Editor's Note

The articles in this issue of the *Cato Journal* were first presented at Cato's 33rd Annual Monetary Conference, "Rethinking Monetary Policy," held in Washington, D.C., on November 12, 2015. At the time of the conference, the Federal Reserve had not raised its policy interest rate since 2006, and had kept it close to zero since 2008. The Federal Open Market Committee then raised the target range for the federal funds rate by 25 basis points in December 2015.

Unconventional monetary policy—characterized by "zero interest rate policy" (ZIRP) and "quantitative easing" (QE), along with macro-prudential regulation—has increased the power of central banks in the United States, Japan, and Europe. Ultra-low interest rates and large-scale asset purchases were supposed to create a wealth effect and stimulate real growth, but those effects have been weak at best. Meanwhile, unconventional monetary policy has created new risks and greatly distorted capital markets.

The monetary base has increased dramatically, along with the size of the Fed's balance sheet, but the monetary transmission mechanism is plugged up by interest on excess reserves, macro-prudential regulation (including, e.g., Dodd-Frank and Basel III), and regime uncertainty. Conventionally measured inflation is low, but Fed policy has encouraged risk taking and helped inflate financial asset prices. Fed watching has become an obsession, diverting resources away from more productive activities.

Money creation is not a panacea and cannot lead to a permanent increase in society's productive capacity or create new wealth. Once rates return to normal, so will asset prices; the Fed's "wealth effect" is really a temporary pseudo-wealth effect. Any benefits of unconventional monetary policy must be weighed against its costs—namely, increased risk taking, misallocation of credit, politicization of investment decisions, decreased private saving and investment, subsidization of government debt, asset bubbles, and rising inequality.

The Phillips Curve is dead but still lives on in Fed models: unemployment has fallen from 10 percent to 5 percent, but inflation has remained less than 2 percent.

The case for ending unconventional monetary policy and normalizing interest rates leads to a deeper issue—namely, how to shape institutions and incentives to achieve a harmonious system of money and banking. That's a fundamental question this volume—and Cato's newly established Center for Monetary and Financial Alternatives—seeks to address.

Contributors to this volume revisit the thinking behind unconventional monetary policy and the "new monetary framework," make the case for transparent monetary rules versus foggy discretion, and point to the distortions generated by ultra-low interest rates and preferential credit allocation. In doing so, they consider what monetary policy can and can't do, what rules could improve the operation of the monetary and financial system, and what steps should be taken to safeguard our property rights in a sound monetary regime.

—J. A. Dorn