

The stock market bubble and Mr Greenspan

Nick Beams
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As the after-effects of the collapse of the stock market bubble flow through the US and global economies with warnings of a Japanese-style stagnation no longer uncommon, the role of Federal Reserve Board chairman Alan Greenspan has come under closer scrutiny.

Faced with the criticism that he should have been aware that a financial bubble was in process—at least from the time he made his famous statement about the “irrational exuberance” in December 1996—Greenspan sought to justify his actions at this year’s annual financial symposium held in Jackson Hole, Wyoming, at the end of August.

The thrust of his argument was two fold: first, it was impossible to tell if a bubble was in formation and secondly, even if the Fed had known, there was nothing that could be done about it.

The existence of the bubble was clearly evident from figures available at the time. As Greenspan himself noted, between 1995 and 2000 the price-earnings ratio of the S&P 500 index rose from 15 to nearly 30. To attribute such an increase entirely to an increase in earnings “would require an upward revision to the growth of real earnings of 2 full percentage points in perpetuity.”



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