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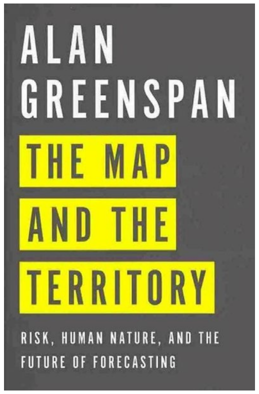

BOOK REVIEW: ‘The Map and the Territory’

by Richard W. Rahn

THE MAP AND THE TERRITORY: RISK, HUMAN NATURE, AND THE FUTURE OF FORECASTING

By Alan Greenspan

Penguin Press, $36, 388 pages

Alan Greenspan began his career in economics as an analyst and forecaster. In his new book "The Map and the Territory," Mr. Greenspan presents an honest assessment of what economists can and cannot predict, along with many useful insights as to the way that both politicians and investors tend to behave. It is also a first-rate history of some of the failures and successes of economic policy over the past century by the ultimate economic-policy insider.

All too many policymakers, once they leave high government positions, write books to tell us how brilliant they were and to settle scores with those who differed with them. Refreshingly, Mr. Greenspan takes a high road in candidly discussing his own mis-forecasts and the lessons to be learned from them, while avoiding speaking ill of others in personal, if not policy, terms. He served as chairman of the Council of Economic Advisers to President Ford (1974-1977) and as chairman of the Federal Reserve from 1987 until 2006.

Mr. Greenspan writes as if he were an outsider observing the intellectual development of Alan Greenspan and the economics profession over the past 60 years. He writes: "I was drawn to the sophistication of the then-new mathematical economics as a graduate student at Columbia University in the early 1950s. But my early fascination was increasingly tempered over the years by a growing skepticism about its relevance to a world in which the state of seemingly unmodelable animal spirits is so critical a factor in economic outcomes." As one who was also a graduate student studying economics at Columbia University (a couple of decades after Mr. Greenspan), I too was first enamored with mathematical modeling only to see its limitations as the real world failed time and time again to behave as the models predicted. (I expect many climate scientists are now going through this same realization.)

In a remarkable statement from a former Fed chairman, Mr. Greenspan writes: "But leading up to the almost universally unanticipated crisis of September 2008, macromodeling unequivocally failed when it was needed most, much to the chagrin of the economics profession. The Federal Reserve Board's highly sophisticated forecasting system did not foresee a recession until the crisis hit. Nor did the model developed by the prestigious International Monetary Fund." There were a few economic forecasters who did get it right, but Mr. Greenspan is correct that most of the economic establishment got it wrong.

Mr. Greenspan has never been closely identified with any one school of economics. At times, he has embraced monetarist, Keynesian, classical and Austrian economic concepts. He now clearly understands F.A. Hayek's argument why neither central planning nor forecasting can succeed because of "limits to knowledge" that all suffer from. Despite his recognition of the severe limits of current forecasting models, Mr. Greenspan argues that in the future, the profession will do better by incorporating more knowledge of how human beings behave in periods of extreme economic stress.

Ever the empiricist, Mr. Greenspan has wallowed in economic data for his entire professional life looking for trends. Looking at data, e.g., the weight of manufactured items shipped by rail, gave him useful insights, which he readily conveyed to rest of us in discussions over the years. In 1983, President Reagan appointed Mr. Greenspan as chairman of a commission to look at the long-term viability of Social Security. (I was on the commission that was looking at Medicare at the same time.) All of us who served on the two commissions came away understanding that the existing structure for the major "entitlements" was not sustainable over the long run — yet here we are 30 years later with the string running out. Mr. Greenspan observes that the "unfortunate consequences of our magnanimity is these benefits have been crowding out private saving almost dollar for dollar." This has slowed productivity growth, but "would have been even worse if we had not turned to borrowing so heavily from abroad."

Those seeking support for more financial regulation will be disappointed by this book, in that Mr. Greenspan details how the regulators and rating agencies failed. He argues that the Dodd-Frank law, which was passed to prevent another financial crisis, is unlikely to do so and may, in fact, add to the problem. He distinguishes between fraud prevention, which is necessary, and much of financial regulation, which is destined to fail. "We need to lift the burden of massive new financial regulation that is becoming increasingly counterproductive." He argues for higher capital standards: "Adequate generic capital eliminates the need for an unachievable specificity in regulation."

Policymakers, from the president on down, students of economic policy and serious investors will find their time well spent in reading this book. Mr. Greenspan's fundamental theme is: "We cannot expect to consume virtually all of current production and still create ever-rising standards of living. The math doesn't work." He wants to be the optimist, but this data-driven man can't find the evidence that the political class will change before it is too late to avoid ever-increasing hardship.

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