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Remarks by

Alan Greenspan

Chairman

Board of Governors of the Federal Reserve System

at a

Convocation

at

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President Sexton, Provost McLaughlin, Chairman Lipton, faculty and students, it is for me a day of nostalgia to be back at New York University, especially having the opportunity to again visit with Bob Kavesh--my classmate of so long ago and partner in founding the classical music society at what is now the Stern School.

I am most appreciative of the honorary degree you have chosen to bestow upon me, and especially honored to be sharing the platform this afternoon with my good friend Gordon Brown. The Chancellor, as you heard a short while ago, has achieved an exemplary record as steward of the economy of the United Kingdom and, indeed, is without peer among the world's economic policy makers.

Gordon, I would like to thank you in particular for your leadership of the Group of Seven this past year. It has been a challenging year, and your voice and vision have been indispensable to the G-7's efforts to maintain global stability and growth in the face of terrorism, further rises in global oil prices, and protectionist pressures.

In the more than fifty-seven years since I received my first degree from this university, I have had a front-row seat in observing the exceptional growth in world living standards. With all that exposure, it was inevitable that I would gain some useful insights into the role of open and competitive markets in engendering the wealth of nations. But it is evident, especially in retrospect, that the thorough grounding in fundamentals that I received at this university was an essential preparation.

The resilience of open and competitive markets was particularly in evidence in the aftermath of the terrorism of September 2001. Fears were widespread that a contraction of international commerce would halt the widening globalization of most of the previous half-century. And, for a short while, these fears were realized. Global trade faltered. Travel

contracted. New projects were postponed. But the freeing of markets over the previous quarter-century had imparted a flexibility that enabled cross-border commerce to quickly stabilize and, by early 2002, to resume its expansion.

Despite worrisome pockets of violence and destruction, commerce and wealth-building continues apace. On average, world standards of living are rising, in large part because of the widening embrace of competitive free markets, especially by populous and growing China and India. Since the autumn of 2001, global gross domestic product per capita has grown more than 8 percent. And growth in developing Asia, where so many of the world's poor reside, has been considerably faster.

Open and free markets are the antithesis of violence. They rest not only on voluntary exchange but also on a necessary condition of voluntary exchange: trust in the word of those with whom we do business. To be sure, all market economies require a rule of law to function--laws of contracts, protection of property rights, and a general protection of citizens from arbitrary actions of the state. Yet, if even a small fraction of legally binding transactions required adjudication, our court systems would be swamped and immobilized.

In practice, in virtually all our transactions, whether with customers or with colleagues, we rely on the word of those with whom we do business. If we could not do so, goods and services could not be exchanged efficiently. The trillions of dollars of assets that are priced and traded daily in our financial markets *before* legal confirmation illustrates the critical role of trust. Even when the law is followed to the letter, appeals to legal authority guide only a few of the day-to-day decisions required of business and financial managers. The rest are governed by whatever personal code of values that market participants bring to the table. Commerce is

inhibited if we cannot trust the reliability of counterparties' commitments. Indeed, the willingness to rely on the word of a stranger is integral to any sophisticated economy.

This necessary condition for commerce was particularly evident in freewheeling nineteenth-century America, where reputation and trust became valued assets. Throughout much of that century, laissez-faire reigned in the United States as elsewhere, and caveat emptor was the prevailing prescription for guarding against wide-open trading practices. A reputation for honest dealing was thus particularly valued. Even those inclined to be less than scrupulous in their private dealings had to adhere to a more ethical standard in their market transactions, or they risked being driven out of business.

To be sure, the history of world business is strewn with Fisks, Goulds, and numerous others treading on, or over, the edge of legality. But they were a distinct minority. If the situation had been otherwise, nineteenth-century market economies would never have achieved so high a standard of living.

Over the past half-century, societies have embraced the protections of the myriad initiatives that have partially substituted government financial guarantees and implied certifications of integrity for business reputation. As a consequence, the value of trust so prominent in the nineteenth century seemed by the 1990s to be less necessary.

Most analysts believe that the world is better off as a consequence of these governmental protections. But corporate scandals in the United States and elsewhere have clearly shown that the plethora of laws of the past century have not eliminated the less-savory side of human behavior.

We should not be surprised, then, to see a reemergence in recent years of the value placed by markets on trust and personal reputation in business practice. After the recent revelations of corporate malfeasance, the market punished the stock prices of those corporations whose behavior had cast doubt on the reliability of their reputations. There may be no better antidote for business and financial transgression.

Corporate scandals and evidence of fraud and malfeasance notwithstanding, the history of rising standards of living in a world fearful of violence is extraordinary testimony to the resilience of free peoples engaged in commerce.

Our system works fundamentally on trust and individual fair dealing. We need only look around today's world to appreciate the value of these traits and the consequences of their absence. While market economies have achieved much in this regard, more remains to be done.

Prejudice of whatever stripe is unworthy of a society built on individual merit. A free-market capitalist system cannot operate effectively unless all participants in the economy have the opportunity to achieve their best. If we succeed in opening up opportunities to everyone, the affluence within our borders will almost surely become more equally distributed. Of even greater import, all people will come to recognize that they are part of a system that is fair and worthy of support.

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America's founding fathers, whose thought had deep roots in the concepts of the British and Scottish enlightenments, bestowed upon us a system of government and a culture of enterprise that have propelled the United States to the greatest material prosperity the world has ever experienced. Today's students, both here at NYU and throughout our country, are carrying

forward those traditions. I know they will improve upon this inheritance of democratic government and free markets in ways that we have yet to imagine.