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The longtime Fed Chairman fed the credit mania that led to the 2008 financial panic.

The Myth of the 'Maestro'

REVIEW & OUTLOOK

Alan Greenspan, who died Monday at age 100, is being hailed in the press as a great central banker with the flaw that he didn't endorse enough financial regulation. That narrative obscures the real success and failure of the man who presided as Chairman of the Federal Reserve from 1987-2006.

The paradox of Greenspan's career is that he presided over the best and worst modern eras of the Fed. Appointed by Ronald Reagan to replace the great Paul Volcker, Greenspan kept the Fed on the policy path of disinflation. This became known as the Great Moderation as inflation was largely contained while the U.S. economy grew in robust fashion.

This was the era when Greenspan, supported by fellow Fed Governor Wayne Angell, followed a de facto price rule in setting monetary policy. The Fed focused on actual prices in the economy, including commodities, and Greenspan told us more than once that he even kept a wary eye on the price of gold.

Along the way he helped prevent various financial panics from becoming more serious—most notably, the stock market plunge of 22.6% on a single day in October 1987 that became known as Black Monday. The Greenspan Fed pledged to provide adequate financial liquidity, and the panic abated. He is also rightly praised for recognizing that the 1990s productivity boom gave the Fed leeway not to raise interest rates amid faster economic growth.

The bad turn came in the 2000s after 9/11 and the dot-com bust. Influenced by then Fed Governor Ben Bernanke, Greenspan became preoccupied with the risk of deflation. In June 2003 Greenspan cut the fed funds rate to 1% and kept it there for a year, though the second Bush tax cut had passed Congress in May and the economy had begun to surge.

Greenspan tightened money slowly after that, despite rising oil and other commodity prices. Thus was born the great credit mania of the mid-2000s. These columns warned consistently in that era that the Fed was too easy for too long, and Greenspan let us know in often contentious phone calls that he didn't like our then-lonely warnings. Only in 2005 did Greenspan finally say publicly that housing prices had become "frothy". But by then the credit mania and housing bubble were already long building. The music stopped in 2008, producing the panic that did so much harm to the free-market economy that Greenspan promoted.

The Fed wasn't alone in feeding the housing bubble, as Congress pressed Fannie Mae and Freddie Mac to guarantee subprime mortgages and "liar loans." To his credit, Greenspan in the 2000s was an ally of the George W. Bush White House in pressing Congress to shore up the capital standards of Fannie and Freddie. But the housing lobby owned Congress, which acted only after it was too late.

Greenspan's worst moment came amid the financial panic, after he had retired from the Fed, when he blamed the financial meltdown on others. "Those of us who have looked to the self interest of lending institutions to protect shareholders' equity, myself especially, are in a state of shocked disbelief," he told Congress in October 2008.

That comment, which received enormous publicity, let the political class off the hook and fed the belief that the panic was a crisis of capitalism that needed more regulation. Greenspan never admitted the failure of monetary policy or of the regulators at the time who had allowed Citigroup and other banks to create the off-balance-sheet vehicles that failed.

The tragedy of this career finale is that it marred what was otherwise Greenspan's keen lifelong understanding that government can't fine-tune the economy or create wealth. The press called Greenspan the "maestro." But he always knew that neither he nor anyone else in Washington conducted the U.S. economy.