

# Central Planning

Why is it a bad thing for a central planner to allocate resources in an economy? The Soviet experience is one example. Underlying it is the lack of alignment of interest between principal and agent. If one does not reap the benefits of one's investment decisions, those decisions are bound to be less than optimal. A central planner will never offer a better solution than rational independent agents making private decisions.

In my previous posts, I have argued that the setting of interest rates by central banks is already a dangerous compromise to the principle of a free market. So, given that we have made that compromise, and the moral hazard that resulted has taken us in no small part to where we are today, a financial crisis feeding and fed by economic recession, lets ask a couple of silly questions.

Why is it a bad thing for a central planner to lend directly to private consumers and private enterprise? From our initial premise, it is equivalent to allocation of resources, in this case financial capital. It presupposes that the central planner has sufficient information and motivation to act in the best interest of the collective (always a dangerous concept), and isn't too clumsy as to make too many mistakes. Today, however, credit spreads have widened to acutely high levels, despite central banks liquefying the banking system. Banks which previously lent in greed, now withhold credit in fear. We know that a central planner is sub optimal compared with rational agents and their private decisions, but what about times when agents are irrational? (again calls for a very tenuous definition of rational and irrational.)

When government chose to bail out the financial system in the Fall of 2008, it had already abandoned the idea of free market solutions. It must have concluded that a climate of irrationality, or, where individual rationality conflicted with collective rationality, existed. Its efforts included a massive liquefaction of the banking industry, an effort that has so far proved futile as banks have saved the liquidity and placed the capital back with the central banks. The intention to get the banking industry to lend once again has been

foiled.

If the premise remains that a climate of irrationality, or ,where individual rationality conflicted with collective rationality, exists, central planners should be happy to extend their abandonment of market solutions.

Lend directly to private individuals and enterprise.

That is the conceptual argument. The devil is in the details.

More on this later.