

MILTON FRIEDMAN

Economic Freedom, Human Freedom, Political Freedom

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Introduction of Milton Friedman
by Charles W. Baird, Director

In 1963 I was an undergraduate economics major in a private university in Massachusetts. In a small seminar class I was assigned to read a new book by Milton Friedman, *Capitalism and Freedom*, and a 1958 book by John Kenneth Galbraith, *The Affluent Society*, which expressed contrary views. My task was to write an essay defending Galbraith against Friedman. I got an "A" on that assignment.

But, in the fullness of time, I made my way to UCLA and the tutelage of Armen Alchian. I came to appreciate the wisdom of Milton Friedman. Moreover, judging from a lecture Galbraith gave at Berkeley just last month, even he is beginning to see the light.

Professor Friedman won the Nobel Prize in economics in 1976 "for his achievements in the fields of consumption analysis, monetary history and theory, and for his demonstration of the complexity of stabilization policy."

He was the Paul Snowden Russell Distinguished Service Professor of Economics at the University of Chicago from 1962 1977. He is now the Emeritus holder of that chair. Since 1977, he has been a Senior Research Fellow at the Hoover Institution.

Professor Friedman was the founder, and chief proponent of the Chicago School of monetary economics. I can recall during the 1960s that the great debate in macroeconomics, set off by Friedman and Schwartz' monumental "Monetary History of the U.S.", was between the Keynesians and the Monetarists. Which was more stable: the Keynesian multiplier or, as Friedman would have it, the velocity of circulation of money? Most economists today would agree that Friedman and company had the better arguments and the better evidence.

Professor Friedman is one of the most versatile members of the profession. His 1953 article, "The Methodology of Positive Economics," is still required reading in almost every class in economic theory. It is the starting point for all discussions of what separates good economics from bad economics. In addition to methodology and macroeconomics, he has made significant contributions in the areas of economic history, statistics, international finance, risk and insurance, and microeconomic theory. He is one of the most cited economists of the latter half of the twentieth century.

Professor Friedman is a founding member and a past president of the Mont Pelerin Society - an international organization of individuals who share a dedication to the principles of free markets and limited government. Without doubt, Milton Friedman is the best known, and most widely respected, freemarket economist in the entire world.

The three books which he coauthored with Rose Friedman, are among the best nontechnical defenses of economic freedom, human freedom, and political freedom ever written by anyone. "Capitalism and Freedom" (1962) set forth the case for market liberalism at a time when almost everyone accepted the premises of the welfare and regulatory state as beyond reproach. "Free to Choose" (1980), was the best selling nonfiction book in the United States for the year 1980, and it was translated into most major languages. It was based on a tenpart television series of the same name. Tyranny of the Status quo (1984) was also complemented by a threepart television series of the same name in which Milton Friedman discussed a broad range of topics with seven university students of widely varying views.

Milton Friedman is one of the most influential economists of the twentieth century. He is unsurpassed as an academic teacher, formidable as a debater, persuasive as a public policy analyst, and pathbreaking as a scholar and scientist. There simply could not be a more appropriate person to deliver the Smith Center Inaugural Lecture.

Please join me in welcoming Professor Milton Friedman.

November 1, 1991

I appreciate that very much, Chuck, but I don't want you to give these good people the impression that Ken Galbraith is all bad. Rose and I were in India in the early 1960s when he was ambassador to India. I wrote Ken to see if I could visit him when we went to New Delhi. He wrote back inviting us to lunch at the embassy, adding that, as I knew, he didn't agree with my ideas but they would do less harm in India than anywhere else he could think of.

In 1962, when our book "Capitalism and Freedom" was published, the general intellectual climate of opinion was very different than it has since become. That book was not reviewed by a single major publication in the United States; not by "Newsweek" or "Time", the "New York Times" or any other major newspaper. It was reviewed only in professional economic journals and in *The Economist* of London. It sold fewer than 10,000 copies in the first year after publication, but since then it has sold well over half a million copies without any reviews whatsoever.

The situation was very different in 1980, as Chuck indicated, when our "Free to Choose" appeared. The difference was not because "Free to Choose" is a better book; it is not. In fact, I believe that "Capitalism and Freedom" is a better book. The difference was because the climate of opinion had changed. In the 1950s and 1960s, socialist thinking was dominant; those of us who rejected that view were regarded as fringe eccentrics. Since then, there has been a reaction against such socialist thinking and a recognition of the importance of private enterprise and of private property. Unfortunately, as I shall note later, the reaction has been more in the climate of opinion than in practice. Talk and rhetoric have been one thing; actual practice has been very different.

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What I want to talk about tonight is the relationship among economic freedom, human freedom, and political freedom. In "Capitalism and Freedom", I wrote: "Historical evidence speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom that has not also used something comparable to a free market to organize the bulk of economic activity" (p. 9). I went on to point out that "History suggests only that capitalism is a necessary condition for political freedom. Clearly it is not a sufficient condition" (p. 10).

Both of those statements remain valid today, thirty years later. Over the centuries many nonfree societies have relied on capitalism and yet have enjoyed neither human nor political freedom. Ancient Greece was fundamentally a capitalist society, but it had slaves. The U.S. South before the Civil War is another example of a society with slaves that relied predominantly on private property. Currently, South Africa has relied predominantly on private markets and private enterprise, yet it has not been a free society. Many Latin American countries are in the same position. They have been ruled by an oligarchy, and yet they have employed primarily private markets. So it is clear that capitalism is not a sufficient condition for human or political freedom, though it is a necessary condition.

While experience has not contradicted the statements I made, it has persuaded me that the dichotomy I stressed between economic freedom and political freedom is too simple. Even at this broad level, I am persuaded that it is important to consider a trichotomy: economic freedom, human freedom, and political freedom.

