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Meet the globe-trotting 'money doctor' who has helped slay inflation all over the world—and is convinced the Fed is botching the job here in the U.S.

BY **SHAWN TULLY**

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Steve Hanke, professor of applied economics at Johns Hopkins University, speaks at the Bloomberg Link Economic Summit in Washington, D.C., U.S., on Tuesday, April 30, 2013. The Bloomberg Washington Summit gathers key administration officials, CEOs, governors, lawmakers, and economists to assess the economy and debate the path beyond the fiscal cliff.

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If you think the U.S. is experiencing economic turmoil, talk to Steve Hanke about Serbia in 1999.

The economist had traveled to Montenegro, which along with Serbia was still part of the Federal Republic of Yugoslavia, headed by notorious dictator Slobodan Milosevic. Handed the cabinet-level position of state counselor, Hanke advised Montenegro's President, Milo Djukanovic, to replace the Yugoslav dinar with the deutsche mark. Djukanovic followed Hanke's plan, a move that set Montenegro on the road to independence. The dinar virtually disappeared from circulation, infuriating Milosevic.

The Yugoslav information minister issued crazy accusations that Hanke was leading a smuggling ring, flooding Serbia with counterfeit dinars, followed by a backup allegation that he was a French secret agent heading a hit team code-named "Spider," gunning for Milosevic. It's not clear if Milosevic was creating a ghoulish comedy of the absurd to undermine the currency gambit, or really dispatching agents to take out Hanke—to whom Montenegro's president assigned the sage's second detail of security guards. "This was serious stuff," recalls Hanke. "Milosevic was so riled he had tanks massed at the Montenegro border, motors running." The switch to the ultra-solid deutsche mark enabled Montenegro to escape from the chronically hyperinflating Yugoslav dinar. Today, the euro is Montenegro's coin of the realm, ensuring that its citizens' paychecks retain their buying power.

But it's exploits like that which have earned Hanke, now professor of applied economics at Johns Hopkins University, the moniker of "money doctor." Yet oddly, despite having helped tamp down inflation all over the world, Hanke's current views are almost totally out of the mainstream in the U.S. in 2022.

In brief, Hanke is a monetarist.

Monetarism holds that a huge surge in the money supply will eventually trigger a surge in inflation. Hanke frequently cites the mantra of Milton Friedman, the legendary monetarist who emblazoned the theory's four-symbol formula, MV = PQ, on his red Cadillac's California license plate: "Inflation is always and everywhere a monetary phenomenon, in the sense that it can only be produced by a more rapid increase in the quantity of money than in output."

From early 2020 to until around March of this year, banks were lending at a rapid pace for everything from mortgages to credit cards, and the Fed added over $4 trillion to its balance sheet buying bonds, padding consumers' wallets, and sending too many dollars chasing too few goods. Between the two founts, the money supply grew by $6.3 trillion or over 40%, at an annualized rate of roughly 16%. It was the M2 blowout that saddled the U.S. with 8%-plus inflation. By Hanke's estimate, 3 trillion in excess dollars are still sloshing around in the overfilled monetary "bathtub," and the overage that will spill forth as inflation will keep price levels elevated into 2024.

Today, monetarism's quantity theory of money is out of vogue, to put it mildly. Hanke is one of its relatively few exponents in academia, and during this period of newly racing inflation, both the White House and the Federal Reserve are claiming that money-supply growth played no role in birthing the problem, and don't raise the possibility that correctly managing M2, the Fed's broad measure of money, is the way to fix it. Its record of failure, Hanke says, shows that "the Fed is simply looking for inflation in all the wrong places." But Hanke's circuitous journey from an Iowa farm to helping governments manage economies across the globe sheds light not just on how things go very wrong, but what governments have to do to get their economies back on the right track.

From farming to trading

Hanke is an unusual blend of sober scholar and action hero. Growing up on 40 acres of woodlands in rural Iowa, he filled teenaged jobs planting corn and soybeans, baling hay, cleaning "farrowing pens," where sows give birth to piglets, building grain silos, as well as melting and recasting lead type at printing shops. That's before he graduated to spreading asphalt on newly built highways. Hanke says, "I had more jobs than you could shake a stick at, and given the current government regulations, they would probably be illegal today because I was underage."

