The Conscience of a Liberal

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Grasping at Straw Men

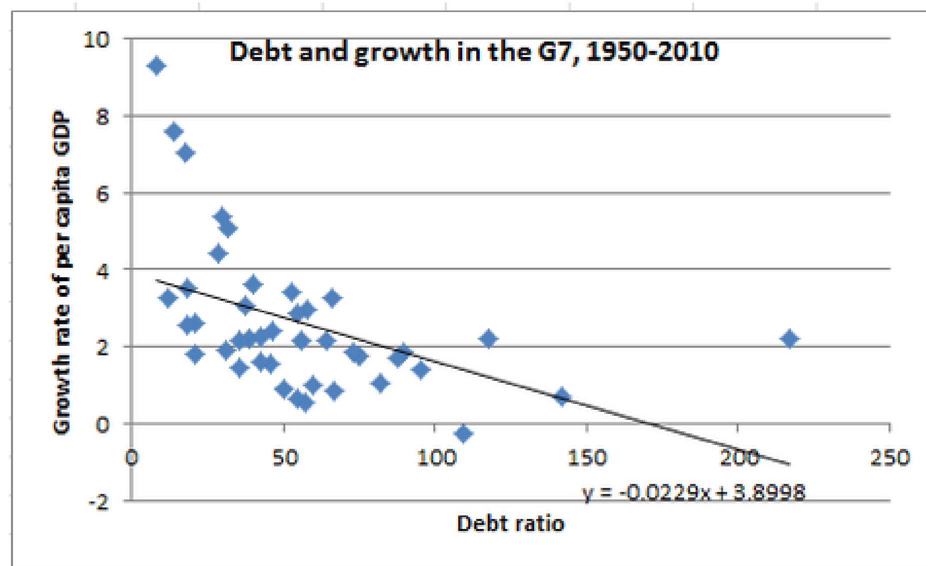
OK, Reinhart and Rogoff have said their piece. I'd say that they're still trying to have it both ways, on two fronts. They deny asserting that the debt-growth relationship is causal, but keep making statements that insinuate that it is. And they deny having been strong austerity advocates – but they were happy to bask in the celebrity that came with their adoption as austerian mascots, and never to my knowledge spoke out to condemn all the "eek! 90 percent!" rhetoric that was used to justify sharp austerity right now. Sorry, guys, but with so much at stake you have a responsibility not just to put stuff out but to make crystal clear what you think it implies for policy.

What was new in this piece, however, was the creation of a straw man. R-R:

> The fact that high-debt episodes last so long suggests that they are not, as some liberal economists contend, simply a matter of downturns in the business cycle.

Who are these "some liberal economists"? As far as I know, none of their prominent critics have made that particular argument. It has always been about the effects of sustained low growth, for whatever reason, on debt ratios.

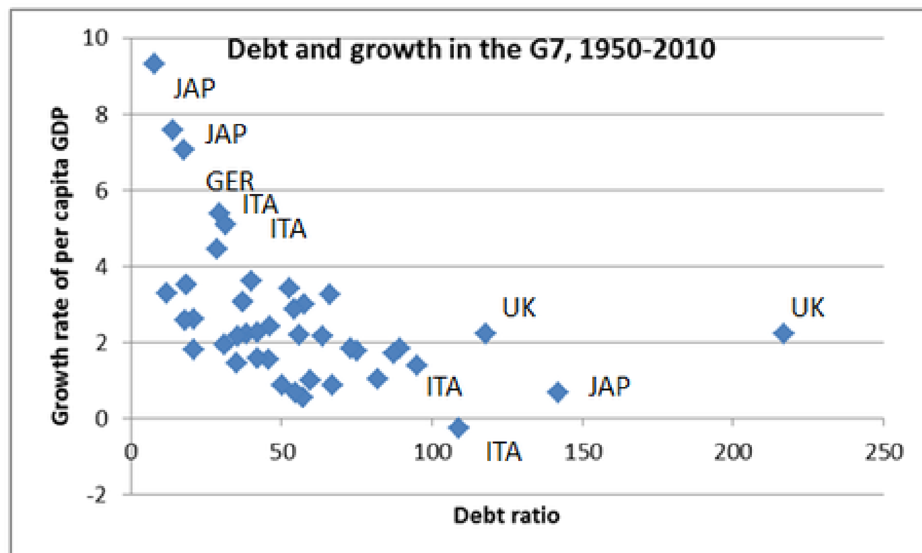
Maybe an exercise I've been doing will help. I've put together what I think of as G7-decadal-RR. I take debt ratios for the G7 (to hold the size of the effort down, and also produce a cleaner graph) only once a decade, at 1950, 1960, etc., and look at growth rates over the following decade. When I do that it looks like this:



So there's a clear negative correlation between debt and growth, although no cliff at 90 percent or actually anywhere. The absence of a cliff is crucial: whereas R-R like to say that debt going above 90 percent cuts your growth rate by 1 percentage point, what we actually find is that raising the debt ratio by 45 points cuts growth by 1 point, which is a very different implication.

As Brad DeLong has been pointing out, numbers like that, even if you take them as causal, are a very weak argument for austerity in a liquidity trap. Suppose you cut spending by 2 percent of GDP. This probably reduces GDP by about 3 percent, and reduces the deficit by only about 1 percent of GDP; meanwhile, if we believe in this relationship, it raises GDP a decade later by 0.23 percent. A slam-dunk case for austerity this isn't.

But anyway, you should not consider this relationship causal. It's driven by a few high-debt low-growth cases on one side, and a few high-growth low-debt cases on the other. Let's label the countries involved:



So, the alleged relationship is driven by (a) fast growth in the former Axis powers, which had very little debt and were recovering from war damage, after World War II; and slow growth in Japan and Italy since 1990. The latter cases were clearly a matter of growth slowdowns leading to higher debt, not the other way around; the former a case of spurious correlation.

This is not stuff that should be having any influence on policy.

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