The Economist posted this week http://www.economist.com/blogs/freeexchange/2012/09/perverse-effects-easy-money (also in today's OECD Press Review):

The perverse effects of easy money

The curious case of William White

Sep 5th 2012, 17:13 by M.C.K. | WASHINGTON

With a few noteworthy exceptions, mainstream academic economists failed to anticipate that the global financial crisis and ensuing collapse of output was even possible. There are several legitimate explanations for this failure, including bad incentives among economists and the absence of a realistic financial system in standard macro models. The most unconvincing excuse, however, is that the crisis was such a freakish event that it was—by definition—impossible to predict. Naturally, this became the academic establishment's main line of defense.

But there *were* people who had accurately foreseen what was to come. These were not astrologers who had gotten lucky but serious thinkers who studied the way the economy and financial system interacted with each other. They just had different models and different assumptions that happened to work a lot better—a very awkward fact for academic economists who pride themselves on being "scientists." As Thomas Kuhn argued in *The Structure of Scientific Revolutions*, new ideas are rarely accepted by an establishment that did not create them. Thus the mainstream has decided to either ignore or ridicule those who dared to be right. The persecution of Raghuram Rajan for his concerns about post-crisis monetary policy should be understood in this context.

Most recently, we have William White, a brilliant Canadian economist who used to do research at the Bank of England and the BIS before taking over the Economic Development and Review Committee at the OECD. He is not, in other words, a nut who hides in the woods with gold bricks and canned food. Moreover, he (along with his colleague Claudio Borio), presented one of the earliest and most thoughtful warnings of the financial crisis back in 2003. Anyone with a brain ought to take him seriously, *especially* when he bucks the conventional wisdom. Thus, this correspondent was very excited to find (via Ed Harrison) that Mr White has just released a thoughtful new paper on the possible "unintended consequences" of actions taken by the big central banks since the crisis. One of its best features is its discussion of the recent literature, including two of the most interesting papers to have been written about the interaction between monetary policy and the financial system since 2007.

Mr White's central thesis is that central banks affect the financial system much more directly than they affect the real economy or even nominal variables such as the rate of PCE inflation or the level of NGDP. As a result, there are times when stepping on the monetary gas pedal does not produce the desired results. During a balance sheet recession, the collapse in interest income hurts savers more than the decline in rates helps prospective borrowers. The collapse of the yield curve threatens the viability of intermediaries and can actually constrain credit creation. The expansion of central bank balance sheets threatens the functioning of the shadow banking system by depriving it of safe collateral. Instead of helping solve the immediate problem, it is possible that central bankers have actually been making it worse. And, of course, there is the possibility that today's monetary policy is planting the seeds for another bubble.

Despite these sensible warnings, Mr White never argues for a sudden change in policy. Rather, he seeks to provide a context for thinking about the tradeoffs that central banks have made and will have to make in the future. Disappointingly, the establishment has not been receptive to this line of thinking. They should not be so quick to judge. Who knows who will be remembered as the modern-day Ptolemaists when the history books are written?