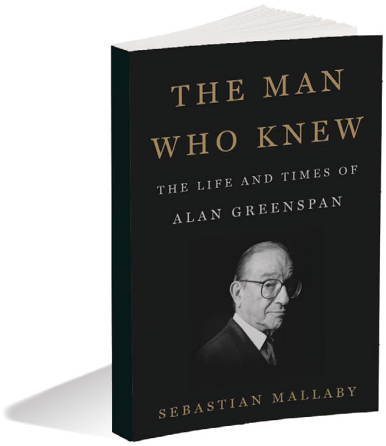
Judging Greenspan



Sebastian Mallaby

The Man Who Knew

The Life and Times of Alan Greenspan

Penguin Press, 2016, 800 pp, $40.00 (hardcover)

Too much success can be a dangerous thing. That is perhaps the key takeaway from Sebastian Mallaby's epic new biography of former U.S. Federal Reserve chair Alan Greenspan, *The Man Who Knew.* The central and (to this reviewer at least) somewhat shocking revelation of the book is that far from being a blind follower of "markets know best" efficiency theory, Greenspan was well aware that easy monetary policy and stock prices could create bubbles in the market—terribly damaging ones (he did a seminal paper on the topic in 1959). And yet, he allowed them to inflate anyway, believing this preferable to more dramatic government interference in the market. The great irony is that thanks in large part to Greenspan, central bankers themselves have become the major player in global markets—something that has introduced huge, unknown risks into our economy. Clearly, the man who knew didn't know everything.

Despite this, many lessons in Greenspan's legacy are relevant to today's economic problems. For one, economics should move toward the empirical. Greenspan had what was arguably his biggest insight when he was deep in the weeds, tallying numbers rather than relying on ivory tower models. I

the summer of 1996, there was a debate at the Fed about whether interest rates should be hiked to ward off overheating in the economy. Wages were rising, and the stock market was up 45 percent over the course of a year. Yet productivity figures seemed oddly weak, given the efficiency gains that businesses were seeing from globalization and new technologies. Solving the conundrum was crucial—if productivity was actually rising, then there was no reason to hike interest rates, since workers making more widgets could also be paid more without triggering inflation. Nearly every economic guru at the time—from Larry Summers to Janet Yellen—worried about inflation. But Greenspan insisted that Fed researchers go back and re-tally the numbers across 155 industries and four decades. The result? The maestro was right; low productivity in services was artificially lowering the overall rate.

The times that Greenspan—and as a result, the economy—faltered were usually when there was too little data and too much ego in the room. The praise and political power that came with his many lucky hunches—and some well-deserved policy home runs—made him less willing to rock the boat and raise interest rates, even when it was clear that this really was what was needed to derail a potential crash and recession. Once a staunch opponent of government bailouts he later supported bailouts of emerging markets like Mexico (whose debt was held by big U.S. banks—a crucial fact that the book underplays). He dismissed warnings by U.S. Commodity Futures Trading Commission chair Brooksley Born on derivatives, believing incorrectly that they weren't as potentially damaging as she thought they might be, but also that it would be too politically tricky to push through regulation. He made sideways references to "irrational exuberance" by the late 1990s, but backed off on curbing it when the markets stabilized. Like most finance-friendly regulators, Greenspan didn't want the music to stop. When it did, to his great credit, he issued a mea culpa, admitting there had been a "flaw" in his thinking. Mallaby— who wrote this book over five years with Greenspan's cooperation while working as a senior fellow at the Council on Foreign Relations—believes it was mistake for him to do so, since ideologically, he had never bought totally into "rational" markets.

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I disagree. Actions matter, and Greenspan took responsibility for his. While his "flaw" was less an intellectual one than a moral one, the fact that he admitted to making a mistake of any kind is one of the things that redeems him. Many others who played a part in the events leading up to the 2008 crisis and Great Recession failed to do so. What's more, Greenspan's admission marked an important departure from the fiction of the omniscient central banker (one that he helped craft). The world has come to depend far too much on central bankers being those "who know." It's time to demand more from the politicians we elect to run the real economy itself.

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