Barnett’s Work on Accurately Measuring Money Cited as Critical in Avoiding Past Fed Mistakes

The critical importance of using the broadest and most accurate measure of money was emphasized in a recent *Forbes* analysis by longtime contributor, Steven Hanke, that highlights the work undertaken by KU’s Dr. William A. Barnett at the Center for Financial Stability.

The article (“The Fed’s Misleading Money Supply Measures”) specifically cites Dr. Barnett’s reputation as the world’s leading expert on Divisia monetary aggregates, which are far more sophisticated than simple-sum aggregates. Dr. Hanke notes that the detailed monthly report put out by CFS on Divisia M4, an especially broad measure of money, is absolutely essential information, given that the Federal Reserve in 2006 stopped reporting even the simple-sum M3 monetary measure.

Dr. Hanke makes the important historical point that when former Fed Chair Paul Volcker sought to slow the inflation rate of the US economy in the late 1970s, he was using a simple-sum measure that provided misleading and inaccurate information. The resulting double digit interest rates meant that the “Fed was not just tapping on the breaks, but unnecessarily slamming on them,” causing excessive tightness that resulted in the early 1980s recession.

The analysis points out that the Fed apparently did not learn from Volcker’s mistake, citing Dr. Barnett’s 2012 book (*Getting it Wrong: How Faulty Monetary Statistics Undermine the Fed, the Financial System, and the Economy*, MIT Press) on how the Fed’s continued refusal to abandon its widespread use of simple-sum aggregates in favor of Divisia aggregates was a major factor behind the far more recent and far more severe Great Recession. The book argues that prior to that crisis, the growing complexity of financial instruments had made traditional simple-sum formulas obsolete; and that the lack of available best-practice data prevented households, firms, and the public sector from correctly assessing the accelerating systemic risk.

Looking at the current situation, Dr. Hanke, who currently teaches at Johns Hopkins and serves as a Cato Institute senior fellow, suggests that past mistakes could again be repeated if Dr. Barnett’s advice continues to be ignored.

“A monetary storm cloud would develop if the Fed were to misstep and slip into a quantitative tightening mode,” he wrote. “Without Divisa M4 on the Fed’s dashboard, the Fed might not realize the storm forming on the horizon.”

In addition to his work as Director of CFS, Dr. Barnett is the Oswald Distinguished Professor of Macroeconomics at KU; the founder and President of the Society for Economic Measurement; Director of the Institute for Nonlinear Dynamical Inference in Moscow; and founder and President of the Cambridge University Press journal, *Macroeconomic Dynamics*.

Link: https://www.forbes.com/sites/stevehanke/2018/10/29/the-feds-misleading-money-supply-measures/#6d4f4c464941