Why Reinhart and Rogoff Results are Crap

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Kudos to UMass economists for exposing the flaws in R&R's empirical work. The conclusion that there is some magic debt ratio beyond which growth slows was never substantiated by R&R's data–they fudged and flubbed the empirical work. True enough.

However, the whole "research" method as well as the "theory" behind it was bunk anyway, as Yeva Nersisyan and I argued from the get-go. You cannot just add up across centuries, exchange rate regimes, public and private debt, and debt denominated in foreign currency as well as domestic currency. Garbage-in and garbage-out research even if they had not made statitiscal errors.

Further, they had no theory of sovereign currency. Not only is the theory in their papers and book fundamentally unsound, I know from quizzing Reinhart during one of her presentations that she's clueless. (And you all recall Rogoff's attempt to explain on-camera what a credit default swap is–you would probably conclude he doesn't know much about finance, anyway. It was almost as funny as Freddie Mishkin's attempt to explain away his fudging of the title of his research on Iceland as listed on his CV.) Like many economists, they do not understand that a sovereign government that issues debt denominated in its own floating currency cannot be forced into involuntary default. And so they make no distinction in their book–and you cannot find out from the book which supposed "sovereign default" was actually a sovereign default. I suspect that almost all of the defaults they list were by governments that issued debt in foreign currency, but they do not provide enough information to tell.

In any case, I did an interview for *Canadian Business;* See here for the story:

http://www.canadianbusiness.com/blogs-and-comment/economist-fight/

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(If clicking does not work, copy and paste into your browser.)

Here's the full interview:

1. Q: You critiqued the Reinhart-Rogoff study very early on (2010) in another paper, but there was little or no reaction then. Why has there been a reaction now to this latest critique from UMass?

A: I think there were two factors. First there was the will to believe. Everyone wanted to believe that government debt is bad. Reinhart and Rogoff seemed to have generated evidence–no matter how shoddy their research was–that supported what they wanted to believe. Second, since they had refused to provide the data, no one could check. Hence our main argument–that the method was flawed because they had no distinction between sovereign debt and nonsovereign debt–did not resonate. In other words, our critique was a bit more sophisticated–we did not accuse them of outright fraud but rather of doing something no historian would take seriously. That is, aggregating up data obtained across various types of countries (different exchange rates, different currency regimes) over hundreds of years, just leads to nonsensical results. So our critique required thinking about the subject at hand. The critique from Umass is easy to understand: they fudged the data to fit their theory. Everyone understands that. But really, if you think about it, that is a much weaker critique.

2. Q: Will the revelations about the RR study have any impact in terms of reversing or slowing the drive toward austerity? Why or why not?

A: Oh, I think so. This was the main empirical work trotted out to support austerity. It is fundamentally flawed in numerous ways. They will not be able to overcome the fact that they fudged the data. I hope people will now rethink the silly approach. Please tell me this. Suppose they really are able to "prove" that countries on gold standards 400 years ago got into trouble if their government issued too much debt that they had promised to convert to gold. Would anyone seriously believe that has any implications for a country like the USA that issues a sovereign, floating currency? You'd have to be incredibly dumb to be swayed by that. Anyone with any understanding of modern monetary relations knows that the US government (and the Japanese, UK, Australian, and Canadian governments) can always "afford" to pay interest. There is zero risk of involuntary default on government debt of such sovereign nations. Greenspan has said this; Bernanke has said it; Samuelson has said it. Rogoff and Reinhart ought to get out of their university offices now and then and confront the real world.

3. Q: Do you think the oversights/errors made by RR were innocent or planned in order to push a particular agenda? If they were deliberate, what is the agenda?

A: I do not know if they intentionally fudged the results, but the evidence points that direction. Motive? To push austerity. Can we prove intentionality? I do not think so nor do I think that is necessary. The research is crap. Ignore it and them on this topic. They do not understand sovereign debt–if they did, they would never have conducted this "research" in the first place.

Let me say that there is one piece–and only one piece–of their research that holds up. When you have a serious financial crisis–such as the Global Financial Crisis of 2008–that does lead to slow growth. However (and this is key) the crisis was set off by private debt, not sovereign debt. Learn that lesson. Forget sovereign, floating currency, debt. It is not the problem. Euro-using countries gave up their currencies and so they can get in trouble. But most of them got high government debt ratios when they tried to bail-out their private sector. That just indicates the set-up of the EMU was flawed; it tells us nothing about a country like the US that retains its own currency.