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Remarks by

Alan Greenspan

Chairman

Board of Governors of the Federal Reserve System

at the

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The other day I told a spendthrift friend that I had to deliver a short address on the history of money He responded, "I understand the history of money When I get some, it's soon history " Fortunately, not all market participants are as spendthrift as my friend Savers have been in sufficient abundance since the beginning of the Industrial Revolution to enable investment to further material well-being Money, as a store of value, was an early facilitator of savings and one of the great inventions of mankind Saving and investment is very difficult in a barter economy

The history of money is the history of civilization or, more exactly, of some important civilizing values Its form at any particular period of history reflects the degree of confidence, or the degree of trust, that market participants have in the institutions that govern every market system, whether centrally planned or free

To accept money in exchange for goods and services requires a trust that the money will be accepted by another purveyor of goods and services In earlier generations that trust adhered to the intrinsic value of gold, silver, or any other commodity that had general acceptability Historians, digging deep into the earliest evidence of human practice, link such commodities' broad acceptability to peoples' desire for ostentatious gold and silver ornaments

Many millennia later, in one of the remarkable advances in financial history, the bank note emerged as a medium of exchange It had no intrinsic value It was rather a promise to pay, on demand, a certain quantity of gold or other valued commodity The bank note's value rested on trust in the willingness and ability of the bank note issuer to meet that promise Reputation for trustworthiness, accordingly, became an economic value to banks--the early issuers of private paper currency

They competed for reputation by advertising the amount of capital they had to back up their promises to pay in gold. Those banks that proved trustworthy were able to broadly issue bank notes, along with demand deposits, that is, zero interest rate liabilities. The profit that accrued from investing the proceeds at interest was capitalized in the banks' market value. In the mid-nineteenth century, equity capital/asset ratios were often several multiples of today's ratios.

In the twentieth century, bank reputation receded in importance and capital ratios decreased as government programs, especially the discount window and deposit insurance, provided support for bank promises to pay. And, at the base of the financial system, with the abandonment of gold convertibility in the 1930s, legal tender became backed--if that is the proper term--by the fiat of the state.

The value of fiat money can be inferred only from the values of the present and future goods and services it can command. And that, in turn, has largely rested on the quantity of fiat money created relative to demand. The early history of the post-Bretton Woods system of generalized fiat money was plagued, as we all remember, by excess money issuance and the resultant inflationary instability.

Central bankers' success, however, in containing inflation during the past two decades raises hopes that fiat money can be managed in a responsible way. This has been the case in the United States, and the dollar, despite many challenges to its status, remains the principal international currency.

If the evident recent success of fiat money regimes falters, we may have to go back to seashells or oxen as our medium of exchange. In that unlikely event, I trust, the discount window of the Federal Reserve Bank of New York will have an adequate inventory of oxen.