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Harvard in the News

# Rogoff: A Whiff of Inflation Now?

News

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  Kenneth S. RogoffPhotograph by Stephanie Mitchell/Harvard News Office

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CABOT PROFESSOR OF PUBLIC POLICY Kenneth S. Rogoff, a member of the economics department widely known as co-author of *This Time Is Different* (read the *Harvard Magazine* review)—an economics bestseller about "financial folly," debt, bubbles, and recessions—has advanced the idea of aiming for a *higher* rate of inflation as a partial cure to the nation's current, protracted recession. Given Rogoff's reputation as an economic conservative, with rather mainstream credentials (he was chief economist of the International Monetary Fund from 2001 to 2003), this policy proposal has raised eyebrows and underscored the seriousness of current economic circumstances: protracted, very high unemployment and continuing depressed (or even deteriorating) real-estate values, which have combined to sap consumer confidence and retard sustainable growth.

In “The bullets yet to be fired to stop the crisis,” his August 8 column in the *Financial Times*, Rogoff wrote that four years into a financial crisis, “the biggest deficit is not in credit, but credibility.” That is, financial institutions have been made whole, but financial recovery has not ensued because this is not a conventional recession caused by tighter credit imposed to cool down an overheating economy with too much demand; rather, this is a “post-financial crisis recovery,” a grinding period following the collapse of asset prices (above all, housing prices in the United States and Europe) and the resulting weakened state of borrowers and of governments. To deal with “a huge overhang of debt,” he wrote, “It is far from clear that any huge temporary fiscal stimulus will rev up the engine enough to achieve self-sustaining growth. Higher government debt adds an overhang of higher expected future taxes on top of pre-existing private debt overhang.” For the United States, that implies “schemes to write down underwater mortgages,” those where the outstanding loan now exceeds the value of the underlying property. Given the political difficulties of effecting this change directly, “there is still the option of trying to achieve some modest deleveraging through moderate inflation of, say, 4 to 6 percent for several years. Any inflation above 2 percent may seem anathema to those who still remember the anti-inflation wars of the 1970s and 1980s, but a once-in-75-year crisis calls for outside-the-box measures.” That is, reduce debt de facto by making it cheaper to pay off—a strategy borrowers like, and lenders have historically detested, for obvious reasons. (Rogoff insists that these measures be paired with “structural reforms” to “unsustainable old-age pension and healthcare funds.”)

Three days later, *New York Times* financial columnist Floyd Norris highlighted Rogoff’s reasoning, in an essay titled “Sometimes, Inflation Is Not Evil.” He noted:

In 2008, when the credit crisis brought the world economy to a screeching halt, governments and central banks stepped in to bail out large financial firms on the theory that a decently functioning financial system was a prerequisite to economic recovery. That analysis was correct, but there were at least two problems with the fix:

First, at least some banks were not really made healthy again. That was especially true in Europe, where recapitalization of banks proceeded slowly. They were thus vulnerable to a new round of credit worries, this one based on sovereign debt issues.

Second, this country is full of people whose homes are worth less than they owe. That provides threats to the lenders and to the borrowers. Those borrowers need debt relief, but there are many issues that have prevented any real action.

Simply put, you can’t operate an economy where huge numbers of people are desperately in debt and have no real way out. We need to either find a way to reduce what they owe or to raise the value of the homes securing the loans, or some of both.

Thus, to the inflation solution. As Norris observed, the idea did not get a uniformly positive reception: “‘I don’t think it’s a good idea,’ was one of the milder comments I got from the most celebrated veteran of those wars, Paul A. Volcker, the former Fed chairman.” There is even a question, Norris noted, about whether the Federal Reserve Board could effect inflation if it wanted to, given the depths of the recession and international competitive factors.

*Boston Globe* Ideas writer Leon Neyfakh ’07 gave Rogoff’s proposal further attention in “The I-word,” a lead report this past Sunday. “As a research economist at the Federal Reserve during the first half of the 1980s,” he wrote, Rogoff “helped ensure that the word ‘inflation’ would never again flash across American TV screens. His reputation as a conservative-minded inflation hawk followed him from the Fed to the International Monetary Fund to his current position in the economics department at Harvard." Today, in different circumstances, according to Neyfakh, Rogoff has come to believe that one solution to the economy's problem is "a temporary burst of inflation," to accelerate the process of returning to normal economic growth.

For more about Rogoff, read the Harvard Portrait (including information on the budding economist's earlier career as a chess champion) and "After *Our* Bubble," Jonathan Shaw's 2010 feature on the prospects for American economic recovery.