Critique of Alan Greenspan's Legacy

Greg's Note: Fred Sheehan returns to commiserate the 20th anniversary of Alan Greenspan's Fed chairman nomination. He applies these flattering terms to the Maestro "lapses in judgment…self-serving…intellectual laziness…furtiveness…gobbledygook…mediocre talents." Need I say more? Please enjoy and send any comments my way: greg@whiskeyandgunpowder.com

Whiskey & Gunpowder
July 20, 2007
By Frederick J. Sheehan

Alan, We Hardly Knew Ye

In June 1987, Alan Greenspan was nominated to succeed Paul Volcker as Federal Reserve chairman. Greenspan's nomination hearing was held on July 21, 1987. With the 20th anniversary upon us, it is worth studying what an intelligent observer might have learned that day. The hearing (and discussion surrounding it) was revealing. Greenspan's character was on full display during the summer of '87: his lapses in judgment, his self-serving declarations, his intellectual laziness, his furtiveness, his gobbledygook, and his mediocre talents.

When the nomination was announced, Greenspan's face was on the front cover of *Time,* with the caption "The New Mr. Dollar." This was prophetic for both the omnipresent Greenspan image and the man who printed more dollars than all of his predecessors combined.

Greenspan was quick to demonstrate how he would shift his opinions to satisfy an audience. In early June, he told a Chicago audience that "over the long run," the value of the dollar would go "significantly lower." A week later, at the press conference announcing his nomination, he discussed "evidence" that the dollar's fall had "bottomed out." In July, before the Senate Banking Committee, he announced the dollar had entered a "period of stability." The last forecast missed by a mile, but this was not his prediction at all. His true position was expressed to the Chicago audience the month before.

Greenspan testified before the Committee on Banking, Housing, and Urban Development. It was headed by Sen. William Proxmire of Wisconsin. The most compelling testimony appeared in the May 21, 2007, edition of *Whiskey & Gunpowder* (see "Help Wanted: A Leading Contrarian Indicator"). Some of it is worth recalling, since it cuts to the heart of the public's 20-year-long miscalculation: He is a man of modest ability. The revelations of his inadequacy for the job were obvious. Yet, the media did not pursue what a Pulitzer Prize-chasing editor could have turned into front-page news. Two decades later, this is still true.

Sen. Proxmire chided the candidate for a "dismal forecasting record" when he was chairman of the Council of Economic Advisers. (Greenspan was CEA chairman during the Ford administration.) In Proxmire's words, the forecasts made by the candidate were "way off." Of the interest rate forecasts made by the CEA, Greenspan's were "wrong by the biggest margin of any of the [CEA chairmen]." Proxmire went on: "There you broke all records for the entire period in error." Of inflation: "There again, you broke all records." The only CEA chairman to adorn the front cover of *Newsweek* estimated the consumer price index would rise 4.5% in 1978. It soared 9.2%.

Greenspan would control such quibbles in later years, but not this day. He replied: "That is not my recollection of the way the forecasts went." Proxmire, forecasts in his hand, read the dates to Greenspan. The candidate admitted: "Well, if they're written down, those are the numbers."

Greenspan then embarked on the gobbledygook so familiar in later years. Proxmire waited patiently, and then responded:

PROXMIRE: "Every one of the chairmen of the Council of Economic Advisers had the same problem, and they didn't miss by as much as you did, not nearly as much…"

GREENSPAN: "I feel sorry for me and happy for them."

Proxmire pursued Greenspan's competence as a private forecaster. "As you know, you put your forecasting to a direct test in the private sector." Proxmire then quoted a recent issue of Forbes magazine. "Greenspan and O'Neil turned in one of the least impressive records of all pension fund advisers."

Greenspan did not throw out an illusory defense this time: "All I can say is I acknowledge that did not work out very well, and I take my share of the responsibility."

PROXMIRE: "I hope…when you get to the Federal Reserve Board everything will come up roses. You can't always be wrong."

GREENSPAN: "All I can suggest to you, Senator, is that the rest of my career has been somewhat more successful."

As a taste of what was to come, this was an introduction to Greenspan's ever-present qualifiers: "Suggest" and "somewhat" giving the candidate room to maneuver, should Proxmire pursue this course of interrogation. The senator did.

Proxmire quoted a forecast Greenspan sent to clients on March 20, 1987. "The recession we had not expected until 1990 now appears more likely to emerge in the last quarter of 1989…A stock market-led expansion of capital equipment in late 1987 is projected to lead to a final surge for the business credit cycle. This surge is expected to precipitate a recession shortly thereafter…[and the] recession is also expected to be somewhat more severe than we had projected in October [1986]."

Proxmire asked Greenspan if he still stood by that forecast:

GREENSPAN: "I don't know how to answer that…"

After not knowing how to answer that, he launched into an answer that was not an answer, but a response full of qualifications that qualified the qualifiers. Proxmire waited patiently before responding: "You were so specific in the dates of this forecast." To this, Greenspan went on to qualify more qualifications. Proxmire, his time up, responded "yes."

Note the turn of the tide. Proxmire was in charge, but Greenspan's furtive nondisclosures had prevented a deeper inquiry into his contestable past.

