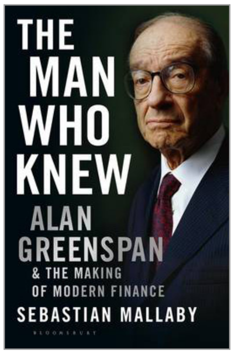


## The Man Who Knew: The Life and Times of Alan Greenspan

By Sebastian Mallaby
Penguin Publishing Group, 2016, Kindle edition, 796 pages

**Reviewed by Stephen Kirchner**

Alan Greenspan was one of the world's most influential central bankers and economic policymakers, chairing the US Federal Reserve Board from 1987 to 2006. With his pedigree as a member of Ayn Rand's inner circle, he was also one of the world's most prominent libertarians. Greenspan successfully negotiated Washington politics under both Republican and Democratic administrations, outmanoeuvring even the likes of Henry Kissinger, an unlikely career for a shy, socially awkward Randian from Washington Heights.

Mallaby builds on existing biographies of Greenspan, written at the height of his influence and reputation, which I reviewed in the Autumn 2001 issue of *Policy*, as well as Greenspan's autobiography, which I reviewed in the Autumn 2008 issue. He also draws on the recent Anne Heller biography of Ayn Rand, which I reviewed in the Autumn 2010 issue. Mallaby extends this material with his own extensive primary research, giving Greenspan's life and career the more definitive treatment it deserves.

Greenspan's libertarianism inevitably colours many of the assessments of his career. To critics on the left, his career is an illustration of the dangers of free market ideology intruding into public policy. For those on the right, his apparent willingness to compromise on free market principles was seen as just as problematic.

In fact, Greenspan was never a particularly ideological economist and his approach to economics was overwhelming empirical and atheoretical, reflecting his undergraduate training. His libertarian convictions, developed through exposure to Ayn Rand, were reinforced by his understanding of economics, but were not embedded in a particular school of economic thought.

Mallaby's obvious lack of sympathy for Rand and other advocates of free market ideas (Bastiat, for example, is dismissed as a 'cultish nineteenth-century French economist' (p.2)) inclines him to try and divorce his subject from these influences. A theme throughout the biography is the alignment between Greenspan's beliefs and actions. Because Greenspan was a prominent advocate of free market ideas, he naturally invites this scrutiny. Yet few other people in public life would be expected to exhibit such a high degree of unity between thought and action, not least because many of them lack any intellectual framework at all.

The compromises Greenspan made between his beliefs and his actions as a policymaker were for the most part inevitable trade-offs in response to political and other constraints. Yet there was a unity of purpose to Greenspan's involvement in public life and the United States would have been poorer without his involvement. As the owner of a successful business and self-made millionaire, Greenspan took a significant pay cut to enter and stay in public office. Mallaby finds that 'Greenspan was honest, decent, and profoundly wise—he was a model of a public servant' (p. 685).

Mallaby tries to be fair to Greenspan and shows how many of the conventional criticisms of Greenspan's career are wrong. In particular, Mallaby highlights Greenspan's longstanding and subtle understanding of the role of finance and asset prices in the economy, refuting the suggestion made by many that he was blind to these influences. Even a cursory reading of Greenspan's public statements, not least his famous 1996 'irrational exuberance' speech, demonstrates this. Mallaby's primary research only serves to underscore what should be obvious from the public record. Mallaby does Greenspan a service by showing how lazy and ill-informed much of the criticism of him has been.

Mallaby shows that Greenspan was one of the most prominent critics of the government-sponsored, housing finance enterprises Freddie Mac and Fannie Mae, and warned numerous times of the threat these entities posed to the US economy. Mallaby says that 'with the unfair benefit of hindsight, Greenspan might have done more to avert this catastrophe' (p. 660) yet the material presented in the book makes clear that his efforts, which were already above and beyond his responsibilities as Chair of the US Federal Reserve and the call of duty, would have made little difference to subsequent events.

Mallaby uses the characterisation 'with the unfair benefit of hindsight' on four separate occasions, but in each case, 'unfair' could be replaced with 'unreasonable.' Mallaby wants to distance himself from many of these negative judgements and in the concluding chapter, substantially walks away from most of them.

Mallaby tries to resist the pull of the morality play narrative, but seemingly against his own evidence and judgement, succumbs to characterising Greenspan's tenure at the Fed as a 'tragedy.' Ultimately, monetary policy is about the one variable that the Fed can reliably control and that's inflation. Greenspan's record on inflation was better than any previous post-World War Two Fed Chair. If Greenspan's tenure was a tragedy, many of his predecessors' records would have to be regarded as catastrophic. The Great Moderation, a two-decade decline in US inflation and output volatility, bookends Greenspan's tenure as Fed Chair. While the role of monetary policy in the Great Moderation is far from being a settled question, the macroeconomic record under Greenspan's tenure is difficult to impeach and Mallaby readily concedes this.

