdom. And it's a conventional wisdom that is reinforced by partisan dynamics. Democrats convinced themselves in 2009 that fiscal stimulus was the key to economic recovery. Republicans, for their part, are drawn to theories that blame too much government—spending, borrowing, regulating—for the sorry state of the economy.

The market monetarist position doesn't fit neatly in either of these conventional narratives. Because we see the recession as primarily a monetary phenomenon, most of us aren't enthusiastic about fiscal stimulus beloved by many on the left. But our view also isn't intuitively appealing to conservatives who tend to see "too much" government as the cause of all economic problems.

As a result, journalists who are used to writing left-versus-right stories tend to ignore Friedmanite monetary explanations for the deep recession and slow recovery. I don't blame Gillespie for falling into the same trap as many other journalists. But I hope that Gillespie, a libertarian whose own political position is often invisible to the press, can understand how market monetarists feel.