



Letters to the Editor – Misreading Reinhart and Rogoff

January 17, 2012

The following are in response to Robert Huebscher's article, [The Misreading of Reinhart and Rogoff](#), which appeared last week:

Dear Editor,

I am writing to thank you for your excellent essay.

Your piece serves your readership in two valuable ways.

First, it corrects a common (and regularly repeated) misperception of the two academics' work. As a side note, the care you took in presenting your argument is commendable. It is rare that commentators go to the lengths you did, basing your arguments on primary documents and direct contact with the authors.

Second, near the end of your essay, you reach an important conclusion – and in my own opinion, the right one – based on the proper interpretation of Reinhart and Rogoff's work. That conclusion is that "the nature of the deficit matters," and "to accept that our government must embark on a series of initiatives large enough in scope to restore the country to full employment." This conclusion has important implications for both policy debates and investment strategies.

I imagine that I share with your readership a general fear over the size and entrenched nature of the U.S. fiscal deficit. I believe we all intrinsically know that "this time it is not different."

Nevertheless, you are correct to advance the idea that not all deficits are created equal: some have the capacity to restore growth and employment. Further, you recognize that at this moment in our nation's history, the imperative to restore full employment may supersede the objective of reducing deficits. In my own view, restoring full employment – in particular, reducing the large ranks of unemployed and underemployed young people – will ultimately do more to cure the country's long-term debt problems than short-term deficit reduction. My hope is that the nation's political debates about the deficit will grow less shrill, and as you aptly stated, that "we heed the lessons of the Industrial Revolution and the Great Depression."

Thank you for (yet another) interesting essay.

Regards,



Andrew Foster
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Dear Editor,

I read your article about Reinhart and Rogoff's *This Time Is Different* with great interest.

There were several points you made that deserve further attention. Here are a few:

1. While Japan's debt-to-GDP ratio is twice as large as ours, its debt to foreign countries is less as a percent of GDP than that of the US. This is very important since internal debt is far less disruptive than foreign debt.
2. The US status as reserve currency is certainly a big factor in protecting the US from disruption, but there are already moves to limit or remove that privilege and change to a basket of currencies or even eliminate our status altogether
3. The Industrial Revolution is history. It is much less likely that there will be a revolutionary change that will give us an automatic ticket to growth in the future. Certainly it is still possible, but one cannot rely on possible.
4. According to *Thinking, Fast and Slow*, by Daniel Kahneman (page 250) the use of high-speed rail has been exaggerated. According to him, a 2005 study examined rail projects undertaken worldwide between 1969 and 1998 and in more than 90% the number of passengers projected to use the system was overestimated by 106%. Furthermore, the average cost overrun in producing the systems was 45%. He further pointed out that as more evidence accumulated, the experts refused to accept that evidence.
5. Changes in the provision and creation of new electrical sources have led to Solyn-dra and other criminal acts by government.
6. Finally, cap-and-trade is only the ideal solution for the furtherance of the accumulation of private funds to further the growth of government.

Your article persuades me that you are dedicated to producing a large government, such as is practiced by the present administration.

If your goal is a larger government, you should state your purposes rather than hiding behind a misinterpretation of a scholarly work and the assertion that you are among the "in" people who can speak with Rogoff on the telephone, as can most media types.

Fred Goodman, CFP



Robert Huebscher responds: I am registered as an Independent, and I have supported Republican, Democratic and Independent candidates in the past. Regarding high-speed rail, I am not familiar with the data Kahneman cited. But I reject funding for such projects based on Solyndra-like loan guarantees or ethanol-like subsidies. Funding would come in the form of an investment by an infrastructure bank and the project would need to be transitioned to our managed by the private sector, so that in the end it would operate as a utility, not part of the government.

Dear Editor,

This is the *best* piece I've read on the subject of debt and its implications for economic growth. As one who has assiduously read Reinhart and Rogoff (I took the book on a sailing trip to Costa Rica!) and never misses John Mauldin's weekly articles, you provide a thoughtful 'outside the box' framework that focuses on policy choices, rather than on the ratio of debt to GDP. You make the case for *productive* growth in the form of infrastructure, job creation and energy policy. The outcomes of these policy choices could create a means to service debt and result in economic growth.

Reinhart and Rogoff show us that defaults are common and occur frequently. It's not different this time. There will be defaults. But that does not mean it will be a cataclysmic event. John Mauldin talks of the end of the debt supercycle when the bond market vigilantes force a day of reckoning. It may happen in Greece, but the ECB will not let Europe go down the tubes. Perhaps the doomsayers are Chicken Little. Their sky may not fall.

