THE BLOG 11/13/2008 05:12 am ET | **Updated** May 25, 2011

Alan Shrugged

By Marty Kaplan

What went wrong?

Greed is only part of it. Yes, the people who sold subprime loans to unqualified buyers were concerned about their cut, not about ARMs spiking and home prices falling. Yes, the Wall Street wizards who sliced and diced collateralized debt obligations were greedy for big paydays and living large.

But invoking greed actually explains little, no more than invoking lust or envy or any other human urge. The mystery isn't why people are greedy; it's how greed gets the better of them.

At a private fundraiser in Houston, when he thought there was no risk of being recorded, George W. Bush offered this explanation for our troubles: "There's no question about it, Wall Street got drunk — that's one of the reasons I asked you to turn off the TV cameras — it got drunk and now it's got a hangover. The question is how long will it [take to] sober up and not try to do all these fancy financial instruments."

There is no reason to question President Bush's credentials for knowing a drunk when he sees one. But Bush, though he says he can't remember a day from prep school to his 40th birthday when he didn't have a drink, also insists that he has never been an alcoholic. He just drank "too much." When he stopped, he didn't acknowledge that he had a disease; what was wrong, it seems, was just typical youthful irresponsibility and a too-protracted youth.

So Wall Street's problem, in the president's mind, is not a systemic pathology, not an illness that comes on the same chromosome as the profit motive. Instead, it's the behavior of a frat boy on a bender, the reckless phase of a good-time Charlie rather than the symptom of profound disease.

Bros will be bros; greed, like stuff, just happens.

A quite different explanation comes from a man to whom Bush gave the Presidential Medal of Freedom, and who is the intellectual parent of this collapse: Alan Greenspan.

It was Greenspan who set the Fed funds rate at an all-time low of one percent, inflating the housing bubble whose existence he denied, insisting that the unprecedented run-up in housing prices was just local “froth.”

It was Greenspan who successfully fought off all efforts to regulate derivatives — the generic name for the financial instruments that have poisoned the world’s economies — by the Congress and the Commodity Futures Trading Commission, proclaiming instead that the market would regulate itself.

When then-Rep. Bernie Sanders (I-VT) asked Greenspan at a Congressional hearing, “Aren’t you concerned with such a growing concentration of wealth that if one of these huge institutions fails that it will have a horrendous impact on the national and global economy?”

Greenspan answered, “No, I’m not. I believe that the general growth in large institutions has occurred in the context of an underlying structure of markets in which many of the larger risks are dramatically — I should say, fully — hedged.” In other words, the bigness of our big banks had conquered risk.

So how does the Oracle, the disciple of Ayn Rand, the libertarian champion of unfettered markets, explain the meltdown? In a speech at Georgetown University earlier this month, he attributed it to “lack of trust in the validity of accounting records of banks and other financial institutions” in the past year. Trust! Who knew?

So it’s not competitive markets and “Atlas Shrugged”-style enlightened self-interest that makes economies work. It’s “reputation and the trust it fosters.” Wealth creation, Greenspan says, requires trusting the people with whom we trade. The better your reputation, the more I trust you, the more able I am to take risks and accumulate more capital. When people “let concerns for reputation slip” the way they have in recent years, when counterparties are “not always truthful,” lenders are hesitant to lend, and credit freezes up.

But even an apostle of free markets like Ronald Reagan said, though in a different context, “Trust, but verify.” For years, credit-rating agencies like Moody’s and Standard & Poor’s, in the words of Nobel economics laureate Joseph Stiglitz, “performed the alchemy that converted securities from F-rated to A-rated” with no apparent damage to their reputations.

For years, the sterling reputations of Bear Sterns, Lehman Brothers and Merrill Lynch served as a substitute for transparency. For years, federal efforts to monitor the trustworthiness of big banks were fought tooth and nail by the same Alan Greenspan who nevertheless says that trust is everything.

James Madison warned us in Federalist No. 51 that men are not angels. Lincoln, while appealing to “the better angels of our nature,” nevertheless acknowledged our darker inclinations.

Anyone who’s been anywhere near a big investment bank knows that the gentlemen who run them have more in common with Hollywood buccaneers and Washington barracudas than they do with the Marquess of Queensbury. Maybe on Planet Fountainhead the economy runs on trust, but on this one, reputations aren't warrants of integrity, they're commodities marketed by the branding industry and burnished by the business journalism business.

Bill Moyers, interviewing George Soros a few days ago, asked him whether the global economic system has "become so complex, with such gargantuan forces interlocked with each other, driving it forward, that it doesn't know how to obey Adam Smith's natural laws."

No, said Soros, "I think our ability to govern ourselves doesn't keep pace with our ability to exercise power over nature, control over nature. And we could actually destroy our civilization because of our inability to govern ourselves."

Since 1980, the religion of free market fundamentalism has held the nation in its thrall. By relinquishing responsibility for the rules of the market, we absolved ourselves of accountability for its outcomes. Self-government is what we do to prevent greed from getting the better of us.

It's the use of power to check power, of human nature to check nature, of policy to check luck.

If Wall Street got drunk, it is the cult of the hidden hand that held the bottle.

This is my weekly column in The Jewish Journal of Greater Los Angeles, where you can email me if you'd like.

Follow Marty Kaplan on Twitter: www.twitter.com/martykaplan

Marty Kaplan
USC Annenberg professor and Norman Lear Center director