WHAT GREENSPAN OWES US

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By Jeffrey E. Garten

[NOTE: I WAS ASKED TO WRITE THIS FOR THE DAILY BEAST, BUT JUST AS I SENT IT IN, I WAS TOLD THE EDITOR WAS SICK OF GREENSPAN AND THEY APOLOGETICALLY KILLED IT – EVEN BEFORE SEEING.]

When Alan Greenspan testifies before the Financial Crisis Inquiry Commission in Washington on Wednesday, he could make a significant contribution to the evolution of banking reform, provided two things happen. First, the commissioners will need to take off the gloves and grill him on his mistakes, how they happened, and his detailed ideas about how to avoid similar errors in the future. Second, the former Fed chair will have to let his hair down, discard any defensiveness for the mistakes he made while in office, and be willing to roll up his sleeves and provide comprehensive answers.

There is no use belaboring Greenspan's role in the financial meltdown – they have been recounted many times -- but the basics do constitute the background for Wednesday's hearing. For thee twenty years Alan Greenspan was in charge, he presided one of the most independent and admired of American institutions, the prestige of which rivaled the Supreme Court. He himself had a reputation for wisdom, dedication, hard work. Then – and now – there was no doubt that he was an honorable man with no personal motives besides serving the country. His tenure was identified with the longest business boom in American history, a time when America dominated the emerging Internet and the globalization of financial markets. He had a clear ideology that supported free markets and as much deregulation as the political system could bear. He held the view that no matter how big or how complex banking became, financial institutions would regulate themselves in a manner that would serve the public interest. *If* he had major critics within the government, they were hard to identify and in any event had little standing compared to him.

When the subprime crisis unfolded morphed into a meltdown of risky assets everywhere, it was clear that Greenspan had made a spectacular error of judgment about how markets really work and about the importance of sound, strong regulation that must evolve with the times. He had a wealth of experience himself, he had more financial information at his finger tips than probably any human being on earth, and he had the capacity to confer with the best economists on the globe, and yet he missed the warning signs about the risks that were building and how those risks were being concentrated in a few institutions.

So this is what I would like the commission to ask him:

Mr. Greenspan, you have said many times, including this past weekend on ABC News, that notwithstanding all the problems that we have had, it would be a mistake to abandon competitive markets. With due respect, sir, no one is advocating so extreme a measure. Would you now agree, however, that a substantial degree of new regulation is necessary to insure that markets function in society's broader interest? If so, what are the five most important regulatory changes you would advocate?

Mr. Greenspan, you are on record as having supported a wide range of unconventional mortgages and as saying that derivatives reduce risks and have a stabilizing impact on financial market. In light of what has happened, please tell us how you would have changed your positions on these issues at the time you opined on them, and give us your recommendations on handling them going forward.

Mr. Greenspan, you have advocated, including in a recent technical paper presented at the Brookings Institution, that a key policy imperative is requiring banks to hold larger capital reserves. There is little controversy about the principle. But who should determine the precise levels? And assuming banks did have a bigger financial cushion, it could never be so big to eliminate all chances of a major crisis. So what is the key to prevent another taxpayer bailout?

Mr. Greenspan, in that same event at Brookings, you expressed your skepticism about having a systemic regulator, someone whose job it is to look at the entire financial system for emerging problems in a way that no existing regulator of a product or of a type of institution can remotely do. Given how interconnected the global economy has become, and given how much in the dark you and everyone else seemed to be about those connections, could you please share your thinking with us?

Mr. Greenspan, we have appreciated your willingness to admit many of your mistakes. But what worries us is that if someone with your brain power, diligence, and public policy ethic could have been so wrong, it must be that you were not sufficiently challenged by other heavyweights with knowledge of finance. If you could be Fed chair all over again, what kind of mechanism would you want to establish that insures you would never be so isolated and that you were surrounded by men and women of equal caliber and equal independence who could vigorously debate with you to make sure that every angle is fully explored, every contingency weighed?

Mr. Greenspan, it worries us that in the congressional debates that are occurring now so little genuine attention is being given to the global aspects of regulation. At a time when the America's biggest banks are on course to earn more abroad than at home; when most of the largest financial institutions are coming out of China; and when American-style capitalism is badly tarnished, what should be our international financial reform agenda and how does it relate to all the issues that the House and Senate are now struggling with?

A few weeks ago I wrote here that the Financial Crisis Inquiry Commission was established too late to do any good. (See _____) But if the members can ask the tough questions in significant enough detail, and if Alan Greenspan is willing to respond frankly, constructively and comprehensively, I am willing to eat my words.

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