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How Greenspan Made the Fed Famous

CAPITAL ACCOUNT

By Greg Ip

When Kevin Warsh told his father in 2006 that he'd been nominated to be a governor on the Federal Reserve, his father, a smalltown businessman, replied: "The thing Greenspan runs."

Alan Greenspan retired as the central bank's chairman just before Warsh, the current chairman, joined the Fed board. To his father and the public, Greenspan was the Fed.

As America's only celebrity central banker, he elevated the Fed to a prominence in U.S. life that it retains to this day. Greenspan aphorisms such as "irrational exuberance" are now part of the vernacular.

The unelected Greenspan was in many ways more influential than the elected people who kept reappointing him. This was first, because he was successful. His predecessor, Paul Volcker, had slain double-digit inflation. Greenspan brought it down to about 2%, and kept it there. He presided over the then-longest economic expansion in U.S. history. Second, he looked like he knew what he was doing. Greenspan understood and interpreted the economy better than anyone.

That was a blessing and a curse. Greenspan basked in the credit for the booms that unfolded under his watch, and chafed at the blame heaped on him for the financial collapse shortly after he left office.

Yet in hindsight, Greenspan's legacy is clear. It wasn't market acumen or grasp of economic theory, but how he combined both with a temperament for navigating relentless political pressure.

Greenspan and me

I started covering the Fed in 2001, late in his tenure. Part of the appeal was observing a celebrity up close. A friend who knew nothing about the Fed was impressed: "You're going to follow Greenspan around?"

At first I was intimidated, but that didn't last. The public (and cartoonists) saw him as inscrutable and humorless. The reality was the opposite. He could write, and speak, with extraordinary clarity and forcefulness. He had a quick, dry wit, even under pressure. Stranded abroad by the 9/11 attacks, he hitched a ride back on an air force tanker and was at his desk the next day. When a caller asked how he was, he responded: reasonably well, "catastrophe-adjusted."

For fellow journalists and me, Greenspan wasn't just a news subject but a bottomless well of insight and ideas.

Note

I came away from every meeting with Greenspan smarter. Admonished for not knowing Knut Wicksell's theory of the natural rate of interest, I quickly brushed up. After a discussion of Keynesian prescriptions for preventing depression in the 1940s, he sent me to George Terborgh, an obscure economist with a contrarian and bullish view on American potential.

Of Greenspan's many speeches, one he was especially proud of was a tribute to the Scottish founder of modern economics, Adam Smith, delivered in Kirkcaldy, Scotland, in 2005. It begins: "In the broad sweep of history, it is ideas that matter.… Emperors and armies come and go; but un--less they leave new ideas in their wake, they are of passing historic consequence."

The speech raised the question: What ideas did Greenspan leave in his wake? Milton Friedman is known for monetarism, John Maynard Keynes for Keynesianism. The essence of Greenspan was distrust of any single "ism." He flirted with every theory while never binding himself to one.

He was less steeped in mathematical models than the Ph.D.s who staffed the Fed and succeeded him. Much of economic activity, he believed, was driven by "animal spirits" that can't be modeled. "Human nature is essentially immutable," was his constant refrain. Note

This layering of psychology on economics guided many of his decisions: his rapid cuts to interest rates after the 1987 stock market crash and in 1998 when Russia defaulted and a big hedge fund nearly failed.

He was accused of inflating bubbles with this readiness to cut rates. In fact, he was well aware of the risks of low rates. In 1994 he tightened aggressively to squeeze out what he thought were dangerous imbalances. When he slashed rates in 2003 all the way to 1%, he felt uneasy; it went against his "19th century" aversion to easy money, he later told me: "My inner soul didn't feel comfortable." It's one reason he never took rates to zero. His successors didn't share that hesitation.

Note

The deregulator

His blind spot about risks in the financial system also owed something to a general aversion to regulation. He had hung around with Ayn Rand in the 1950s and 60s and saw free market capitalism as intrinsically moral and government as fundamentally coercive.

Note

The financial crisis tarnished the Fed's reputation, not just Greenspan's. His successors Ben Bernanke, Janet Yellen and Jerome Powell were, like him, competent, nonpartisan technocrats confirmed on bipartisan votes. But confirmation margins have been shrinking. Warsh was confirmed last month by the narrowest margin since senate approval became a requirement in 1977.

The partisan polarization and populism that have consumed American politics have come for the Fed. President Trump launched an attack with no modern precedent on Fed independence. He has sought to fire a governor, Lisa Cook, ostensibly for mortgage misrepresentations (which she denies) but in reality to gain control over the Fed and interest rates.

In one of his last public acts, Greenspan, along with all other living former Fed chairs, signed an amicus brief asking the Supreme Court to block Trump's effort to remove Cook.

With Trump's demands for loyalty and lower rates hanging over him, Warsh and his colleagues last week unanimously voted to leave rates unchanged. Afterwards, he declined to say where rates might go. In his studied inscrutability Warsh was emulating his role model and the man who came to personify what it means to be a central banker.

