

Alan Greenspan, *The Age of Turbulence. Adventures in a New World*

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Alan Greenspan was Chairman of the US Federal Reserve Board from August 1987 to January 2006. He served a total of five terms under four presidents, from Ronald Reagan to George W. Bush. In August 2005, at the annual conference hosted by the Federal Reserve Bank of Kansas at Jackson Hole, Wyoming, a symposium was devoted to *The Greenspan Era: Lessons for the Future*. In their 94-page assessment of Greenspan's work as Fed Chairman, Alan Blinder and Ricardo Reis concluded that: 'While there are some negatives in the record, when the score is toted up, we think he has a legitimate claim to being the greatest central banker who ever lived.' John B. Taylor agreed that Greenspan was 'the greatest central banker who ever lived.' Allan Meltzer, the acclaimed historian of the Fed, was more qualified in his evaluation. Nevertheless, of the Fed's 12 chairmen since 1913, Meltzer judged that 'Alan Greenspan stands in the front rank'.²

For 18 years, Alan Greenspan was one of the most powerful men in the world. Yet he was something of an enigma, and consequently there has been a yearning to know what made him tick. As his retirement from the Fed approached, Greenspan accepted a multi-million-dollar advance from Penguin Press to write about his life: *The Age of Turbulence* is the result. It is likely to earn the author many more millions of dollars.

The book is generally well written and has been lavishly promoted and extensively reviewed. But it is a curious book. For a start, to what exactly does the title refer? Does *The Age of Turbulence* refer to the period of Greenspan's chairmanship of the Fed, which included the stock exchange collapse of 19 October 1987, the boom and collapse of the late 1980s–early 1990s, the Mexican, Asian, Russian, Argentine and Long Term Capital Management (LTCM) crises, the equity bubble and collapse of the late 1990s–early 2000s, the Y2K scare, 9/11, and the origins of the sub-prime mortgage crisis? Or does it refer to the times that Greenspan himself lived through: the Great Depression of the 1930s, the Second World War, the Great Inflation of the 1970s and the Great Moderation

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² These papers can be accessed at: <http://www.kc.frb.org/publicat/sympos/2005/sym05prg.htm>

of the 1990s and early 2000s? Or again, is it the era that began with the attacks on New York and Washington on 9/11, 2001?

The book is a curiosity for another reason. It is divided into two distinct parts. The first part is a memoir of Greenspan's life and career. Here the reader is taken through the main events of the author's life: his Jewish forebears — the Greenspans and Goldsmiths — who had arrived in New York in the late nineteenth century from central Europe; the divorce of his parents soon after his birth; his upbringing by his mother in the Washington Heights neighbourhood of Manhattan's upper-west side; his undergraduate studies at NYU and early work for a doctorate at Columbia under Arthur Burns (he eventually took his Ph.D at NYU); his work as a financial analyst at the Conference Board and the occasional journalism he undertook for *Fortune* magazine; the establishment of his own economic consultancy firm; his association with Ayn Rand, and her circle; his participation in Richard Nixon's campaign for the US Presidency in 1968; his appointment by President Ford as Chairman of the Council of Economic Advisers; his dating of two of the most powerful women in television news and current affairs — Barbara Walters and Andrea Mitchell;³ and his various assignments for the Reagan Administration, culminating in his appointment as Chairman of the Fed.

The second half of the book comprises a series of essays on various topics, including recent economic developments in different parts of the world, the sources of economic growth, the nature of capitalism, international debt, globalization and regulation, education and income inequality, the financial implications of ageing populations, and the problems besetting corporate governance. The book concludes with a chapter on future economic developments, appropriately entitled 'The Delphic Future'.

The two parts do not sit comfortably together. It is possible that Greenspan — or his publishers — considered that there was insufficient autobiographical material to sustain the reader's interest, and so the disjointed series of essays that constitute the second part of the book were added. Greenspan himself has confessed that most of the book was composed while he soaked in the bath each morning for therapeutic purposes. Clearly this is not an ideal way of writing any book requiring substantial research, though it may be satisfactory for a book comprising subjects that catch the author's fancy as he enjoys the recuperative powers of a hot tub.

Greenspan was one of the world's pre-eminent economic-policy advisers and policy-makers of the final quarter of twentieth century, and unquestionably the world's leading central banker of the past two decades. We could have learnt much more than is provided in this book about the work of a central banker,

³ The latter, to whom the book is dedicated, he married after an extended courtship.

and particularly about the *modus operandi* of Greenspan himself as he went about his work as the head of the world's most powerful central bank.

