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The Cost-Benefit Challenge

In its latest Room for Debate feature, *The New York Times* poses the question "Should the Fed Risk Inflation to Spur Growth?" Befitting a balanced panel of blogging experts, Mark Thoma (*Economist's View*) says "yes," John Cochrane (*The Grumpy Economist*) says "no," and Edward Harrison (Credit Writedowns) says something like "irrelevant question, it's going to do neither."

The whole discussion, naturally, is about differing assessments of the costs and benefits of additional monetary stimulus. Not surprisingly, this was also a theme disclosed in the just released minutes of the July 31–August 1 meeting of the Federal Open Market Committee:

> Participants also exchanged views on the likely benefits and costs of a new large-scale asset purchase program. Many participants expected that such a program could provide additional support for the economic recovery both by putting downward pressure on longer-term interest rates and by contributing to easier financial conditions more broadly. In addition, some participants noted that a new program might boost business merits of purchases of Treasury securities relative to agency MBS. However, others questioned the possible efficacy of such a program under present circumstances, and a couple suggested that the effects on economic activity might be transitory. In reviewing the costs that such a program might entail, some participants expressed concerns about the effects of additional asset purchases on trading conditions in markets related to Treasury securities and agency MBS, but others agreed with the staff's analysis showing substantial capacity for additional purchases without disrupting market functioning. Several worried that additional purchases might alter the process of normalizing the Federal Reserve's balance sheet when the time came to begin removing accommodation. A few participants were concerned that an extended period of accommodation or an additional large-scale asset purchase program could increase the risks to financial stability or lead to a rise in longer-term inflation expectations...

The questions about the costs and benefits of any particular policy intervention are abundant, and for virtually every potential pro there is a potential con. Here is my personal, certainly incomplete list of pros/cons or benefits/costs associated with another round of large-scale asset purchases:

Pro:	Lower interest rates (and perhaps a lower dollar) will on balance spur spending.
Con:	The expectation of low interest rates for a longer period of time will reduce the urgency to borrow and spend.
Pro:	Expanded asset purchases and lower rates will preserve needed liquidity in financial markets.
Con:	Expanded asset purchases and lower rates will create or exacerbate financial market distortions.
Pro:	More monetary stimulus reduces the probability of an undesirable disinflation in the near term.
Con:	More monetary stimulus increases the probability of undesirable inflationary pressures in the longer term.
Pro:	Lower Treasury and MBS rates will induce an appetite for risk taking that is needed to get productive resources "off the sidelines."
Con:	Lower Treasury and MBS rates will induce an appetite for risk taking that sets us up for the next bubble.
Pro:	Monetary policy is the only channel of support for the economy, absent new fiscal policies.
Con:	Monetary policy support is relieving the pressure to make needed fiscal reforms that would be much more effective than monetary stimulus.
Pro:	With additional monetary stimulus, GDP growth will be higher and unemployment lower than they would otherwise be, and outcomes may be more consistent with the FOMC's mandate to promote maximum employment.
Con:	With additional monetary stimulus, the exit from monetary stimulus once the economy improves will be more difficult than it would otherwise be, and outcomes may be inconsistent with the FOMC's mandate to achieve price stability.
Pro:	The performance of the economy has not been consistent with the FOMC's mandated objectives.
Con:	The economy is slowly moving in the direction of the FOMC's mandated objectives, and the Fed should "keep its powder dry" in case of further deterioration of the economy.

Many, if not all, of these benefits and costs are familiar, and there has been no shortage of opinions advanced. To some extent, it is inevitable that the weighting of these costs and benefits will be to a large degree judgmental. How one weights the risks associated with continued high rates of unemployment versus the risks of imbalances that may arise from low interest rates, for example, *is* a subjective thing.

Nonetheless, it would be helpful to frame these subjective judgments with a background of some hard evidence. For example, how much employment can we gain for a given quantity of asset purchases (or any other monetary policy option on the table)? What are the likely—or existing—distortions created by low interest rates, and what do we think are the tangible costs associated with those distortions? And so on.

So, here is my challenge question: No matter what your opinion about what *should* be done, and whether you arrive at a conclusion by casual observation, econometric studies, or historical evidence, what do you think is the best *evidence* concerning any or all of these costs and benefits?

OK, then. Bloggers blog, commentators comment.

Update: Jon Hilsenrath sizes up some of the costs of a new bond-buying program.

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