

## [Demand Matters](#) [1]

Written by [Ben Southwood](#) [2] | Thursday 8 August 2013

Markets are about supply and demand. Scarcely a more banal thing could be said in economics, and yet some of the time it seems like free-market economists look only at supply. Glance over policy recommendations from a free-marketeer and you'll often see only tools for freeing up supply?labour market deregulation, planning reform, a bonfire of the quangos, an end to unbalancing subsidies or tax breaks, liberalisation of trade barriers. These are all fantastic things, which we definitely need. And even through the visor of the AS/AD model, even in a slump, these can make things better both by cutting prices and by raising wealth. But either deliberately or unconsciously, these economists are completely avoiding the demand side.

Is this because there are no doctrinaire libertarian things that can be done on the demand side? I've certainly heard many policies like quantitative easing called "socialism" by fellow travellers, but I'd like to think that my libertarian-leaning friends were more thoughtful than instinctively dismissing ideas they see as ideologically impure out of hand.

And further than that, there *are* things we can do to make the demand side more libertarian, at least if we don't make the perfect the enemy of the good. School voucher systems are not decried for their "socialism" by libertarians despite the fact that under these systems schools are still paid for and run by the state. Monetary policies that are more free market ([and more sensible](#) [3]) than our current one should be looked upon in the same way. It's not the case that anything short of abolishing the central bank is "socialism"?unless we want to completely devalue the word. And even if an intermediate policy were a form of "socialism" or "central planning", the realistic alternative is not a free market in money, but an abysmal central plan!

What are these intermediate policies that free-marketeers seem to be ignoring? Firstly there is [nominal income targeting](#) [4], which relies on markets both to stabilise demand and to allocate that demand among competing industries according to consumer preferences; and secondly counter-cyclical taxes, which rise automatically in good times and fall in bad times. Those are both thoroughly libertarian and entirely focused on demand.

In fact, the two most important libertarian economists of the 20th century?Friedrich A. Hayek and Milton

Friedman?both endorsed demand-side policy, in the right circumstances. [Friedman blamed the US Great Depression on the Federal Reserve](#) [5], allowing a massive collapse in the money supply and aggregate demand. Hayek said that after the inevitable collapse of a misallocated capital structure there could also be "[secondary deflations](#)" [6], where aggregate demand collapses and there is a costly adjustment period. Both would support monetary policy to deal with this issue?stabilising demand, so as to avoid painful adjustments from big inflationary or deflationary shocks. [If money is non-neutral in the boom, why would it be neutral in the downturn?](#) [7]

One response libertarians might make is that [Say's Law](#) [8] shows there is nothing we can do about demand. But Say's Law clearly doesn't hold in the short-run, and Austrian economists who rightly critique the assumptions economists often make about equilibria should be absolutely clear of this. In the short-run, a dip in aggregate demand?absent any response from the government, central bank, or hypothetical free banks working together?necessitates a period of deflation. But we know that (at least nominal)[wages are sticky-downwards](#) [9], meaning that calling for an adjustment to the new equilibrium means calling for years of the [grave evil of unemployment](#) [10] foisted on millions. Say's Law reasserts itself in the medium- to long-run, and by then the misery and destruction of potential wealth has all already happened.

What libertarians are missing is that the relentless focus on supply is leaving them almost completely out of the conversation, and thus [leading to worse policy than necessary](#) [11]. If free marketeers were talking about the [best things to do on the demand side](#) [12], as well as on the supply side, then there would be [less of the all-eggs-in-one-basket big project spending stimulus, and more diverse market-oriented ways of countering the demand shortfall](#) [13].

[blog comments powered by Disqus](#) [15]

---

**Source URL:** <http://www.adamsmith.org/blog/economics/demand-matters>

#### Links:

- [1] <http://www.adamsmith.org/blog/economics/demand-matters>
- [2] <http://www.adamsmith.org/taxonomy/term/5918>
- [3] <http://www.adamsmith.org/blog/economics/despite-its-problems-qe-might-be-right>
- [4] [http://www.adamsmith.org/sites/default/files/resources/ASI\\_NGDP\\_WEB.pdf](http://www.adamsmith.org/sites/default/files/resources/ASI_NGDP_WEB.pdf)
- [5] [http://www.fee.org/the\\_freeman/detail/the-great-depression-according-to-milton-friedman](http://www.fee.org/the_freeman/detail/the-great-depression-according-to-milton-friedman)
- [6] <http://www.coordinationproblem.org/2011/05/hayek-on-deflation.html>
- [7] <http://www.adamsmith.org/blog/economics/austrian-business-cycles-and-neutral-money>
- [8] [http://en.wikipedia.org/wiki/Say's\\_law](http://en.wikipedia.org/wiki/Say's_law)
- [9] [http://scholar.google.co.uk/scholar?hl=en&q=sticky+wages&btnG=&as\\_sdt=1%2C5&as\\_sdtp=](http://scholar.google.co.uk/scholar?hl=en&q=sticky+wages&btnG=&as_sdt=1%2C5&as_sdtp=)
- [10] [http://econlog.econlib.org/archives/2013/04/the\\_grave\\_evil.html](http://econlog.econlib.org/archives/2013/04/the_grave_evil.html)
- [11] <http://www.adamsmith.org/blog/economics/mark-carney-bottles-it-with-baby-steps>
- [12] <http://www.adamsmith.org/blog/economics/welcome-mark-carney-now-heres-what-you-need-to-do>
- [13] <http://www.criticalreview.com/crf/jf/society.pdf>
- [14] [http://disqus.com/?ref\\_noscript](http://disqus.com/?ref_noscript)
- [15] <http://disqus.com>