

Alan Greenspan: The resilience of free societies and the impact of free markets

Remarks by Mr Alan Greenspan, Chairman of the Board of Governors of the US Federal Reserve System, on the occasion of his acceptance of the Eisenhower Medal for Leadership and Service, Eisenhower Fellowship, Philadelphia, 20 May 2004.

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I am honored to accept the Eisenhower medal, which symbolizes a program for advancing leadership around the world. Such a program and the civil values of understanding and peace that it espouses stand in stark contrast to the rising level of violence so evident today. Nonetheless, civil values continue to prevail. The resilience of free societies and economies to threats has been most notable in recent years.

In the aftermath of the terrorism of September 2001, fears were widespread that international commerce would contract and the ever-widening globalization of most of the previous half-century would come to a halt. And for a short while it did. Global trade faltered. Travel contracted. New projects were postponed. But the freeing of markets over the previous quarter-century had imparted a flexibility and, hence, a resilience that enabled cross-border commerce to quickly stabilize and, by early 2002, to resume its expansion.

Despite the worrisome pockets of strife and destruction, commerce and wealth building continue apace. On average, world standards of living are rising, in large part owing to the increasing embrace of free markets, especially by populous and growing China and India. Since the autumn of 2001, global gross domestic product per capita has grown some 5 percent. Growth in developing Asia, where so many of the world's poor reside, has been considerably faster.

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 into immobility.

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 illustrate the critical role of trust.

Even when followed to the letter, laws 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' information and 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 trading 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 recent 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 re-emergence in recent years of the value placed by markets on trust and personal reputation in business practice. After the revelations of corporate malfeasance, the market punished the stock prices of those corporations whose behaviors had cast doubt on the reliability of their reputations. There is no better antidote for business and financial transgression.

Corporate scandals and evidence of fraud and malfeasance notwithstanding, the history of ever-rising standards of living in a world fearful of violence is extraordinary testimony to the resilience of free peoples engaged in commerce. As President Eisenhower opined during the height of the Cold War, stating a view that remains applicable today, “[W]e now stand in the vestibule of a vast new technological age - one that, despite its capacity for human destruction, has an equal capacity to make poverty and human misery obsolete.”