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On Monetarism and libertarianism

By John Burton

The topic of monetarism lies at the eye of a stormy debate about the general direction of economic policy in Britain today.

The nature and content of this public debate - at least as conducted in the media and Parliament - is often rather dispiriting. Many politicians are quite willing, it is so apparent, to make pronouncements upon a topic about which they have little or no knowledge. The result is that some severely mistaken notions are being perpetrated in this debate, and have been conveyed to the general public through uncritical media reportage. To try to reveal all of the falsehoods that have gained some currency in this ongoing debate on monetarism is quite beyond the scope of this short article. Here, I am concerned with two major and mistaken notions that are implicit in much of the contemporary commentary on monetarism. First many commentators discuss monetarism as if it is a monolithic paradigm, offering but one view of the way that monetary processes work in the economy, and an associated singular set of policy prescriptions. Second, the impression seems to reside, in the minds and mouths of many commentators, that there is some necessary and automatic connection between monetarism and classical liberalism/ libertarianism. As an example of this latter point, it is instructive to note the manner in which the Thatcher Administration's varied economic policies are commonly labelled together by many commentators as being a 'programme of monetarism' - or 'punk monetarism', as Mr. Healey prefers to put it. The current Administration's policies embody, *inter alia*, both a commitment to certain monetary growth targets and (rather limited) commitments to reducing the role of the State in the economy; but these two aspects of policy are, so commonly, labelled under the singular title of 'monetarism' in press coverage.

Both of these notions are in fact incorrect, and their continued existence in public discussion is, I fear, responsible for the fact that much of that discussion represents an admixture of gross over-simplification and pure baloney.

One possible source of these two mistaken notions may lie in the influence that a classical liberal has exerted upon contemporary public discussion! I refer to Milton Friedman, and his recent TV documentary series and book (co-authored by his wife) both entitled 'Free to Choose'.[1] Friedman is the most internationally prominent academic advocate of monetarism. There is a tendency for many to assume that Friedman's particular brand of monetary analysis represents the totality of monetarist analysis. Second, because Friedman is both a noted advocate of monetarism and of classical liberal ideas, the impression seems to have gained currency that there is some necessary and automatic connection between the two. Friedman himself is not responsible for perpetrating these errors: but one can see how his great personal influence on public discussion may have abetted their emergence. The purpose of this article is to overturn these two mistaken notions.

Brands of monetarism

First, let us examine the nature of monetarism. It is not a monolithic school of thought, with Friedman acting as its agreed 'spokesman'. Friedman's monetarism in fact represents only one particular brand of monetarism. Other varieties of monetarist model exist - and yield differing approaches to both macro-economic analysis and policy to that advocated by Friedman - those including rational expectations monetarism, global monetarism and fiscal monetarism. This is not to deny that all schools of monetarism agree on certain fundamental propositions. The most important ingredient, common to all varieties of monetarism, is the hypothesis that monetary changes have impulse dominance in the economy. That is, changes in the stock of money are the predominant factor in causing changes in the level of nominal national income. A second common ingredient is the proposition that the private sector is 'inherently stable': that disturbances in the level of private sector activity result primarily from 'shock' changes in the time-pattern of money supply growth.[2] But, over and beyond these common features of all monetarist analyses, important differences and disputes exist among the variants of monetarism.

One example may bring home the important analytical and policy disputes involved: the differences between Friedmanite monetarists and fiscal monetarists. The fundamental analytical differences involved cannot be treated adequately here; suffice it to say that fiscal monetarists would charge that the Friedmans' and of monetarism ignores any explicit role for relative prices in macro-economic adjustment processes.[3]

The differences regarding economic policy between these two schools of monetarist thought are of particular importance - indeed, of acute relevance to the debate about monetary and fiscal policy in Britain today. Friedmanite monetarists argue that all that is necessary to bring down inflation is for the government/monetary authorities to achieve control of the rate of growth of the money supply, and that the latter can be done without controlling the size of the government's budget deficit.[4] The implication for anti-inflation policy is that "*only* money matters": the size of the public sector borrowing requirements can he ignored. The fiscal monetarists would argue that this is true only of the short run. According to their analysis, a growing budget deficit - even if financed purely by issue of government bonds, and not by money creation - will eventually generate inflation, through the feedback effects that an increased quantity of government debt exerts upon asset markets and the creation of money by commercial banks. The fiscal monetarists do not dispute Friedman's contention that "inflation is always and everywhere a monetary phenomenon"; but they go further than the Friedmanites and argue that a containment of the budget deficit is a necessary condition for the control of inflation in the long run, because there can be no control of the rate of growth of the money supply without containment of the budget deficit.

