

[Scott Sumner's right you know](#) [1]

Written by [Tim Worstall](#) [2] | Thursday 14 November 2013



Last time around that we had some vast economic disaster we ended up with the conventional wisdom being that fiscal policy was everything and that, as Keynes pointed out, governments should just spend more in fiscal stimulus and she'll be right. As Friedman and Schwartz then went on to point out this wasn't quite so. The real cause of the Great Depression was not the stock market crash but the monetary response to it. The Fed rather screwing up by allowing the money supply to fall.

As we went through this particular little disaster we had Ben Bernanke no less informing us that Friedman was right and that the Fed weren't going to do that again. Thus quantitative easing and the Treasury/Bank of England agreed and we did the same. The ECB over on the Continent didn't seem to have got the message meaning that the eurozone hasn't had that monetary policy suitable for [the times](#) [3]:

If you are going to criticize Fed policy, you really ought not mention any eurozone policymakers, especially German policymakers. The Germans were the ones pressing the ECB to adopt a tighter monetary policy. How did that work out? Well back in 2009 and 2010 the eurozone and the US had almost identical unemployment rates (close to 10%). Since then the eurozone rate has risen to 12.2% while the US rate has fallen to 7.3%. And what explains that vast difference in performance? Mostly differences in NGDP growth, i.e. monetary policy. And what explains the difference in monetary policy? The Fed was doing one QE after another, with the avowed intention of boosting aggregate demand. The ECB was raising short term interest rates in 2011 with the intention of reducing aggregate demand. Both ?succeeded.?

As Sumner has also gone on to point out fiscal policy is usually ineffective anyway. For while the Keynesian diagrams might convince the politicians (who do so love to spend lots more money) the Central Banks end up taking the monetary actions which negate that fiscal expansion.

The end result of all of this is that monetary policy is the only one that has the desired effects out there in the real world. As, in fact, most Keynesians should agree. For all would agree as long as we're above the lower zero bound and as the various US, UK and Japanese experiences have shown, given QE and expectations management there isn't actually a zero lower bound to constrain the effectiveness of monetary policy.

Or, as I say, we could just conclude that Scott Sumner is correct.

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