

## BOOK REVIEWS

### **The Age of Turbulence: Adventures in a New World**

Alan Greenspan

New York: The Penguin Press, 2007, 505 pp.

Alan Greenspan, for an \$8 million advance, has written two books in one. The first 11 chapters are a personal memoir from his earliest childhood memories through the end of 2006. The final 14 chapters are a series of lectures about the major recent changes in the United States and the world economy. The book is written in clear English, not Greenspan's occasional "Fedspeak," and is a pleasure to read—the result of a productive collaboration with Peter Petre, who taught him to write in the first person as a participant rather than only as an observer of the many important events in the past several decades. This is important because Greenspan has a lot to say about the people and policies of six administrations from that of Richard Nixon to that of George W. Bush. And it is important for both economists and others to understand the major lessons from this period.

For economists, it is important to understand Greenspan's preparation for his several public roles. Most of his broad economic education seems to have been self-taught, derivative of his long experience as an economic consultant. His only course in macroeconomics was from Arthur Burns, a distinguished academic specialist in business cycles and later a chairman of the Federal Reserve. Like most economists of his age, Greenspan's own macroeconomics may best be described as casual Keynesianism. Like his mentor Burns, Greenspan believed that most major trends in the inflation rate were the result of *nonmonetary* forces—Burns, as an explanation (or rationalization) of the rapid increase in inflation on his watch, and Greenspan, as an explanation of the broad reduction of inflation and long-term interest rates on his watch. And, again like Burns, Greenspan believed that the most important general cause of inflation was excess government spending. Greenspan never had an academic appointment or a record of articles in peer-reviewed professional journals, which seems like a very strange background for someone who would become the most important central banker in the world.

The memoir section of this book is long on commentary about the

people with whom he dealt but short on reflections about his experience as chairman of the Fed. Among issues that I had hoped to read about are the following.

The book does not mention what might have been Greenspan's reflections about the lessons to be learned from the experience of his predecessor. Paul Volcker inherited an inflation rate (of the consumer price index) of 13.7 percent in 1979 and immediately implemented a tight monetary policy, leaving a healthy economy and a 4.4 percent inflation rate to Greenspan in 1987. I wonder what nonmonetary condition Greenspan considers may have explained this substantial reduction of inflation.

The book describes in some detail the decisions by the Federal Reserve in response to the sharp reduction in stock prices in October 1987 and the series of financial crises in 1997 through 1999. But it does not recognize that the Fed may have overreacted to these financial crises or say anything about the post-crisis effects of the Fed intervention. One might hope that the Fed intervention in response to a financial crisis would be sufficient to prevent a decline in aggregate nominal demand relative to some target path, but in each case the intervention led to a post-crisis bubble. The monetary tightness necessary to eliminate the bubble following the 1987 crisis led to the mild 1991 recession and a slow early recovery. Similarly, the monetary tightness necessary to eliminate the second bubble led to the mild 2001 recession and a slow early recovery. A third demand bubble developed during the last three years of Greenspan's watch, leaving the reduction of demand growth to the target path to his successor, Ben Bernanke.

The book does not mention the Basel Accord of 1988. This accord, to which Greenspan agreed, established an international standard on commercial bank portfolios with the goal of reducing the risk of bank failures and a bank run. Implementation of this standard increased the shares of government securities and mortgages in bank portfolios at the expense of a lower share for commercial and industrial loans. In the United States, this standard constrained any increase in commercial and industrial loans from 1989 through 1994, contributing to the mild 1991 recession and the slow early recovery.

On the other hand, the book records that Greenspan was increasingly strident about the increasing federal budget deficits during both the first and second Bush administrations, warning that "history suggests that an abandonment of fiscal discipline will eventually push up interest rates, crowd our capital spending, lower productivity growth, and force harder choices upon us in the future." Such public comments significantly weakened the relations between Greenspan and the two Bush administrations. Greenspan was correct to make a case against the prospective deficits, although the Federal Reserve has no responsibility for fiscal policy, but his simple Keynesian argument was wrong. In fact, there have been no significant effects of the budget deficit on inflation and interest rates in the United States and other major countries. Deficits *do* matter,

however, but for different reasons. First, a tolerance for deficits leads to *increased* government spending, an outcome quite contrary to the “starve the beast” hypothesis favored among Republican politicians. Second, deficits represent an involuntary transfer from future taxpayers, many of whom are not yet born, to current voters. In this sense, deficits are *immoral* unless they lead to significant future benefits.

(One minor irritation: in this book by a former chairman of the Council of Economic Advisers, the word “advisers” is consistently misspelled as “advisors.”)

The later chapters address a wide range of topics. The chapters on economic growth, the modes of capitalism, China and the other Asian tigers, Russia, and Latin American are informative and wise without being especially controversial. The chapter on the U.S. current account deficit makes the case for his view that this is a rather benign condition. I hope he is right, but I am not confident. The chapter on globalization and regulation makes the case for accepting most of the changes resulting from globalization without overregulation. He attributes the unusually low long-term interest rates of the past 15 years to the global capital market and increased global saving, not to monetary policy. Greenspan directs his strongest policy criticism to the poor performance of our public schools and to the huge unfunded promises for future Social Security and Medicare benefits. Somewhat to my surprise, he endorses expensing stock options and autocratic CEOs in his chapter on corporate governance.

I was flabbergasted, however, that Greenspan believes that “the Iraq war is largely about oil.” Even in desperation for trying to find a credible rationale for the Iraq war, the Bush administration never used the oil rationale. Greenspan concludes his chapter on energy by stating, “Until industrial economies disengage themselves from, as President George W. Bush put it, ‘our addiction to oil,’ the stability of the industrial economies and hence the global economy will remain at risk.” But somehow, the real dollar price of oil has tripled over the past five years without a serious risk to either the U.S. or world economy. This is the least well reasoned chapter in his book. Unfortunately, Greenspan’s views on energy are shared by other people who ought to know better.

In the final chapter, Greenspan returns to his professional specialty as an economic forecaster. He discusses the conditions that will affect America’s economic future and then makes a forecast of U.S. economic conditions in 2030. On one issue, I am concerned that Greenspan may be too optimistic. He writes, “Since knowledge is never lost, productivity will always rise.” But knowledge about the conditions that contribute to economic growth has often been forgotten or dismissed in the pursuit of other values. On another issue, I hope that Greenspan will prove to be too pessimistic. He anticipates substantial increases in the average inflation rate and the interest rate on 10-year bonds, outcomes that he regards as the normal condition since the end of the gold standard and the growth of the welfare state. The book ends on an awkward note that the

conditions that led to a substantial reduction in the inflation and interest rates in the past three decades were an accident and are not likely to be repeated. How sad.

William Niskanen  
Cato Institute