Hanke got his first taste of the markets working at his grandfather's egg operation. "He had a large facility in Iowa. Eggs were collected, crated, graded, and put in cold storage, and eventually shipped to New York or Boston," Hanke recalls. "To hedge the fluctuations in prices, he sold eggs 'forward' on the Chicago Mercantile Exchange." It enthralled Hanke that a marketplace providing protection for his grandfather also offered the lure of big profits to risk-takers who took the other

side of the transactions. He opened his first trading account speculating in soybeans at age 14, and has been trading ever since.

At 17, Hanke enrolled at the University of Colorado, and a year after his graduation in 1964, enrolled in its Ph.D. program in economics. While working toward his doctorate, Hanke doubled as a full-time professor at the prestigious Colorado School of Mines, rated today as the world's top academic institution in the field by Mining.com. At the time, the school offered degrees in the likes of mining, metallurgy, petroleum, and geological engineering, but just one basic economics course that Hanke taught. He quickly developed new classes in petroleum and mineral economics, and in the process earned the equivalent of another advanced degree in those disciplines. "I got to know all the famous petroleum and mining economists around the world," he says. That immersion in the workings of the oil market would guide his bet against OPEC years later.

Although the University of Colorado only had a small free-market contingent, one of Hanke's favorite professors often sported a T-shirt billboarding, "Adam Smith was right—pass it on." Two strains of thought captivated Hanke, the first being the monetarism pioneered by Irving Fisher of Yale and by Hanke's mentor, Milton Friedman, and the second being the Austrian School of Economics, which focuses on the study of markets and advocates free-market economics. He lauds the Austrian approach for its pragmatism. "It's macro and microeconomics, and international as well," he says. "It covers everything. It gives you the tools to spot mispricing in commodities and other markets. It's not a hairy theory out there on another planet."

For Hanke, the appeal of combining monetarism and the Austrian strain was the foresight it provided in spotting bubbles. "Monetarism and the Austrian School said the same thing about asset prices," says Hanke. "You inject lots of money into the system, and one to nine months later, the prices of commodities, stocks, houses, or other assets go way up." It was a rational explanation of how too much money can drive asset prices to irrational heights, to far above their fundamental value where the balloon is bound to pop.

As a student, Hanke experienced another pivotal moment attending a series of lectures at the University of Virginia by one of its professors, Warren Nutter. "Nutter's extensive research proved that the seemingly great economic numbers issued by the Soviet Union were a pure fabrication, the opposite of what pro–big government economists like John Kenneth Galbraith were saying," recalls Hanke.

He says that his loyalty to monetarism and the Austrian School are both rooted in a belief in classical liberalism, a guiding philosophy he and his Parisian wife, Liliane, have spent many years exploring. "It's based on three pillars," he notes. "Free markets, small government, and private property. I have chosen the economics compatible with those three pillars."

In 1985, Hanke deployed the principles of Austrian economics to win a huge score in the energy market. That opportunity arose after a lunch where he hit it off with Albert Friedberg, one of the world's greatest commodity and currency traders and founder of Friedberg Mercantile Group, a hedge fund in Toronto, and where Hanke currently serves as chairman emeritus. Friedberg was also a fellow devotee of the Austrian School. Shortly after that fortuitous rendezvous, Hanke became Friedberg's chief economist. "Based on Austrian principles, Friedberg has an uncanny ability to take the temperature of the markets and spot opportunities thrown up by mispricing," Hanke notes.

While working a side job as the hedge fund's chief economist, Hanke, employing insights from Austrian economics, was able to anticipate the coming collapse of OPEC. On Nov. 17, 1985, Hanke was one of the first to predict the implosion, writing in Friedberg's *Commodity and Currency Comments*: "Our analysis strongly supports a continued bearish position on crude oil." What was Hanke's analysis? To put it simply, at the time, the spot price of oil was far above the forward price. As the expression goes, the market was in "backwardation." This suggested a massive shortage of inventory and capacity would firm up prices.

But Hanke spotted a paradox. The apparent "shortage" was artificially engineered by OPEC. Indeed, Saudi Arabia had plenty of excess capacity. Eventually, Hanke contended, the Saudis would use its excess capacity to punish members of OPEC who were cheating on their quotas as well as non-OPEC producers. With that, prices would crater to below $10 per barrel.

