In Defense of Greenspanism

J. Bradford DeLong
Professor of Economics, U.C. Berkeley
Research Associate, NBER

brad.delong@gmail.com

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FOR nearly 20 years Alan Greenspan, as head of America's central bank, was the most powerful economic central planner the world has ever seen. What did he do? Roughly twice a year the Federal Reserve chairman had to make a substantive decision about whether to raise, lower, or keep the level of U.S. interest rates in the same.

Why is that important? To lower interest rates is to make the future more valuable relative to the present; to raise interest rates is to make the future less valuable. When the future is more valuable, more people in the economy focus their eyes on it and more actions are taken that will have an effect in the future: the building of factories, investment in research, construction of houses and apartments. To lower interest rates is to shift economic attention and focus from the present to the future. To raise them is to shift that balance back again.

Isn't this odd? Don't we have a market economy? Why should a central planner setting interest rates? The only reason is that this system appears to work less badly than the alternatives we have tried. Institutions and human psychology lead financial markets to bounce back and forth between exuberant greed and catatonic fear. Times of fear generate high unemployment. Times of greed are likely to be times of destabilizing inflation. Whether justified in the economic terms of Milton Friedman, those of John Maynard Keynes, or -- as Greenspan did early in the Clinton administration, confusing everybody -- the pre-Keynesian Swedish school, economies seem to function better when intelligent, skilled, and public-spirited technocrats perform the calming, coordinating, and leaning-against-the-wind role of managing interest rates to curb greed and fortify fear with some low-interest rate Dutch courage.

Greenspan is world famous because he was very good and very lucky at this role. During his tenure at the Federal Reserve, he made roughly 36 substantive decisions about the direction interest rates should go. Six times I disagreed with him. Five of those six times I was wrong. (The sixth? In the summer and fall of 2000, as the dot-com stock market bubble crashed, I would have been cutting interest rates had I been sitting in Greenspan's chair; he waited for more information to see how much the fall in stock market values would affect high-tech investment spending before he acted.)

That is an amazing record -- much better than Barry Bonds, and Greenspan clearly has never been on steroids. It is certainly much better than most economists I know could have done. Now this veritable rockstar economist-technocrat has written “The Age of Turbulence” with Peter Petre (who wrote the autobiographies of Gen. H. Norman Schwartzkopf and IBM head Thomas J. Watson Jr.). The voice in the book is Petre. In a sense this is too bad: Greenspan's voice is unique and a good window into his mind. But it is also nearly incomprehensible, even to trained professionals. And Petre has done a superb job at translating Greenspanese into English.

“The Age of Turbulence” is three books in one.

The first tells us who Greenspan is. It is the one that will speak to non-economist non-financier readers. The stories are wonderful.: Of a professional-caliber jazz clarinetist in New York in the 1950s, playing his sets and then reading his economics books during the breaks while fellow musicians went backstage to party and get high.

Of a 26-year-old "math junkie" being knocked back on his heels by his philosophical guru Ayn Rand, objectivist author of "The Fountainhead" and "Atlas Shrugged," when she pulls Descartes' "I think, therefore I exist" move on him. Of an economic advisor trying to educate, serve, and guide presidents Nixon, Ford, Reagan, Bush I, Clinton, and Bush II. (Nixon wasn't just anti-Semitic, Greenspan tells us, but anti-everyone: "I don't know anybody he was pro.") Of inviting NBC News correspondent Andrea Mitchell, now Mrs. Greenspan, back to his apartment to read his essay on monopolies.

The second book gives Greenspan's view of the world and is, I think, least successful. He is trying to convey complicated and subtle technocratic ideas about the global economy -- its current structure and how it functions in a way that is comprehensible to general readers whose purchases drive bestseller lists. My students will read it because it will be on the midterm. But the book's target audience is likely to find this tour of the world a slog, and they are not incentivized by midterms.

The third book -- Greenspan's account of public policy -- is making the biggest splash as news. But it is news only in a very peculiar sense. That Greenspan and other committed small-government Republicans have been horrified at the turn their party has taken, and have desperately sought some way to take it back from the cynical media consultants and political hacks who now run things, is well known -- to readers of Ron Suskind's "The Price of Loyalty" and Bruce Bartlett's "Imposter" or a host of people who know people who know Bush administration undersecretaries. Greenspan's much quoted judgment in the book -- that current Republicans officeholders "deserve to lose" elections because they sold their principles for power and "ended up with neither" -- should come as no secret. Yet news stories over the last few days have breathlessly reported selected phrases from the new book, characterizing them, as the Washington Post's Bob Woodward did, as "unusually harsh criticism [of] President Bush and the Republican Party" for abandoning "the central conservative principle of fiscal restraint."

It is not surprising that a prominent economist with a lifelong commitment to sound money and sound public finance does not like the policies the current governments has followed. The news is that the east coast establishment dailies have not reported this before.

One piece of this third book is worth noting: Greenspan's defense of his tenure as Fed chief. Why does he need a defense? -- 35 out of 36 is a very good batting average. But one could indict Greenspan on four counts: that he should not have, but did, support the Bush tax cut of 2001; that he should not have, but did, encourage new U.S. homeowners to get adjustable-rate mortgages -- ARMs -- in the early 2000s; that he should have done something to abort the dot-com bubble of the late 1990s; and that he should have done something to prevent the real-estate bubble of the 2000s.

The first two counts are misdemeanors, and Greenspan pleads guilty. He says that he was warned that his testimony on the proposed 2001 tax cut would send a different message than he intended, that he ignored those warnings, which proved correct. Greenspan writes that his support for a tax cut was nuanced and partial, provided there were triggers to prevent budget deficits, but that his statements were interpreted by the news media and politicians as a blanket endorsement. He adds that he did not understand how institutionally corrupt and thus unconcerned about good budget policy his Republican Party had become by early 2001. He says he did not properly understand in the early 2000s the large effect low teaser interest rates and prepayment penalties would have in leading new and financially-strapped homeowners into deals that were not in their best interest.

The other two counts could be considered economic felonies, and here Greenspan stands his ground. Given the state of investor psychology, he says, he could have aborted the stock market and housing bubbles of the late 1990s and the early 2000s, but only by paying an unacceptable price in idled factories and unemployed workers. He may be right and he may be wrong in this judgment -- I don't know. I do know that this is a judgment call, a difficult aspect of monetary policy.

I also know that Greenspan's judgment on monetary policy is very good, and looks to be better than mine.