The following is an excerpt from **Age of Greed: The Triumph of Finance and the Decline of America**, 1970 to the Present *by Jeff Madrick.*

After the attacks on the World Trade Center in September 2001, the Fed, already trying to restart the economy, cut rates faster, three reductions in a row of a half point each. By the end of 2001, the target federal funds rate, some 6.5 percent only two years earlier, was now only 1.75 percent. But the economy was not expanding at a healthy rate. And with the tax collections cut due to recession, on top of the loss of former capital gains collections, the federal budget fell into a $150 billion deficit. It was a stunning reversal, and expensive incursions into Iraq and Afghanistan were looming.

In 2002 and 2003, the economy was still not recovering adequately despite the extreme rate cuts the Greenspan Fed initiated. Now Greenspan thought deflation— an overall decline in prices— was a far greater worry than inflation, which could result in financial turmoil. Debtors don't pay back their loans because dollars are more valuable— they can buy more. Creditors take large losses. Greenspan always believed he could recharge the economy by cutting rates sharply. The financial markets had come to depend on this ever since his rescue in 1987, and it became known as the "Greenspan put"—a floor Greenspan would always place under securities prices. But now the lower rates were not working. As economist Mark Zandi said, Greenspan realized the only way out was to push interest rates even lower to ignite a housing boom. Perhaps he believed he could this time pull the plug just short of its becoming a housing bubble. If housing was stimulated, higher house prices in turn would encourage consumers to spend— the "wealth" effect, as it was called. Greenspan cut the target federal funds rate to 1 percent and kept it there until mid- 2004, the lowest since the early 1950s.

The low rates between 2000 and 2004 were the lifeblood of the housing boom. Thousands of new mortgage brokers, and twenty or so giant ones, were vying with one another to sell mortgages to lower- income Americans, relying in particular on adjustable rate mortgages, or ARMs. Buyers paid low interest rates in the first two years of the mortgages after which rates rose, usually substantially. But with house prices rising relentlessly, the homeowner could refinance with another ARM, or pay down some of the mortgage and reduce the monthly payments. A rapidly growing number of these were subprime mortgages, sold to home buyers with poor credit. But middle-income Americans also often took ARMs, to buy homes once out of their reach. With rates so low and no federal oversight, mortgage lending practices, long suspect, became widely abusive. Even the FBI warned in 2004 of an "epidemic" of fraud in subprime mortgage writing, but it had devoted so many of its resources to antiterrorist activities, it had little left to pursue unscrupulous mortgage brokers.

Greenspan knew about these loans, and was warned by associates at the Federal Reserve that abuses were mounting. He had the authority to investigate but chose not to. In 2004, remarkably, Greenspan himself spoke favorably of the ARMs. "Many homeowners might have saved tens of thousands of dollars had they held adjustable-rate mortgages rather than fixed-rate mortgages." As economist Zandi wrote, such a comment was essentially an endorsement of the practice.

At last, the economy started to grow strongly again, based on the housing boom, and Greenspan began to raise the federal funds rate in mid-2004, eventually by more than 4 percentage points. Inflation was increasing only moderately, but Greenspan's other great concern, the federal deficit, now enlarged by war spending, was about to exceed $400 billion, some 4.5 percent of GDP.

The rising federal funds rate, which reached 5.25 percent by the end of 2006, did not dampen the flow of mortgages, since Wall Street was now the most important source of mortgage money, not the thrifts. Packaging mortgages into securities—securitization—had made such institutional investors as pension funds and insurance companies the major providers of funding for mortgages. Hundreds of billions of dollars of new money found its way to homeowners each year. When Greenspan raised rates, it did not staunch this flow because mortgage brokers, which now included giant mortgage specialists like Countrywide Financial, big commercial banks like JPMorgan and Citigroup, and the major Wall Street investment banks, like Lehman Brothers, pushed ever harder to sell the ARMs with the low initial rates or mortgages known as Alt-A that required no verification of income. They knew that Wall Street had an almost bottomless pit of demand for the new securitized debt from pension and investment managers as well as financial institutions around the world. Greenspan just could not get long-term interest rates to rise much.

Greenspan, based on his firm market principles, approved strongly of securitization and most derivative products as a way to spread risk— a view traditional market economists like Summers shared. But even when crisis struck in 2008, it was clear the Federal Reserve economists in Washington and New York did not understand how excessive and risky the borrowing now was. In particular, the relatively new collateralized debt obligations (CDOs), a way of packaging risky mortgages for investors willing to make only low- risk investments, was not understood or even investigated. Greenspan's ultimately naive and dangerous faith in competitive markets showed itself nowhere as damagingly as in the Fed's failure to be vigilant about the CDOs. Not only did his interest rate increases fail to dampen the financing, but they encouraged Wall Street to take more risks and mortgage brokers to write more bad loans because their profit margins had narrowed. They made up in quantity what was lacking in quality. The high dollar coupled with the trade deficit, which put even more dollars in foreign hands, which they in turn confidently invested in U.S. securities, provided ample funds. Between 2000 and 2005, according to Wellesley 246 age of greed economist Karl Case and Yale's Robert Shiller, house prices rose faster than at any time in modern history, and the number of mortgages being written exploded.

But when Greenspan raised rates in 2004—on which adjustable rate mortgages were based—the clock began to tick. The rates on tens of billions of dollars of ARMs would be reset upward in 2006. That year, default rates on mortgages started to rise rapidly and home prices for the first time started to fall. In 2007, two hedge funds at Bear Stearns went broke and the worst credit crisis since the Great Depression got under way. In early 2008, Bear Stearns was saved from bankruptcy in a distress sale to JPMorgan Chase. In September, Lehman Brothers collapsed altogether and the Bush Treasury initiated a $700 billion bailout of commercial and investment banks. Many observers blamed Greenspan's extreme monetary easing in the early 2000s for the debacle, making credit too cheap. But regulatory vigilance could have prevented the excesses. Greenspan would have none of it.

Greenspan retired at the end of 2006. In congressional hearings in 2008 before a House committee chaired by Henry Waxman, Greenspan testified that he "made a mistake in presuming that the self- interest of organizations, specifically banks and others, were [sic] such that they were best capable of protecting their own shareholders and their equity in the firms." He found, he went on, a "flaw in the model that I perceived is the critical functioning structure that defines how the world works … I was shocked because I've been going for forty years or more with very considerable evidence that it was working exceptionally well." His admission was welcome but misleading. His model of economic behavior and government policy resulted in profound financial instability every few years and subpar economic performance for the nearly twenty years he was Fed chairman. The boom of the late 1990s, the one exceptional period, was highly dependent on spending encouraged by the stock market bubble and benefited from low inflation due to falling oil prices, a high dollar, and plunging computer prices. In the 2000s, he traded a boom in housing for the boom in high-technology stocks.

In his memoir, Greenspan wrote, "assisted by the wave of deregulation since the mid-1970s, today's U.S. economy remains the most competitive in the world, and American culture still exhibits much of the risk taking and taste for adventure of the country's earlier years." Yet, in more regulated times, America exhibited the very same entrepreneurial behavior and risk taking that it did in Greenspan's time, and perhaps more. In the 1950s, with the rise of Xerox, Kodak, IBM, Sears, Syntex, Merck, Johnson & Johnson, Hewlett-Packard, and others, innovation and regulation went hand in hand with financial stability, rising wages, and income equality. Had he achieved that record, he would have deserved the praise he had received.

The unleashing of unregulated self-interest since the 1980s, he believed, was a sufficient condition for prosperity.