Hanke and Friedberg went short in every possible way, both in the New York and London markets. In addition, they went short on the Saudi riyal and Kuwaiti dinar. From November 1985 to July 1986, OPEC became unglued and the price of oil fell from around $30 per barrel to $9.25 per barrel. All of Friedberg's bets paid off, and all of its clients garnered a hefty payday.

In 1992, Hanke bet big again for Friedberg, this time in the currency markets. The European Monetary System "pegged" the 12 member nations' currencies to the

deutsche mark within narrow exchange-rate bands. Hanke figured that despite a recent improvement, France typically suffered from greater structural rigidities, higher labor costs, and higher inflation than Germany, and needed a far cheaper currency to challenge its neighbor. He believed the artificial support from the EMS rendered the franc substantially overvalued. Indeed, keeping the franc within the system's prescribed exchange-rate band was proving extremely costly to France and Germany. Eventually, market forces would hammer its value, Hanke believed.

So he pushed those forces along by taking a big speculative position against the franc. In July of 1992, the selling pressure from Friedberg and other shorts caused the French currency to tumble. By August, the exchange-rate band was widened, greatly lowering the franc's permitted floor versus the deutsche mark, notching another coup for Hanke and Friedberg. "Our position helped break the back of the franc fort," says Hanke.

Where is he betting now? Long lithium, a key ingredient in batteries used to power electric cars. In the past year, battery-grade lithium is up 276%.

The globe-trotting money doctor

In 1981 and '82, Hanke served as a senior economist on President Reagan's Council of Economic Advisers. In that role, he developed a sweeping plan for selling federal land to private owners that was endorsed by Reagan. As the president wrote in his budget message, delivered in February of 1982, "During the next three years we will save $9 billion by shedding these unnecessary properties while fully protecting and preserving our national parks, forests, wildernesses, and scenic areas." In the end, the plan failed to get traction—Hanke bemoans that the blueprint was a "classic case of failed government execution." But he credits the proposal for creating a neologism, the word "privatize," a French term that Hanke used at the suggestion of his Parisian wife, Liliane. "Before I used it, the term didn't even appear in *Webster's*!" he notes. So as Hanke sees it, the only productive aspect of Reagan's privatization program was that it motivated Hanke to lobby Merriam-Webster, which eventually resulted in the word being entered in the 1983, ninth edition.

But in public life, Hanke's principal mission is working as a global money doctor. His specialty: advising nations suffering from hyperinflation on how to establish stable currency regimes. His solution: a currency board, which issues a domestic currency that trades freely at a fixed change rate with an anchor currency, such as

the dollar or deutsche mark; or dollarization, which entails replacing the domestic currency with the U.S. dollar.

An early opportunity came in 1991. Hanke recalls, “It was then that Argentina adopted a Convertibility system. Although it wasn’t an orthodox currency board system, it was good enough to smash a stunning inflation rate of 2,314% triple-digit inflation immediately.” Next was Estonia in 1992, where Hanke designed a currency board, replacing the hyperinflating Russian ruble with the newly issued Estonian kroon. It was the ticket to establish Estonia’s own currency and ensure stable prices for the nation’s citizens. In 1994, Hanke held a cabinet-level rank in Lithuania, designing and implementing a currency board system that successfully brought fiscal discipline to Estonia’s neighbor. In 1997, Hanke stopped a raging hyperinflation and banking crisis in Bulgaria by installing a currency board. Finally, again in 1997, Hanke helped implement a currency board in Bosnia and Herzegovina, a country so fresh out of a civil war that the smell of gunpowder still hung in the air.

The money doctor made many more memorable house calls. According to Hanke, the stab at reform in Albania was a surreal experience. “The entire country only had a handful of cars. Most were Mercedes and carried no license plates. That changed very fast when the Albanian mafiosi started stealing cars from all over Europe,” he recalls. As for the deputy prime minister, whom Hanke advised, “he was full of colorful ideas, but a complete disaster as an administrator.” In his office, he’d greet the economist with a revolver strapped to his belt, and standing before a portrait of native Albanian Mother Teresa. “He and other leaders later shocked the EU officials by showing up at the Brussels airport carrying sidearms!” marvels Hanke. The Albanians recognized Hanke’s contributions in introducing them to the high-and-mighty in both the Balkans and Europe, naming him a Knight of the Order of the Flag, even though they proceeded sans currency board.