His most deliberate nondisclosure passed without much notice. Greenspan had submitted a written statement of relationships that might cause conflicts of interest. Sen. Proxmire questioned Greenspan on two relationships Greenspan had not listed: Sears, Roebuck & Co. and Lincoln Savings & Loan of Irvine, Calif. Greenspan had distinguished the two by slipping them in the side pocket of "advocacy projects." Cutting through the euphemism, he was paid by each to lobby for banking deregulation. As Fed chairman, he would become the nation's banking regulator. He had good reason to leave both off the full-disclosure list. Besides the conflict of interest, Greenspan's relationship with Lincoln Savings & Loan was more discreditable than is commonly believed. That story deserves wider circulation.

The other senators had different concerns. This is not to disparage their interrogation. Their questions and statements were intelligent. A consistent theme was the senators' concern that the growing indebtedness of the United States to foreigners was creating a dependency on foreign charity. This has come to pass. It is also lost on today's politicians.

Sen. Shelby from Alabama asked Greenspan if he was troubled that, as a nation "the U.S. had added $1.5 trillion to the national debt over the previous five years when it took the first 195 years to accumulate $1 trillion." Greenspan responded, "It bothers me a great deal." He then attempted to pacify the senator: "We're starting to deal with it." Shelby was having none of this: "We haven't even started to deal with it." The nominee thought he might soothe Shelby by claiming he did not think "it would be necessary to actually reduce the national debt." Greenspan then launched into some equivocations, that, if read five or 10 times (not a luxury available to the senators), essentially meant: "We can't reduce it because we won't reduce it." This, of course, was true, and it was diplomatic of Greenspan not to call the kettle black to the very men who had let the kettle rot.

In an Abbot and Costello routine so common in later years, Shelby worried about America's status as the largest debtor nation in the world. Greenspan replied, it "isn't clear" which is the largest debtor nation in the world:

SHELBY: "If we are not first, who is?"

GREENSPAN: "Oh, there are a lot of others."

End of discussion. Shelby did not have time to clarify questions and answers for a Trivial Pursuit contest. The senators were allotted a given amount of time to quiz the nominee. There may be a good reason for this (the filibustering of politicians comes to mind), but Greenspan knew — if not on this day, soon enough — he could run out the clock with his own form of filibustering.

Shelby warned that the national debt was "a ticking time bomb." He worried that the U.S. was vulnerable to foreign influence on the dollar. He asked the nominee: Since the Germans, French, and several others held an abundance of dollar claims, could they, in unison, decide to peg the U.S. dollar at a specific rate convenient to their own policies? Greenspan's answer was ambiguous but concerned the senators enough that he was asked if the Federal Reserve could intervene in the foreign currency markets to set the price of the dollar.

The senators agreed some questions were difficult to answer on the spot. He was asked to reply to these questions in writing. He wrote that the Federal Reserve should not intervene in currency markets. It could, however, set the currency rate, but only for a short period of time. This is a topic that would have made for a fascinating discussion later in his term. Interest seems to have faded after the hearing.

In another written response, Greenspan disavowed his former advocacy of the gold standard. His reasoning was specious: "Considering the huge amount of dollar claims in world markets, fixing the price of gold [by central bank intervention] seems out of reach." It is safe to assume he pulled this response out of a hat. He wanted to be Federal Reserve chairman. The committee wanted to assure itself Greenspan was not one of those dreaded gold bugs. Each side got what it wanted.

Sen. Sasser from Tennessee was concerned with debt accumulation. He thought rising corporate debt associated with mergers and acquisitions was troubling, particularly the capacity of business to operate in the next downturn. Greenspan agreed. He was concerned with "debt charges…specifically, debt service, which obviously does not decline when gross operating incomes fall, and the so-called 'coverage' of the interest becomes insufficient…We are increasing debt at levels which should make us all uncomfortable. It certainly makes me uncomfortable." Once he became Federal Reserve chairman, Greenspan steered clear of any discussion of leveraged buyouts, junk bonds, or bank solvency. This response to Sasser appears to be an answer the nominee knew would assuage his interrogators, after which he shied away from discussing such a delicate misappropriation of the banking system when he was in charge of it.

Proxmire closed the hearing, resigned to the result. The senator had greater concerns than Greenspan's wayward forecasts. "It seems to me that banking in this country and finance in this country is moving very sharply…in a direction of concentration and in a direction, which, I think, most senators, if they thought about it very long, might be very concerned about." This gives the sense of a man with a clear view of the future, but who did not think much of his fellow senators. (He also did not think much of the Federal Reserve Board: "[Y]ou will move in with a board of clones — not clowns — clones.")

Greenspan lacked the mental vigor to ever imagine the future: Witness his consistent inability to discuss even present dangers. Greenspan's trail of misapplied economics would be clear soon enough. One of many examples that would pass unnoticed: In January 1990, Greenspan prophesized, "Such imbalances and dislocations as we see in the economy today probably do not suggest that anything more than a temporary hesitation in the continuing expansion of the economy." In the wake of this speech, Drexel Burnham Lambert failed. This fractured the junk bond market. The economy was in recession by midyear.

The economic consulting firm of Townsend-Greenspan died quietly on July 31. The White House asked Greenspan to remove his name from the firm. The furniture and computers were sold at the beginning of August. The White House request was fortuitous. Pierre Rinfret, a New York consulting economist (who served with Greenspan on Nixon's 1968 economic advisory panel), refuted the common perception: "Everyone thinks that Greenspan gave up a lucrative consulting business to work in the public sector. In actuality, his business had been losing clients steadily to the point where he hardly had any left by the middle of the 1980s." The new Fed chairman had spent the past few years lobbying for the Fed chairmanship. Townsend-Greenspan had been hollowed out. A hollow man would be the new Federal Reserve chairman.

Regards,
Fred Sheehan