Greenspan sees the light

(submitted to The Huffington Post, October 23 2008)

A remarkable thing happened in late October, on the way to the most important election in modern times. Alan Greenspan saw the light.

For over three decades now we have been told – by him and by others – that the main problem with government is that it interferes too much in the market. General prosperity and individual liberty, we hear endlessly, requires that market forces be given entirely free rein. The less government we have, the freer we are supposed to be. Let deregulation reign: that has been the governing ideology.

The financial melt-down of lightly-regulated financial markets, and the growing evidence of the adverse impact of that melt-down on jobs, wages and pensions, has called that governing common sense into question. For the first time in decades, both the ideology and its leading advocates are now under fire: hence the appearance of the man Bob Woodward once labeled "The Maestro" before a Congressional committee that once was uniquely deferential to him but is now uniquely hostile.

When Alan Greenspan appeared before the House Committee on Oversight and Government Reform, the committee chairman Henry Waxman criticized him fiercely on two fronts: for having an ideology, and for having the wrong one. Greenspan quite properly educated the chairman in the importance of ideologies. Everyone possesses one, he said: they are simply conceptual frameworks without which none of us can make sense of the world. He was quite right. Political choice is not about whether to hold an ideology. It is always about the adequacy of the ideology chosen.

But then came this amazing admission from the most influential advocate of a deregulated market system: that the ideology he had held to so fervently for 40 years was flawed. "Those of us who have looked to the self-interest of lending institutions to protect shareholder equity," he told the Committee, "myself included, are in a state of shocked disbelief". Before the watching world, the former chairman of the Federal Reserve admitted that his faith in deregulation had been shaken. "The modern risk management paradigm held sway for decades," he said. "The whole intellectual edifice, however, collapsed in the summer of last year".

> *"Do you feel your ideology pushed you to make decisions you wish you had not made," Waxman asked.*
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> *"Yes, I found a flaw," Greenspan responded. "I don't know how significant or permanent it is. But I've been very distressed by that fact."*

That was a huge moment in modern American politics.

It freed (and indeed obliged) the rest of us to explore precisely how significant and permanent is the flaw in market deregulation that suddenly is distressing the former chairman of the Federal Reserve.

That flaw is, in fact, both enormous and permanent.

- ** Fully deregulated markets necessarily create a divided society: left to themselves, markets generate vast inequalities in income and wealth. We have seen that truth in operation year by year over the last two decades in the United States.*
- ** Unless regulated in the need for the longer view, markets necessarily make for impatient capital: unregulated, they privilege the taking of short-term profits over long-term investment growth.*
- ** And unless properly managed, unregulated markets necessarily generate long term economic and social instability: such markets clear only through unavoidable cycles of boom and bust that destroy both job security and savings for old age.*

We need to remember all of this on the next occasion that we are told by the Rush Limbaughs of this world that tighter federal regulation of financial markets is simply creeping socialism. It is nothing of the kind. Managing markets is not anti-capitalist. Just the reverse: managing markets in the public interest is a vital guarantor of the long-term health of the private sector, and of the well-being of all those who rely on the private sector for their job security and income growth.

Markets work wonderfully as allocators of resources over time only if everyone has the same purchasing power within them, and only if institutions outside the market so organize them as to tip the direction of financial self-interest towards the service of long-term societal goals. Left to their own devices, markets are huge engines of inequality, short-termism and crises. Unregulated markets serve nobody but themselves, and they hurt us all.

We are now in the most severe financial crisis of our lifetimes because an ideology of de-regulation prevailed in Washington for far too long. Let us hope that the current crisis will be quickly managed away by the quality of government intervention. Let us hope too that the potential severity of the current crisis will now at last educate us all in the important role that public policy necessarily has to play in preventing any future repetition of crises of this kind.

Whatever else we need in public policy right now, we do not need more of the same. Alan Greenspan, of all people, just told us so!