Over-simplification

We can now see how the public debate on monetarism in Britain today has become grotesquely over-simplified. Mr. Healey's public pronouncements on 'punk monetarism' provide a good example. He does not deny that control of the rate of growth of the money supply is a necessary condition for the control of inflation; but he implies that the current government, and their advisers, have adopted some naive - 'punk'- form of monetarism. What (as I understand him) Mr. Healey is really arguing is that we could allow the level of government expenditure and the budget deficit to be higher (i.e. more job subsidies, industrial 'regeneration' via dollops of government expenditure, etc.) - without any, serious consequences for inflation, so long as a tight grip is kept on the rate of growth of the money supply. In other words, Mr. Healey is adopting Friedmanite monetarism, and arguing that the fiscal monetarist view is incorrect. Yet it cannot be denied that the fiscal monetarist analysis is founded upon a more theoretically sophisticated (or, at least, more complicated!) analysis than that employed by Friedman,[5] or that there is econometric evidence for the UK economy to support the fiscal monetarist view.[6]

None of the foregoing, it should be noted, constitutes a defence of the monetary and fiscal policies adopted by the present government. Indeed, serious criticisms can be made of them, from both Friedmanite and fiscal monetarist perspectives: neither the adherence to announced monetary targets, nor the containment of the budget deficit, as yet attained, is such as to generate much enthusiasm. What I am arguing is that much of the public debate on these policies has been grossly oversimplified.

Libertarianism

I now turn to the question of the connection between monetarism and classical liberalism/ libertarianism.[7] There can be no denying that there is 'an' association between the two sets of ideas, in at least two ways. First, there is an historic association. The classical liberal political economists of earlier centuries - Adam Smith being the supreme example - wrote to destroy previous mercantilist teaching, namely, that a country could make itself rich by protectionism designed to produce a 'favourable' balance of trade, and the importation of gold (money) into the country. Changes in the stock of money, they argued, do not constitute a change in the quality of real resources available to a society - and it is upon the latter (plus the efficiency with which they are used) that the real 'wealth of nations' rests.[8] Second 'a' connection beween monetarism and libertarianism - at least on a head-count principle - continues to exist to this day. It cannot be denied that many monetarists are libertarians and that many libertarians are monetarists. The blurb put out by the Libertarian Alliance about its policy views exemplifies this. It contains the proposition that trade unions are not responsible for inflation ; that the (proximate) origins of inflation lie in excessive monetary growth created or condoned by governments.

However, while there is 'an' association between monetarism and libertarianism there is no necessary and automatic logical connection between these two sets of ideas. It would be quite possible to be a libertarian but not a monetarist; or conversely to be a monetarist but not a libertarian. Let me take these two points separately.

Firstly, even if one rejected both of the common ingredients of all monetarism stated above, it would still be logically possible to hold to a libertarian position. The issue of whether money or 'autonomous' expenditures - this is partly the monetarist v. Keynesian debate - have impulse dominance is not really germane to the libertarian position. I am a libertarian because I hold that a free society is a better society. Scientific arguments about the empirical predominance of certain forces - and that is what the monetary impulse dominance hypothesis is about - are not relevant to that proposition. Let us assume that monetarists and Keynesians are both wrong - perhaps the 'sun-spot theory of the trade cycle' is correct. This would in no way alter my libertarian views: I would still hold that a free society is a better society. Furthermore, even if one rejected, along with Keynes and Keynesians, the second proposition of monetarism - that the private sector is inherently stable - this would not preclude one from being a libertarian. It may be - although I know of no economic evidence to this effect - that the private sector is dynamically unstable. So what? Keynes made the implicit assumption that if it was dynamically unstable, then there was an *a priori* case for government to step in, and do something about it. This is a *non sequitur*, for two reasons. First, macro-economic intervention could, quite easily increase rather that reduce instability - the evidence is strong that 'stabilising' actions by government have more commonly had the *opposite* effect.[9] Second, there is no guarantee that government will utilise any discretionary power it is given as regards monetary and fiscal policy to act according to Keynesian precept, as the 'benevolent despot' that acts in the public interest.[10] It seems more likely that governments will generally use any discretionary powers they have to further their own interests: to indulge in macro-economic manipulation for policital profit. This in fact is the sorry history of Keynesianism: the persistent misuse of Keynesian teaching by governments to run perennial budget deficits. Even if Keynes and the Keynesians were right in the hypothesis that market economies are dynamically unstable - and, to repeat, I know of no econometric evidence to this effect - I would still be a libertarian. Government intervention would make any instabilitiy the worse, and produce a persistent bias to another sort of instability: a bloated and expanding state sector, fmanced by deficits that generate serious economic side-effects.