We will incur economic pain as a result of our deficit spending and have difficult choices to make. Mauldin, Rogoff, Reinhart, you and others are trying to get politicians to focus on those choices. In that regard, I offer two predictions. John Mauldin often includes intriguing and important articles in his newsletter, and one is that he will publish yours in an upcoming commentary. The more uncertain prediction is that those who have authority to make choices will read it, and more importantly, that they will come to the table and act responsibly.

Susan G. Freed, CFP
President
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Chevy Chase



Dear Editor,

The opinions of Robert Huebscher are unimpressive and left-leaning. His remarks about Japan's debt-to-GDP ratio and contrasting that to the US is like saying apples taste like oranges. Japan's debt is almost entirely held by the citizens of Japan and therefore is much more tolerable. The majority of US debt is held by China, Japan and the European nations. These countries will be a lot less tolerant of actions by the Fed to devalue the dollar through inflation. (Our adjusted monetary base has increased from \$800 billion to over \$2.4 trillion since October 2008. That is unprecedented.)

Moreover, public debt is just the beginning. Roll in the unfunded entitlements and what we really should be talking about is the over \$60 trillion in debt and entitlement liability.

You can't trust the government to deficit spend and stimulate the economy. Tax cuts and business incentive programs to keep more money in the private sector will also increase deficit but will stimulate economic growth the likes of which we haven't seen since President Reagan.

Bryan D. Myers, AIFA
President
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Robert Huebscher responds: Entitlement programs, like Social Security and Medicare, cannot be compared to US Treasury debt. Our government can and will default on entitlements. It will do so, for example, by increasing the retirement age for Social Security or means-testing Medicare. By contrast, the government will not default on Treasury bonds.

Dear Editor,

I applaud you for roundly taking to task the media and an ocean of pundits (from Bill Gross to John Mauldin) who have jumped on the notion that a 90% debt-to-GDP ratio is somehow a death knell for an economy.

Reinhart and Rogoff did find that a 90% debt-to-GDP level would likely reduce growth. But pundits have turned this finding into a warning that the US is poised to turn into Greece, fueling the fire of those demanding draconian and immediate deficit reduction. As Huebscher explains, and Reinhart and Rogoff confirm, this is not at all what they wrote and those making this claim are simply wrong. I recognize that you are not endorsing a "What Me Worry" approach to a significant long-term structural debt problem. But only a true understanding of the data can lead to solutions that will address our debt problem and not just create a crisis of another variety.



How I long for the day (there was one, wasn't there) when our elected leaders and respected media figures could hold a rational public debate on the economic, for that matter any public policy, issues. (For one example of what I mean, see [Alan Simpson \(on Fareed Zekaria\)](#), who finds some sensible common ground on deficit reduction). Alas what we are offered instead is a steady barrage of media porn.

This was one of your best, and certainly most important, yet. It should be required reading by Congressional staff.

Martin Weil
MW Investment Strategy
Healdsburg, CA

Dear Editor,

Yours was an excellent piece on Reinhart and Rogoff. If only everyone writing about economics (and every economist, for that matter) would keep repeating things like "correlation does not imply causation" and "past performance is not indicative of future results" we'd be a lot better off. In my 2012 Investment Outlook, I was careful only to call current debt-to-GDP levels dangerous. Thanks for the good work.

Robert P. Seawright
Chief Investment & Information Officer
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Dear Editor,

Thanks for this article. Even some of the brightest minds have taken the information gleaned from Reinhart and Rogoff in the wrong way.

In an [interview](#) with the CFA magazine in November Ken Rogoff suggested even more spending might be necessary if spending is done in the wrong way. See professors Rogoff's answers to the two questions on page two. Perhaps you can answer two questions: What could have been done better? What's your view on the U.S. debt-ceiling deal of early August?

Thanks for the article.

James B. Cornehlisen, CFA



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Robert Huebscher responds: Regarding your two questions, for the most part the government took the right steps after the crisis. I fault the government for its handling of some of the major bankruptcies, when it unnecessarily protected certain stakeholders. The primary cause of the crisis was excess leverage, and the government needs to do more to address that issue. The debt-ceiling deal was a sideshow. The major deficit-related issue that must be confronted is entitlement reform, and neither political party has shown any willingness to take that on.

Dear Editor,

I appreciate your comments in your piece on the misreading of Reinhart and Rogoff.

Economics is an imprecise science, if it is science at all. Misinterpreting correlation as causation may lead to unwarranted and unproductive policy. Science may or may not direct policy but when policy directs science then knowledge is reduced to commerce.

Regarding "good" and bad "debt" I am reminded of a well known farmer's quote, "Never borrow money for anything that won't make you money."

Thank you for the continued excellence of Advisor Perspectives. It is in my opinion by far the best of class if not indeed best of show.

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