

Getting It Wrong

economics

How Faulty Monetary Statistics Undermine the Fed,
the Financial System, and the Economy

WILLIAM A. BARNETT

Blame for the recent financial crisis and subsequent recession has commonly been assigned to everyone from Wall Street firms to individual homeowners. It has been widely argued that the crisis and recession were caused by “greed” and the failure of mainstream economics. In *Getting It Wrong*, leading economist William Barnett argues instead that there was too little use of the relevant economics, especially from the literature on economic measurement. Barnett contends that as financial instruments became more complex, the simple-sum monetary aggregation formulas used by central banks, including the US Federal Reserve, became obsolete. Instead, a major increase in public availability of best-practice data was needed. Households, firms, and governments, lacking the requisite information, incorrectly assessed systemic risk and significantly increased their leverage and risk-taking activities. Better financial data, Barnett argues, could have signaled the misperceptions and prevented the erroneous systemic-risk assessments.

When extensive, best-practice information is not available from the central bank, increased regulation can constrain the adverse consequences of ill-informed decisions. Instead, there was deregulation. The result, Barnett argues, was a worst-case toxic mix: increasing complexity of financial instruments, inadequate and poor-quality data, and declining regulation.

Following his accessible narrative of the deep causes of the crisis and the long history of private and public errors, Barnett provides technical appendixes, containing the mathematical analysis supporting his arguments.

WILLIAM A. BARNETT is Oswald Distinguished Professor of Macroeconomics at the University of Kansas, Director at the Center for Financial Stability in New York City, and Senior Fellow at the IC² Institute at the University of Texas at Austin. He is Editor of the eminent journal *Macroeconomic Dynamics* and coauthor with Nobel Laureate Paul A. Samuelson of the book *Inside the Economist's Mind*, translated into seven languages. He was on the staff of the Federal Reserve Board from 1974 to 1982.

“Leading up to the financial crisis, investors displayed an incorrect assessment of systemic risk and significantly increased their leverage and risk-taking activities. Barnett documents that better Federal Reserve data could have signaled the error in that view. This error led to the credit-driven, asset-price bubble in the US housing market. He also has shown that as a result of measurement errors, monetary policy was damaged, with tragic consequences. He is the world’s foremost authority in the study of monetary and financial aggregation using index number and aggregation theory.”

James J. Heckman, University of Chicago and University College Dublin, Nobel Laureate in Economics

“I would never fly in an airplane designed by an economist. Unfortunately, I have to live in an economy where policy makers listen to economists. Professor Barnett, a former rocket scientist, shows clearly how important it is that economists pay attention to details and teaches economists how to do far better. Until economists absorb these lessons, the policy makers they advise will be flying blind.”

Kenneth L. Judd, Hoover Institution, Stanford University

“*Getting It Wrong* is a gripping combination of colorful mini-biographies, memoir from a close witness to our financial troubles, and well-argued case for better monetary statistics. This book first makes you care about monetary aggregation and then masterfully shows you how it should be done.”

Julio J. Rotemberg, William Ziegler Professor of Business Administration, Harvard Business School

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