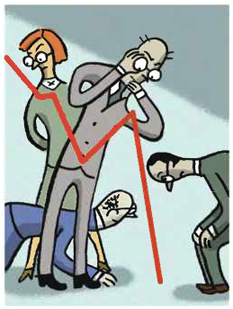


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**The Reinhart and Rogoff Controversy: A Summing Up**

Posted by [*John Cassidy*](http://www.newyorker.com/magazine/bios/john_cassidy/search?contributorName=John%20Cassidy)



In one of life’s little ironies, last Friday’s disappointing G.D.P. figures, which reflected a sharp fall in government spending, appeared on the same day that the economists Carmen Reinhart and Kenneth Rogoff published [an Op-Ed](http://www.nytimes.com/2013/04/26/opinion/debt-growth-and-the-austerity-debate.html?hp&_r=0) in the *Times* defending their famous (now infamous) research that conservative politicians around the world had seized upon to justify penny-pinching policies. Addressing a new paper by three lesser lights of their profession from the University of Massachusetts, Amherst, which uncovered data omissions, questionable methods of weighting, and elementary coding errors in Reinhart and Rogoff’s original work, and which went around the world like a viral video, the Harvard duo dismissed the entire brouhaha as “academic kerfuffle” that hadn’t vitiated their main points.

Really? Even somebody living in a bubble stretching over Harvard Yard would have difficulty believing that. For all of the illuminating work Reinhart and Rogoff have done on the history of financial crises and their aftermaths, including their [popular 2011 book](http://www.amazon.com/This-Time-Different-Centuries-Financial/dp/0691152640) “This Time Is Different: Eight Centuries of Financial Folly,” their most influential claim was that rising levels of government debt are associated with much weaker rates of economic growth, indeed negative ones. In undermining this claim, the attack from Amherst has done enormous damage to Reinhart and Rogoff’s credibility, and to the intellectual underpinnings of the austerity policies with which they are associated. In addition, it has created another huge embarrassment for an economics profession that was still suffering from the fallout of the financial crisis and the laissez-faire policies that preceded it. After this new fiasco, how seriously should we take any economist’s policy prescriptions, especially ones that are seized upon by politicians with agendas of their own?

**The Marketing of Austerity Policies**

Let’s remind ourselves about the policy agenda that Reinhart and Rogoff were promoting—and I use that word unhesitatingly—back in early 2010, when they put out their original [working paper](http://www.nber.org/papers/w15639), titled “Growth in a Time of Debt.” At that juncture, governments on both sides of the Atlantic were pursuing Keynesian stimulus programs that had been introduced following the 2008 financial crisis. In the United States and Europe, the big debate was about whether these expansionary policies, which involved taking on high levels of borrowing to finance additional government spending and tax cuts, should be continued or wound down in an effort to balance the budget.

In their *Times* Op-Ed, Reinhart and Rogoff stated, “Our consistent advice has been to avoid withdrawing fiscal stimulus too quickly, a position identical to that of most mainstream economists.” But does this really jibe with what they were saying at the time? In January, 2010, in [an Op-Ed](http://scholar.harvard.edu/files/rogoff/files/why_we_should_expect.pdf) in the *Financial Times*, the two of them cited their own research and wrote, “Given the likelihood of continued weak consumption growth in the US and Europe, rapid withdrawal of stimulus could easily tilt the economy back into recession. Yet, the sooner politicians reconcile themselves to accepting adjustment, the lower the risks of truly paralysing debt problems down the road. … Countries that have not laid the ground work for adjustment will regret it.” Later in 2010, Rogoff wrote [another article](http://scholar.harvard.edu/files/rogoff/files/no_need_for.pdf) in the *Financial Times* in which he reiterated: “The risks of rising debt, while apparently far off, cannot be lightly dismissed.” And he added, “In this environment, measures to gradually stabilise debt burdens—to restore normality—surely make sense.”

It may be true, as Reinhart and Rogoff now claim, that some politicians exaggerated the conclusions of their research, which purported to show that countries with high levels of debt—specifically, those with debt-to-G.D.P. ratios of more than ninety per cent—grow much more slowly. But why didn’t they point this out at the time? In February, 2010, to cite one prominent example, George Osborne, the soon-to-be Chancellor of the Exchequer, cited the authors several times by name in [a key speech](http://www.conservatives.com/News/Speeches/2010/02/George_Osborne_Mais_Lecture_-_A_New_Economic_Model.aspx) laying out his policy proposals and calling for big cuts in government spending. Here are some excerpts:

«So while private sector debt was the cause of this crisis, public sector debt is likely to be the cause of the next one. As Ken Rogoff himself puts it, “there’s no question that the most significant vulnerability as we emerge from recession is the soaring government debt. It’s very likely that will trigger the next crisis as governments have been stretched so wide.»

«The latest research suggests that once debt reaches more than about 90% of GDP the risks of a large negative impact on long term growth become highly significant. If off-balance sheet liabilities such as public sector pensions are included we are already well beyond that. And even on official internationally comparable measures of debt, we are forecast to break through 90% of GDP in just two years time… »

To entrench economic stability for the long term, we need fundamental reform of our fiscal policy framework….As I have made clear, our aim will be to eliminate the bulk of the structural current budget deficit over a Parliament.

As far as I recall, neither Reinhart nor Rogoff objected to Osborne’s speech, or to the citing of their work by other austerity-minded politicians, such as Paul Ryan and Olli Rehn, the euro zone’s commissioner of economic affairs. In the debate between the Keynesians and the Hooverites, they were clearly on the side of the latter. Trying to rewrite history won’t alter that.

