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Easy Money Is Not Central Planning

The *New York Times* has a review of *Keynes Hayek: The Clash That Defined Modern Economics.* It focuses on the debate between the two great economists about how to deal with the Great Depression. Well, sort of:

After serving in World War I, [Hayek] found his beloved Vienna "devastated and its people's confidence broken," Mr. Wapshott writes. During the ensuing decade, hyperinflation pummeled the Austrian economy, melting away the savings of millions of people.

This experience, Mr. Wapshott argues, hardened Hayek "against those who advocated inflation as a cure for a broken economy." And he came to believe "that those who advocated large-scale public spending programs to cure unemployment were inviting not just uncontrollable inflation but political tyranny"…

In 1936, Keynes published "The General Theory of Employment, Interest and Money," which took on classical economics and people like Hayek who subscribed to its tenets. Keynes's targets included several long-accepted ideas: that employment levels are determined by the price of labor, that supply creates its own demand and that savings automatically translate into investment…

Hayek did not publicly detail any criticisms of "The General Theory." But in 1944, he brought out "The Road to Serfdom," which has become a libertarian classic. Hayek aimed to expose socialism and fascism as twin evils, warning of the potential dangers of central economic planning in the aftermath of World War II.

"It is Germany whose fate we are in some danger of repeating," Hayek wrote.

Keynes was swift to respond, reminding Hayek that the rise of National Socialism was fueled not by big government but by mass unemployment and a failure of capitalism.

I bolded that sentence because it's exemplifies the confusion at the heart of this review, and indeed of a lot of discussion of Hayek and Keynes's legacies. There are actually three different issues at play here. (1) whether central bankers should use easy money to offset the business cycle, (2) whether legislatures should use deficit spending to do the same, and (3) whether governments should engage in central planning, by which Hayek (and those he was criticizing) meant the nationalization of major industries, and the direction of these industries by government bureaucrats.

The *General Theory* focused on the first two issues. *The Road to Serfdom* focused on the third. The latter is not, in any meaningful sense, a response to or refutation of the former. To the contrary, while Keynes apparently found *The Road to Serfdom* alarmist, he also said that "morally and philosophically I find myself in agreement with virtually the whole of it." Keynes was not an advocate of socialism or central planning. And so it's strange that the review juxtaposes the works as though they were two sides in the same debate.

In reality, debates over limited government and debates over macroeconomics have very little to do with one another. Although government efforts to stimulate the economy might involve bigger government, there's no necessary connection between the two. Advocates of limited government will prefer some methods of stimulus (monetary easing, deficit-financed tax cuts) over others (deficit spending). And libertarians might favor abolishing the Federal Reserve and replacing it with a less centralized mechanism for regulating the supply of money. But given that the Federal Reserve exists (which it will at least until Ron Paul abolishes it in 2014), it has an obligation to do its job well, and sometimes that means expanding the money supply in order to boost demand.

This matters because the confusion of these issues seems to have convinced many libertarians and conservatives that easy money is a kind of central planning, causing them to become inflation hawks. But this makes little sense. Given that the Fed has the power it does, it has an obligation to exercise that power wisely. Sometimes monetary policy is too tight, in which case the Fed has an obligation to stimulate the economy by buying Treasury bonds. There’s no reason to think monetary easing puts us on the road to serfdom.