In 1994, shortly after Kazakhstan gained independence, President Nursultan Nazarbayev invited Hanke to Alma-Ata and appointed him as his adviser. His charge was to establish a currency board to stabilize its tenge. According to Hanke, the effort ended in failure because “Moscow did not want a sound tenge. At that point the Russians preferred a weak, unstable tenge and a neighbor that was not sure-footed.”

Four years later, Hanke got ensnarled in his most controversial currency venture. Indonesian strongman Suharto engaged Hanke as a “special counselor” to design a

blueprint for a stable rupiah—the currency had collapsed after Suharto followed the IMF's advice to let it "float" on the open market. Hanke huddled with Suharto on evening after evening in a small den at his private residence, and proposed "an orthodox currency board in which the rupiah would be fully convertible into and backed by the U.S. dollar at a fixed exchange rate." Suharto endorsed the idea. When the news hit the next day, the rupiah jumped 28% versus the dollar. Suharto told Hanke the revolutionary concept made him a "marked man" by the president's political opponents, and apportioned a big part of his security detail to protect the economist and his wife.

But the Clinton administration and the IMF hated the idea because a stable rupiah could help keep Suharto in power, and they wanted him gone. According to Hanke, Clinton told Suharto that if he followed through with Hanke's currency board idea the Indonesian leader would have to forgo $43 billion in foreign assistance. Suharto buckled, and the weak rupiah bashed the economy—and helped trigger his departure months later.

Hanke also clinched a major success in Ecuador. In 2000, he served as counselor to the finance minister, recommending that the nation supplant its sucre with the dollar. Ecuador made the switch late that year to become the first Latin American country to dollarize since Panama over a century ago. El Salvador followed suit a year later. In the past two decades, Ecuador has benefited from one of the world's lowest rates of inflation.

Along the way, Hanke forged close friendships with some of the most influential economists of recent times. One of his closest collaborators was Sir Alan Walters, who designed Margaret Thatcher's privatization and deregulation campaign that revived Britain in the 1980s. "Through Alan, I saw every element of those plans as he developed them," says Hanke, who credits the free-market principles followed by Walters for the program's success.

Among his buddies was the leading of all Hanke's favorite theory's icons, Friedrich Hayek. At one of the longest dinners on record at Washington's famed Maison Blanche restaurant with Hanke and his wife, Liliane, Hayek confided that in his youth, he'd vainly wanted to romance a great Viennese beauty—who just happened to be Liliane's aunt.

Of course, those towering figures of economics such as Hayek and Friedman are no longer around to ponder the course the U.S. is on currently. But Hanke is not

optimistic. He believes that the inflation schedule's already locked in, and that though the trajectory will gradually trend downward, prices will still be waxing at a formidable 5% by the close of next year. The big question, the piece so uncertain in severity and timing, is what happens to the economy. For Hanke, it's crucial to understand the lag between sustained changes in the money supply and their impact on the real economy. That span is typically six to 18 months. So what's happening today with M2 will guide GDP growth at some time during that window.

We know what the Fed plans to do with QT and the Fed funds rate, based on its statements and the big crunch since April. The uncertainty surrounds what occurs in the private sector portion, in banking. "If credit stays positive and is just enough to blunt the Fed's negative contribution to M2, the money supply will flatline, and we'll have a recession," warns Hanke. "And it will happen sometime within that six- to 18-month window. Keep in mind that M2 growth went to zero in April, so the time frame for a downturn is now between October of 2022 and October of 2023." But the bank lending that's a positive, countervailing force has been falling in recent months. Say that continues. "In that case, money-supply growth would go negative. Instead of a milder recession that would accompany zero M2 growth, you'd get a recession much sooner that's a lot more severe," Hanke notes. "The Fed's policies are bad to begin with, but what makes them worse is the unknown reaction of the banking system to an increase in the Fed funds rate, and whether that will result in a bank lending contraction that could worsen and extend a recession." The Fed isn't keeping its finger where it belongs, on the money pulse. For the money doctor, that makes the central bank's regimen a travesty in malpractice.

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