**The Relationship between Debt Levels and Growth**

Rather than rehashing all the details of the dispute between Reinhart and Rogoff and their critics, some of which I addressed in [an earlier post](http://www.newyorker.com/online/blogs/johncassidy/2013/04/margaret-thatcher-and-the-crumbling-case-for-austerity-economics.html), let’s focus on what both sides agree on. If you combine data covering dozens of countries collected since the Second World War, you find that higher debt-to-G.D.P. ratios are associated with lower levels of G.D.P. growth. According to the [paper](http://www.peri.umass.edu/236/hash/31e2ff374b6377b2ddec04deaa6388b1/publication/566/) by the three Amherst economists—Thomas Herndon, Michael Ash, and Robert Pollin—countries with debt-to-G.D.P. ratios below thirty per cent grew at an annual rate of 4.2 per cent; countries with debt-to-G.D.P. ratios of between thirty and sixty per cent grew at an annual rate of 3.2 per cent.

That’s an interesting finding, and it’s hardly surprising that Reinhart and Rogoff have seized upon it to argue that there isn’t anything new in the Amherst paper. But, wait a minute. Annual growth of 3.2 per cent doesn’t sound too bad. Is there a level of indebtedness at which growth ceases or turns negative? Reinhart and Rogoff argued that there was, and that’s what gave their pro-fiscal-consolidation message its potency. In the 2010 paper at the center of the dispute, they identified the threshold as a debt-to-G.D.P. ratio of ninety per cent. Once debt rose above that level, they said, the average growth rate was negative 0.1 per cent.

Ninety per cent wasn’t just any old figure. With large budget deficits and debt-to-G.D.P. ratios in the range of sixty to eighty per cent, many advanced countries, including the United States and Britain, were fast approaching the threshold of doom, or so it seemed. If you took Reinhart and Rogoff’s findings at face value, as many people did, it was hard to argue with the Hooveresque logic of, say, Osborne.

It turns out, however, that the ninety per cent threshold is phooey: it doesn’t exist. When the Amherst economists reworked Reinhart and Rogoff’s calculations to take account of programming errors and data omissions, they came up with a figure of *positive* 2.2 per cent for average growth in countries with a debt-to-G.D.P. ratio of ninety per cent or more. That’s less than 3.2 per cent—the figure for countries with debt ratios of sixty to ninety per cent—but it’s not zero, or negative.

Some defenders of Reinhart and Rogoff point out that a shortfall in growth of one per cent a year eventually compounds into big differences in living standards. That’s true, but there’s another note of caution about the data. If you eliminate from Reinhart and Rogoff’s sample countries with very high indebtedness—those with debt-to-G.D.P. ratios of more than a hundred and twenty per cent—and very low indebtedness—those with debt-to-G.D.P. ratios less than thirty per cent—the negative relationship between growth and debt is hard to discern. The scatterplot is all over the place, with perhaps a slight negative lean. In fact, after carrying out some formal tests, Herndon, Ash, and Pollin report that “differences in average GDP growth in the categories 30-60 percent, 60-90 percent, and 90-120 percent cannot be statistically distinguished.”

To sum up, there may well be a threshold at which high levels of public debt tend to be associated with very bad growth outcomes and financial crises, but it isn’t ninety per cent of G.D.P., or even a hundred per cent. Maybe it’s a hundred and twenty per cent, although that figure isn’t a firm one, either.

So far, I haven’t mentioned the issue of causation. Do high debts cause low growth, or vice versa? Theoretically, it could go either way. High levels of public debt, through their impact on interest rates and business confidence, can crowd out private-sector spending and reduce growth. But low growth depresses tax revenues and forces the government to spend more on things like unemployment insurance and food stamps. That increases the budget deficit, which necessitates the issuance of more debt.

Reinhart and Rogoff acknowledge this ambiguity. “Our view has always been that causality runs in both directions,” they said in their *Times* Op-Ed, “and that there is no rule that applies across all times and places … Nowhere did we assert that 90 percent was a magic threshold that transforms outcomes, as conservative politicians have suggested.”

Set aside the last sentence, which is another example of Reinhart and Rogoff trying to distance themselves from their intellectual protégés. Whichever way the causation goes, the issue has always been whether there was room for further fiscal stimulus, or whether debt levels were getting so high that further borrowing and spending was likely to be counter-productive. Back in 2010 and 2011, the Keynesians said there was room; the austerians said there wasn’t. Purely on the basis of the corrected Reinhart and Rogoff figures, there was, and is, room. In the United States, the ratio of net debt-to-G.D.P. is seventy-three per cent. In the United Kingdom, it is about the same. In Germany, it is about eighty per cent. In France, it is about ninety per cent.

**How Seriously Should We Take Economics?**

Since this post is getting long, and I’ve already addressed this issue [at book length](http://www.amazon.com/How-Markets-Fail-Economic-Calamities/dp/B004E3XIC6), I’ll try and keep it brief. Economics is a science—it proceeds via hypothesis and empirical testing—but it’s a soft and squishy one, and any argument to the contrary should be treated with great suspicion. Especially in macroeconomics, hard-and-fast laws are hard to find. So are stable parameters and reliable empirical studies. Often, about the best we can do is isolate general tendencies, and then look carefully to see whether they apply in the case under consideration.

Reinhart and Rogoff identified what they said was one such tendency, but they and the policy makers who seized upon this work pushed the argument too far. In Britain and Europe, great damage has been done as a result. In the United States, we’ve been more fortunate, but even here there are dangers. By raising payroll taxes and letting the sequester go into effect, we’ve recently introduced a little mini-austerity experiment of our own, the early results of which, as evidenced by that [disappointing G.D.P. report](http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm), are hardly encouraging.

*Illustration by Marc Rosenthal*