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Quantitative Easing Is A Bottom-Up Policy

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Russ Roberts, the George Mason economics professor who hosts the popular EconTalk podcast, posted a clever video called "Fight of the Century: Keynes vs. Hayek" earlier this year:

It's an extremely nerdy "rap battle" video between John Maynard Keynes and F.A. Hayek. The lyrics to the song are interesting. The refrain starts "Which way should we choose? More bottom up or more top down?" Hayek explains this contrast in more detail around 5:45, in response to Keynes's question "When we're in a mess, would you have us just wait doing nothing until markets equilibrate?":

I don't want to do nothing, there's plenty to do
The question I ponder is who plans for whom?
Do I plan for myself or leave it to you?
I want plans by the many, not by the few.

I found this passage confusing because it seems to lump together several policies that seem quite different to me. On the one hand, you've got stimulus spending. Here, Hayek's anti-central-planning critique seems compelling. When Hayek says he wants "plans by the many, not by the few," I take that to mean that stimulus spending shifts power over the economy (and the resulting wealth) to Washington. There's a real danger that this top-down allocation of resources will lead to money being wasted on make-work projects whose only virtue is that they can be started quickly.

Yet there's another class of government actions that don't seem to fit Hayek's critique. Take deficit-financed tax cuts, for example. Tax cuts *don't* involve "plans by the few." The private parties whose taxes are cut get to decide to spend the windfall. Yet as I understand it, Keynesian theory is indifferent between spending hikes and tax cuts as a means of stimulus. Keynesians would argue that the various possible spending plans and tax cuts have different multipliers, but in principle they're all stimulative.

So it's not clear that Hayek and Keynes are disagreeing here. Combine Keynes's desire for stimulus with Hayek's desire to avoid central planning, and you might get a big payroll tax cut.

The same observation applies to expansionary monetary policy. The government expands the money supply by buying Treasury Bonds. This is an arms-length market transaction that doesn't give the Fed any meaningful control over the allocation of resources in the real economy. The new money the Fed injects into the economy gets spent by private parties, not by the government. It's a "bottom-up," "plans by the many," kind of policy.

A lot of people seem confused about this, though. A while back I asked Robert Murphy for his thoughts on my critique of his sushi allegory, and he pointed me to this thought experiment about the devastating consequences of mischievous gnomes re-arranging the nation's capital stock. He's absolutely right that this would be devastating, but I'm baffled about what this has to do with monetary policy. The whole point of buying Treasury bonds (rather than buying millions of iPads or sending million-dollar checks to friends of members of the Fed's open market committee) is that it doesn't pump money into any specific sector of the economy or open the door for the Fed to do special favors for any particular segment of society. It's the bottom-up *alternative* to top-down stimulus spending.