Paul Krugman - New York Times Blog

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Calvinist Monetary Economics

Aha. In his latest op-ed, John Taylor comes out as a full-fledged monetary Calvinist. No, not a disciple of John Calvin, the preacher — a disciple of Calvin of Calvin and Hobbes.

Way back when, Mike Konczal felicitously made that analogy to discuss the people who were calling for a rise in interest rates despite high unemployment and low inflation — a group at the time exemplified by Raghuram Rajan. For those who don't read the classics, Calvinball is a sport in which you change the rules whenever you feel like it, very much including in the middle of games.

Back then the tight-money types were inventing new and peculiar principles of monetary policy on the fly; it was obvious that they were looking for some reason, any reason, to justify a rise in rates, because, well, because.

Now Taylor is doing the same thing. He claims that he can show that the Fed's low-rate policy is actually contractionary, using "basic microeconomic analysis". Actually, as Miles Kimball points out, he's committing a basic microeconomic fallacy — a fallacy you usually identify with Econ 101 freshmen early in the semester (and as it happens the same fallacy committed by Rajan).

For Taylor argues that low rates engineered by the Fed are just like a price ceiling that reduces the supply of loans, and therefore reduces overall lending.

Wow. No, the Fed's interest rate target isn't a price control; there is no legal or other restraint on the rates lenders can charge. The Fed is driving down interest rates, or equivalently driving up the price of bonds, by buying bonds; I can't think of any kind of economic analysis in which that would reduce the quantity of bonds sellers end up issuing, that is, the amount of borrowing (and lending) in the economy.

It's just bizarre, and bears no resemblance to anything a clearly-thinking economist would say.

All I can make of this is that Taylor, like Rajan, has some visceral dislike of easy-money policies, and is grasping at anything to justify his gut feelings. And that, ladies and gentlemen, is not how you do economics.