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## The I-word

Harvard economist Kenneth Rogoff has spent his career fighting inflation. Now he thinks it might just save the economy.



(Viktor Koen for The Boston Globe)

By [Leon Neyfakh](#)  
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LIKE CORRUPTION, crime, and asbestos, “inflation” is a word that many Americans imagine in all-red capital letters, flashing across TV screens amid warnings of crisis. For anyone who remembers the gloomy, scary 1970s, when the inflation rate in the United States reached double digits, the word is shorthand for an economy that has spiraled out of control, the dollar losing value and prices climbing feverishly. “Inflation is as violent as a mugger, as frightening as an armed robber, and as deadly as a hit man,” said Ronald Reagan in 1978, as nervous citizens imagined the day when they’d have to push a wheelbarrow full of cash to the grocery store in order to buy a loaf of bread.



(David L. Ryan/Globe staff)

That particular nightmare never came to pass, thanks to drastic measures taken by the Federal Reserve. For the better part of the past 30 years, the dollar has stayed stable, reassuring American families and the nation's trading partners, with the central bank standing guard over the economy and doing everything necessary to keep inflation low.

You might say that Kenneth Rogoff has been one of the guards. As a research economist at the Federal Reserve during the first half of the 1980s, he 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.

But then came the financial crisis of 2008, and the ensuing slump. And as the economy has continued to stagnate, Rogoff, 58, has become the flag-bearer for an unlikely position: that as we struggle to help the economy find its way out of the darkness, inflation could be the answer. It's time, Rogoff says, to put Reagan's "hit man" to work for the good guys.

Over the past several years, Rogoff has emerged as one of the world's leading experts on the history of financial crises and how they work, a unique perch that has given him a long view on what is happening to our economy and what lies ahead. In the bestselling 2009 book "This Time Is Different," he and Carmen Reinhart, currently a senior fellow at the Peterson Institute for International Economics, laid out a detailed analysis of financial crises that have taken place around the world going back 800 years, and they put forth an alarming idea about our current predicament. What we're going through, they argued - what we've been going through ever since the subprime mortgage crisis - has not been just a typical recession, as our leaders have been treating it, but something much worse, something that demands altogether different tools to stop it.

One of these tools, Rogoff believes, is a temporary burst of inflation. And for the past several weeks, as the stock market has convulsed and debate raged over the Fed's next move, he has been making his case publicly, through syndicated opinion columns, high-profile TV appearances, and numerous interviews. It's an argument that Rogoff himself admits is

“radical,” and one he says he’d rather not be making. But as he sees it, what’s holding the country back from recovery is not just a lack of consumer confidence or suppressed demand, as in a normal recession, but an immense overhang of debt: thanks to the collapse of the real-estate bubble, millions of American families owe so much to banks that they’re focusing all their energy on paying down their debts instead of spending their money on new investments. There will be no recovery until the painful process of working through that debt is behind us, Rogoff argues, and an increase in the annual inflation rate, which has floated around 2 percent since the early 1990s, would make it easier for debtors to pay down what they owe.

“There’s no penicillin for this,” he said in an interview. “There’s no quick getting better. What you’re really talking about is taking the edge off the downturn and coming back to normal growth somewhat faster.”

Rogoff’s call to raise inflation has come under attack from several different directions. Some economists think it wouldn’t do any good - that trying to raise inflation wouldn’t create demand or spur growth the way Rogoff thinks - while others believe that, given that prices actually seem to be in danger of falling at the moment, the Fed couldn’t make it happen if it wanted to. But perhaps the biggest problem for Rogoff is that, for most policymakers, elected and otherwise, the idea of courting inflation on purpose sounds downright crazy - not to mention politically disastrous.

“Going around the country saying, ‘We need more inflation’ is not going to be a big seller,” said Michael Mussa, a senior fellow at the Peterson Institute and a former adviser to Reagan. “Inflation means that the costs of everybody’s goods and services are going up . . . And I believe it’s a substantial symbol of mismanagement by the government and the central bank.”

Rogoff, however, remains convinced that as the situation grows more desperate, our leaders will feel pressure to start considering their options with more open minds. “As more and more people realize that we’re not quickly going back to normal,” he said, “they become more flexible.”

THOUGH ROGOFF speaks with unflinching steadiness, hearing him explain how badly our leaders misdiagnosed the economy after the crash, one imagines a doctor banging his fists against the door of a surgery ward, trying to warn his colleagues that he has checked their patient’s chart and realized they’re about to make a huge mistake.

The mistake we all made, as Rogoff sees it, was thinking this was going to be nothing more than a regular recession, the same kind of thing that has happened in the United States once or twice every decade for the past 150 years. These cyclical recessions come and go, and we

have a pretty reliable playbook for dealing with them: usually, an increase in government spending and lower interest rates to encourage money to flow. Recessions tend to end after about a year, at which point unemployment starts to fall and normal growth resumes.

Far less frequently, something more serious grips an economy: a financial crisis that breaks the pattern, and from which it is much more difficult to recover. Rogoff and Reinhart's book suggests that such contractions are characterized above all by severe, widespread debt, which leads to long periods of economic stagnation and uncertainty. Rogoff puts our current situation in that category, along with the Great Depression, and he fears that if we do not act quickly and creatively to dig ourselves out of it, we risk settling into a long-term slowdown along the lines of what Japan has been going through since the 1990s. Mistaking this crisis for a typical recession, he says, is like mistaking pneumonia for a stubborn cold. "They're very, very different animals."

The animal we're wrestling with today, of course, was born of the vastly overheated real estate market that collapsed in 2007, temporarily paralyzing the global financial system and taking some powerful banks down with it. Today, its legacy is a towering mountain of consumer debt, government debt, and millions of underwater mortgages that are gumming up the economy and preventing it from coming back to life.