Divorce

Conversely, it is possible to be a monetarist but not a libertarian. There are, as noted above, some Marxists who would accept basic propositions of monetarism - that money has impulse dominance in macro-economic fluctuations, and that the proximate origins of inflation lie in an excessive growth of the money supply. It is only the 'Inherent stability of the private sector' proposition that they rail against. Such Marxists are, if you like '90% monetarists' and 'zero % Liberatrians!'

When we turn to the actual behaviour of Eastern bloc regimes, the divorce between monetarist and libertarian ideas is also seen to be marked. Although most centrally-planned economics have extensive systems of price control, this does not mean that they reject the need for monetary and fiscal control to contain inflation. Most of them in fact utilise a (very crude) version of the quantity theory, and almost invariably the planners seek a situation of budget balance or budget surplus in state finances. In fact (as in West Germany) earlier experiences of hyper-inflation seem to have given rise to " …a deep strain of conservativism, of monetary and fiscal orthodoxy, in the bank-ers and monetary planners of the centrally-planned economics."[11] Clearly, the rulers and planners of these countries are not averse to monetarist policies; and, equally clearly, they are very averse to libertarian policies.

I suspect that many British collectivists who attack 'monetarism' do not really understand what they are arguing about. They rail against monetarism, when what they are really seeking to attack is anything leading to a reduction in the state's role in economic life. It needs to be stressed to them that there is no necessary connection between monetarism and libertarianism.

Here again I must make it plain that these comments in no way represent a defence of the Thatcher government's policies. It is true that *some* Conservative politicians have been influenced by some libertarian ideas over recent years. But deep strains of state paternalism and corporatism linger in the breast of many Conservatives. The Thatcher government may be committed to monetarism; but I have yet to see much evidence that they will take anything but a few halting steps in the libertarian direction. Be that as it might, the fact is that the public debate on monetarism is being conducted under a fog of illusion and inclarity. If the Thatcher government fails to regenerate economic processes in Britain - or if it does a U-turn - collectivists will harp on the theme that "the return to a free market economy" has failed. Libertarians should take care to guard against that argument now, by debunking the myths that infuse the present political controversy.

Notes

[1] Milton and Rose Friedinan, *Free to Choose: A Personal Statement*, London: Seeker and Warburg, 1980.

[2] Those Marxists who are also monetarists would accept the first proposition, but deny the second; Keynesians would deny both propositions.

[3] See K. Brunner and A. H. Moltzer, 'Friedman's Monetary Theory', *Journal of Political Economy*, 1972, pp. 837-851. (Brunner and Meltzer are the originators of fiscal monetarist theory). A similar charge - that Friedman ignores relative prices in his macro-econoinics - would also be made by 'Austrian' economists.

[4] See, for example, L. C. Andersen and K. M. Carisen, 'A Monetarist Model for Economic Stablisation', *Federal Reserve Bank of St. Louis Review*, April, 1970:

[5] The basic theory of fiscal monetarism is elaborated in K. Brunner and A. H. Meltzer, 'Money, Debt and Economic Activity', Journal of Political Economy, Vol. 80,1972, pp. 951-977; Friedman's basic analytical framework is set out in his 'A Theoretical Framework for Monetary Analysis', *Journal of Political Economy, Vol. 78*,1970, pp. 193-238.

[6] See P. Minford, 'Monetarism, Inflation and Economic Policy', Liverpool Occasional Papers, No. 1, 1980.

[7] To avoid confusion, I shall henceforth generally use the singular term libertarianism in this article. Classical liberals are believers in a minimalist - 'nightwatchman' - state. The term libertarianism, as employed by the Libertarian Alliance in Britain, covers a wider spectrum of thought, ranging through classical liberalism - itself, a wide church! - to anarcho-capitalist positions.

[8] Herein lie the origins of the quantity theory of monay, the central analytical strut of modern monetarism. However, in the light of the foregoing, it is now more precise to talk not of "the" quantity theory of money, but rather a *number* of quantity theories.

[9] The classic example is the "great contraction" in the US in the Thirties. The follies during this episode of "stabilising" discretionary monetary policy are analysed, in great detail, in M. Friedman and A. J. Schwarz, *A Monetary History of the United States, 1867-1960*, Princeton: Princeton University Press, 1963.

[10] J. M. Buchanan, J. Burton and R. E. Wagner, *The Consequences of Mr. Keynes*, London: Institute of Economic Affairs, 1978, Hobart Paper, 78.

[11] R. Portes, 'Inflation under Central Planning', in F. Hirsch and J. H. Goldthorpe, The *Political Economy of Inflation*, London: Martin Robertson, 1978, p. 78.