What does Alan Greenspan reveal about himself and his approach to policy? Though he was unquestionably committed to market forces, he refused to subscribe to a particular monetary theory or monetary policy framework. He thought little of Keynesian economics, but he describes Keynes's *General Theory* as 'a mathematically elegant solution to why the world had stagnated and how government deficit spending could bring prompt recovery' (p.15). He knew Milton Friedman well and worked with him on ending conscription in 1973, but he was not taken in by monetarist doctrine. Indeed, in the early 1990s he officially ended the Fed's half-hearted dalliance with monetarism by switching its operating procedures from a focus on monetary aggregates to the rate of interest charged on cash in the overnight bank market (the 'federal funds rate'). He was also sceptical of the Phillips curve approach to macroeconomic policy, dismissing the idea that there existed a unique 'non accelerating inflation rate of unemployment', or a 'natural' rate of unemployment. Nor did he support inflation targeting; he was committed to maintaining low rates of inflation, yet he refused to be pinned down to a particular inflation target. He rejected the view that the monetary authorities should intervene to prick an asset-price bubble. It might be legitimate enough for a central bank to warn the public of the dangers of 'irrational exuberance', but financial bubbles were often the result of innovation, which, for Greenspan, is the essence of capitalism.

If he supported any set of economic ideas, it was the views of Joseph Schumpeter that attracted his attention. Greenspan maintained that caution should be exercised at times when activity was accelerating lest the creative processes that lie at the heart of capitalism are stifled. For him, central banks face the difficult task of ensuring that inflation does not get out of hand while, at the same time, allowing the dynamic processes of innovation, competition and 'creative destruction' to proceed. Once the boom has collapsed, however, it is then the duty of central banks to flood the financial system with liquidity, thereby preserving solvent institutions that have temporarily become illiquid.

It is this outlook that explains Greenspan's delay in tightening policy in the years preceding the recessions of the early 1990s and 2000s; his failure to limit the 'high tech' bubble of the late 1990s; and his dramatic easing of policy in 2002, to which many observers have attributed the origins of the current sub-prime mortgage crisis. It helps to explain his response to the New York Stock Exchange crash of 1987 and to the expected financial instability arising from 9/11. And it also explains his association with the rescue missions following the financial crises in Mexico, Asia, Russia and Argentina, and his role in the bailing out of LTCM.

Greenspan appears to have developed the idea that policy settings should be based on a risk-management assessment of the probability of inflation or recession. If such an exercise were to conclude that there was a high probability of inflation, he would recommend to the Fed's Open Market Committee (FOMC) that monetary policy should be tightened; the probability of a recession would lead him to recommend an easing of policy. If inflation was accelerating but it was probable that a recession — or deflation — would soon occur, Greenspan was likely to recommend an easing rather than a tightening of rates. From this approach to monetary policy it is possible to identify the genesis of the housing bubble that began after the recession of 2000–01. As Greenspan explains:

At the FOMC meeting in late June [2003], where we voted to reduce interest rates further, to 1 per cent, deflation was Topic A. We agreed on the reduction despite our consensus that the economy probably did not need yet another cut. The stock market had finally begun to revive, and our forecasts called for much stronger GDP growth in the year's second half. Yet we went ahead on the basis of a balancing of risk. We wanted to shut down the possibility of corrosive deflation; we were willing to chance that by cutting rates we might foster a bubble, an inflationary boom of some sort, which we would substantially have to address. I was pleased at the way we'd weighed the contending factors. Time would tell if it was the right decision, but it was a decision done right. (p.229)

Three pages later, he acknowledged the creation of the housing bubble, but again justified the policy that had produced it:

More recently, the unwinding of the housing boom has hurt some groups. It did not create great difficulties for the great mass of homeowners who had built up substantial equity in their houses as prices rose. But many low-income families who took advantage of subprime mortgage offerings to become first-time homeowners joined the boom too late to enjoy its benefits. Without an equity buffer to fall back on, they are having difficulty making their monthly payments, and increasing numbers are facing foreclosure ... I was aware that the loosening of mortgage credit terms for subprime borrowers increased financial risk, and that subsidized home ownership initiatives distort market outcomes. But I believed then, as now, that the benefits of broadened home ownership are worth the risk. Protection of property rights, so critical to a market economy, requires a critical mass of owners to sustain political support. (pp. 232–3)

When future historians of the Fed come to make their assessments of monetary policy during the early years of the twenty-first century their conclusions may not be as favourable to Alan Greenspan as were those of the eminent economists who spoke at Jackson Hole in 2005.