So wherein lies the tragedy? Like many other commentators, Mallaby blames US monetary policy under Greenspan's tenure for asset price booms and busts, in particular, the US housing boom in the run-up to the 2008-09 Global Financial Crisis (GFC). Mallaby suggests monetary policy should have leaned more heavily against asset prices, that Greenspan was wrong to argue otherwise and should have known better (hence 'The Man Who Knew'). Like other Greenspan critics, Mallaby never suggests how much additional tightening (whether actual or threatened) would be required to curb these asset price inflations because to do so would give the game away. We know to a first approximation what an increase in real interest rates does to output and inflation. It is not hard to show that a tightening directed at limiting asset price inflation would crush the nominal and real economy and bring about the very outcome it sought to avert.

Mallaby maintains that the arguments against such a policy of trading off inflation outcomes against financial stability are unconvincing and no more than assertion, but this does not begin to do justice to a very serious debate among economists on this issue (I review these debates in my 2009 CIS Policy Monograph *Bubble Poppers*). Lars Svensson, for one, has shown how disastrous such policies can be both in theory and practice. Sweden has negative official interest rates today in large part because it conditioned past monetary policies on household debt and house prices at the expense of inflation, with unfortunate consequences that were the subject of a critical official review by Marvin Goodfriend and Mervyn King.[1]

While a biographer can be forgiven for not wanting to spend too much time on what can be a very technical debate, the claim that monetary policy should lean against asset price inflations is also thoroughly ahistorical. The record shows that the most serious mistakes made by central banks have not been the result of keeping monetary policy too easy. As Milton Friedman showed with respect to the Great Depression and Scott Sumner has shown with respect to both the Great Depression and the 2008-09 GFC, central banks are more likely to err on the side of keeping monetary policy too tight, especially when second-guessing the market on asset prices. With both Greenspan and Bernanke presiding over the lowest rates of inflation in the post-World War Two period, any claim that monetary policy was systematically too loose is impossible to sustain.

Mallaby does Greenspan a service by substantially rescuing his reputation from his many critics. But he conditions his judgements about Greenspan on a false narrative about the stance of US monetary policy and its role in the economy. He is hardly alone in this, but one can't help but get the sense that Mallaby over-reaches for narrative effect. To conclude that Greenspan was not just the 'Man Who Knew', but that he was substantively right on just about everything perhaps does not serve a biographer's dramatic purpose. It would also be a tough sell to a readership already conditioned to see Greenspan and US monetary policy as being implicated in the Crisis that took place years after he left the Fed. The adulation Greenspan received as he departed the Fed in early 2006 tells us that any blame should be more widely shared.

It is his successor as Fed Chair, Ben Bernanke, who deserves more criticism for keeping US monetary policy too tight during and in the aftermath of the GFC. It is still not widely understood that the Federal Reserve under Bernanke largely sterilised its quantitative easing program, deliberately creating incentives for financial institutions to hoard liquidity for fear it would stoke inflation at the same time that inflation expectations and nominal spending in the United States were collapsing (see Scott Sumner's 'A New View of the Great Recession' in the Winter 2013 issue of *Policy*). This is despite Bernanke having authored numerous academic papers demonstrating a sophisticated understanding of how to effectively conduct monetary policy through quantitative operating instruments. Bernanke was someone who knew, but failed to act in response to a real as opposed to a hypothetical or apprehended crisis. The contrast with the Greenspan Fed's deft handling of the 1987 stock market crash could not be starker.

Far from being a tragedy, Greenspan's tenure at the Fed was a spectacular success, as Mallaby for the most part acknowledges. This is not to say that US monetary policy could not have been improved by a more rules-based and transparent approach. Mallaby briefly mentions nominal gross domestic product targeting as an alternative to inflation targeting, but does not elaborate on its significance. Greenspan could have moved the Fed in these directions at the expense of his own authority and influence. While one can fault Greenspan's highly discretionary approach to monetary policy on procedural and other grounds, the results were far better than could reasonably be expected and this is in no small part due to Greenspan's judgement, which was spectacularly right more often than not. Had Greenspan gone against his own free market instincts and sought to second-guess financial markets on asset prices, as Mallaby suggests, the results would almost certainly have been disastrous and his biography would relate a different type of tragedy. The counterfactual in which someone other than Greenspan was Fed Chair (and we largely know who the alternatives might have been) is one that is worth contemplating.

In the end, Mallaby wants us to think Greenspan could have done even better than he did and that this is the stuff of tragedy. Some will be persuaded by that conclusion, but it is a misreading of history that mars an otherwise exceptional biography. Mallaby would have served his readers better by completely overturning the flawed conventional narrative about the role of monetary policy and Alan Greenspan in recent US economic history. Surely there is as much drama in triumph and vindication as there is in tragedy?

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## Endnotes

1 Marvin Goodfriend and Mervyn King, 'Review of the Riksbank's Monetary Policy 2010-2015' (Stockholm: 2015), http://www.riksbank.se/Documents/Rapporter/%C3%96vrigt/utvardering_penningpolitik_2010_2015_eng.pdf