"It's very unlikely that all these debts are going to get repaid in full," Rogoff said. Banks have loans on their books that people simply don't have - won't have - the money to pay off, and expecting it to happen means we'll just stay frozen in place, waiting. What needs to happen, Rogoff says, is "some transfer from creditors to debtors." The ideal way for that to happen, he says, would be through loan renegotiation, whereby banks would forgive some homebuyers and strike repayment deals with others. But that sort of piecemeal renegotiation has proved very difficult to carry out.

A more viable way to start fixing the nation's balance sheets, Rogoff argues, is by inducing a temporary bout of inflation. If the Federal Reserve raises its target inflation rate by several percentage points - up from around 2 percent, where it's been for the past decade, to somewhere in the neighborhood of 4 to 6 percent - and injects new money into the economy until it gets there, then debtors will get some relief and the wheels of the economy will once again start to turn.

Rogoff first laid out the argument for embracing inflation in one of his columns in December of 2008 - a move that came as such a surprise to people who knew his reputation that he got letters from central bankers who were sure they'd misunderstood him. Rogoff had worked at the Fed under none other than Paul Volcker, whose mandate as Fed chairman was to drive inflation down at any cost. Under Volcker's watch, inflation fell from 13.3 percent in December of 1979 to just 3.8 percent four years later. And though Rogoff at

the time was just starting out as an economist - indeed, he was still transitioning from his first career as a professional chess player - he soon became an intellectual force in the movement to make central banks the economy's first defense against inflation. In 1985, he published what would become one of his most widely cited academic papers in the *Quarterly Journal of Economics*, arguing that healthy economies depended on central banks being reliably committed to holding inflation down in all but the most extreme circumstances.

Rogoff says he hasn't changed his mind on how central banks should behave, and still thinks our fears of runaway inflation are well-founded. He just thinks that right now, it's a risk worth taking. "There's certainly some benefit in a society having a very, very strong conviction about keeping low inflation," Rogoff said. "But I think right now it's not helpful. You can have a very strong conviction that you don't want to take medicines . . . And I respect that, but there are times when there's really no choice."

Though Rogoff's idea about raising inflation has so far not gained much purchase in the economics profession - Mussa, for instance, called it "a hare-brained crackpot scheme" - he is not alone in his thinking. Versions of the same call have been taken up by several prominent economists across the political spectrum, including Olivier Blanchard, the chief economist at the International Monetary Fund; Joshua Aizenman, co-editor of the *Journal of International Money and Finance*; Harvard's Greg Mankiw, a former adviser to George W. Bush; and Paul Krugman, the Nobel Prize-winning *New York Times* columnist.

THOSE WHO disagree with Rogoff cite several key objections. One is that inflation can be hard to stop once it starts: if the Fed turned on the spigot, there's no guarantee they'd be able to turn it off before inflation got out of hand. Another objection is that if the Fed does raise its inflation target, pumping more money into the system and allowing the dollar to lose some of its value, lenders here and abroad will lose faith in the currency and respond by raising interest rates, which would ultimately make it harder for Americans to borrow money. A third objection is practical: that even if the Fed tried to trigger inflation, it simply might not be able to. The problem with the economy right now, some critics say, is a lack of demand for workers and products, and blowing air into the money supply would not change that.

"This idea that there's some separate policy instrument called 'creating inflation,' I think, is a little problematic," said Lawrence Summers, the former secretary of the Treasury and Harvard president who also served as the director of President Obama's National Economic Council. Increasing demand should be the primary goal, with inflation a possible byproduct, Summers said. "I don't think the idea that you could simply get more inflation by saying you want more inflation is a promising one."

Rogoff is not swayed by these arguments. He emphasizes that the level of inflation he is calling for is very modest - and that there's no really no reason to think that the Fed would be incapable of inducing it or reining it in at will. As for damaging the central bank's credibility, Rogoff reiterates the extraordinary nature of the present circumstances. "This is a very exceptional situation - a once in Halley's Comet kind of phenomenon," he said. As he wrote in his column earlier this month, "These are times when central banks need to spend some of the credibility that they accumulate in normal times."

Trying to persuade central bankers to go for that plan involves a different kind of problem: a political one. Inflation devalues the dollar and makes things more expensive, making it an easy political target. Earlier this month, as Wall Street and Washington waited to hear how the Fed would approach monetary policy going forward, Texas Governor Rick Perry more or less threatened Fed chairman Ben Bernanke with violence if he "prints more money" before the next election. What he was talking about wasn't even inflation, but a policy called "quantitative easing," in which the Federal Reserve injects new money into the economy by buying billions of dollars worth of Treasury bonds from banks. The Fed has already tried this twice since 2008, and each time it has been controversial. While Rogoff's plan to raise the inflation rate target is conceptually different from quantitative easing, it would involve the same mechanism, and would push the same political buttons in an even more extreme way.

Underlying that opposition is more than just patriotism: it's also a moral objection. Transferring the debt burden from borrowers to creditors, after all, effectively bails out borrowers by punishing the banks that lent them money, as well as devaluing the savings of their more prudent neighbors. That kind of rescue plan strikes many as fundamentally unfair.

Rogoff understands this objection, and doesn't dispute that what he's proposing is on some level unfair. But ultimately, he argues, this contraction is dragging us all down together, and even those lenders and savers will be better off if America's debt overhang is taken care of swiftly. Once that happens, and the economy starts to recover properly, we'll be able to focus on designing better policies that will make us less vulnerable to financial crisis in the future. For now, a little inflation might just be the cost of getting us to where that might be possible.

"One way or another," said Rogoff, "we're going to be doing things we would not dream we would ever do before this is over."

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