EDITOR'S NOTE

The articles in this issue of the *Cato Journal* were first presented at the Cato Institute's 26th Annual Monetary Conference, November 19, 2008. The intent of that conference was to focus on the U.S. subprime crisis, but by the time of the conference it was clear we were facing a full-blown financial crisis. As the real economy has weakened, massive government intervention, including a rapid expansion of the Federal Reserve's balance sheet, has changed the financial landscape. As toxic assets become socialized and government grows, there is an increasing threat to the future of economic freedom.

The contributors to this volume take an in-depth look at the causes of the subprime/financial crisis, reflect on the lessons that can be learned, and consider the way forward to restore financial stability.

Although one can debate the relative importance of the various causes of the subprime/financial crisis, there is little doubt that U.S. housing policy along with securitization and easy money contributed to the asset price bubble in the housing market. Without Fannie and Freddie's status as government-sponsored enterprises, the Community Reinvestment Act, flawed financial-risk models, regulations that encouraged "shadow banking," innovations that allowed banks to overleverage, and Fed policy that kept the real federal funds target rate too low for too long, the subprime/financial crisis could have been averted.

The distinguished contributors to this volume address a number of questions that deserve careful consideration if we are to return to financial stability and maintain it:

- Should the Federal Reserve take account of asset prices in the conduct of monetary policy? Would adherence to a monetary rule help prevent asset bubbles? If so, what should the rule be?
- How can policy rules and incentives be changed to reduce the problem of moral hazard—that is, what steps need to be taken to get prices right so that those who take financial risks bear the full costs of their decisions?
- Was the subprime/financial crisis chiefly the result of the clustering of private mistakes or primarily due to government policy errors, including monetary policy?
- In the case of insolvent banks, is the appropriate policy to bail them out or let market forces determine their fate and use bankruptcy law?

- What institutional reforms are needed to ensure a sustainable financial sector that creates rather than destroys wealth?
- Is regulation the answer or is more radical reform of money and banking called for?
- How will the Fed exit its current strategy, limit its exposure to toxic assets, and maintain price stability?

Much can be learned from the current financial crisis. One of the most important lessons will be the role of government in a free society—especially, the role and scope of the Federal Reserve in protecting the long-run value of money. In a world of pure fiat money, what is to prevent a continual upward drift in the price level?

—J. A. Dorn