The example that persuaded me that the relationship was less simple than the one I had sketched in "Capitalism and Freedom" is Hong Kong as it developed in the 1950s and especially as it has developed in the period since *Capitalism and Freedom* was written. Hong Kong has been though unfortunately as the Mainland communist regime takes over it will not remain one of the freest, if not the freest, of countries in the world in every respect but one. Hong Kong has had an extraordinary degree of economic freedom: no tariffs and no import or export quotas, except as we in our wisdom have forced such quotas on Hong Kong in order to protect our industries from its efficiency. (It is truly absurd for the United States to force Hong Kong to limit the output of textiles so that our textile industry will not be bothered. That is no way for a great nation to behave.) Taxes have been very low, 10 to 12% of the national income. (In the United States today, government spending is 43% of the national income.) There are few regulations on business, no price controls, no wage controls.

Hong Kong's completely free economy has achieved marvels. Here is a place with no resources except a magnificent harbor, a small piece of land, an island off a peninsula, a population of 500,000 after World War II that has grown to a population close to six million over ten times as large and at the same time, the standard of life has multiplied more than fourfold. It has been one of the most rapidly growing

countries in the world, a remarkable example of what free markets can do if left unrestricted. I may say that Hong Kong is not a place where most of us would want to live. It is not a place where most of the people there want to live. It is very crowded; it is a very small area. If other places would take them, the people would love to go. However, the remarkable thing is that under such adverse circumstances they have done so well.

In addition to economic freedom, Hong Kong has a great deal of human freedom. I have visited many times and I have never seen any evidence of suppression of freedom of speech, freedom of the press, or any other human freedom that we regard as important.

However, in one respect Hong Kong has no freedom whatsoever. It has no political freedom. The Chinese who fled to Hong Kong were not free people. They were refugees from the communist regime and they themselves had been citizens of a regime that was very far from a free society. They did not choose freedom; it was imposed on them. It was imposed on them by outside forces. Hong Kong was governed by officials of the British Colonial Office, not by self-chosen representatives. In the past couple of years, in trying to persuade the world that Britain has not done a dastardly deed in turning Hong Kong over to the communists, the British administration has tried to institute a legislative council and to give some evidence of political representation. However, in general, over the whole of that period, there has been essentially no direct political representation.

That brings out an enormous paradox, the one that as I said caused me to rethink the relationship among different kinds of freedom. The British colonies that were given their political freedom after World War II have for the most part destroyed the other freedoms. Similarly, at the very time officials of the British Colonial Office were imposing economic freedom on Hong Kong, at home in Britain a socialist government was imposing socialism on Britain. Perhaps they sent the backward people out to Hong Kong to get rid of them. It shows how complex the relationship is between economic freedom and political freedom, and human freedom and political freedom. Indeed, it suggests that while economic freedom facilitates political freedom, political freedom, once established, has a tendency to destroy economic freedom.

Consider the example that I believe is most fascinating, India. It was given its political freedom by Britain over forty years ago. It has continued, with rare exceptions, to be a political democracy. It has continued to be a country where people are governed by representatives chosen at the ballot box, but it has had very little economic freedom and very limited human freedom. On the economic side, it has had extensive controls over exports and imports, over foreign exchange, over prices, over wages. There have been some reforms in the past year or so, but until recently you could not establish any kind of enterprise without getting a license from the government. The effect of such centralized control of the economy has been that the standard of life for the great bulk of the Indians is no higher today than it was forty years ago when India was given its political freedom.

The situation is even more extreme if you consider that Hong Kong, which I started with, got zero foreign aid during its growth. India has been a major recipient; it got some \$55 billion of foreign aid over the past forty years. It is tempting to say that India failed to grow despite foreign aid. I believe that it was the other way: in part, India failed to grow because of foreign aid. Foreign aid provided the resources that enabled the government to impose the kind of economic policies it did.

What is true for India is true much more broadly. Foreign aid has done far more harm to the countries we have given it to than it has done good. Why? Because in every case, foreign aid has strengthened governments that were already too powerful. Mozambique, Tanzania, and many another African country testify to the same effect as India.

To come back to Hong Kong, the only reason it did not get its political freedom is because the local people did not want political freedom. They knew very well that that meant the Chinese communists would take them over. In a curious way, the existence of the Chinese communist government was the major protection of the economic and human freedoms that Hong Kong enjoyed. Quite a paradoxical situation.

Hong Kong is by no means unique. Wherever the market plays a significant role, whether you have political freedom or not, human freedoms are more widespread and more extensive than where the market does not play any role. The totalitarian countries completely suppressed the market and also had the least human freedom.

Another fascinating example that brings out the complexity of the situation is Chile. Chile, as you know, was first taken over by Salvador Allende and a socialist group. Allende came into power as a result of an election in which no one of the three major parties was able to get a majority, and subsequent political maneuvering, along with his promise to abide by the constitution. No sooner in office, however,

than he reneged on his promise and proceeded to try to convert Chile into a fullfledged communist state. The important thing for my purpose is what happened after Allende's policies provoked the military to overthrow him and set up a military junta led by General Pinochet to run the country.

Almost all military juntas are adverse to economic freedom for obvious reasons. The military is organized from the top down: the general tells the colonel, the colonel tells the captain, the captain tells the lieutenant, and so on. A market economy is organized from the bottom up: the consumer tells the retailer, the retailer tells the wholesaler, the wholesaler tells the producer, and the producer delivers. The principles underlying a military organization are precisely the reverse of those underlying a market organization.

Pinochet and the military in Chile were led to adopt freemarket principles after they took over only because they did not have any other choice. They tried for a while to have military officers run the economy. However, inflation doubled in the first eight or nine months of their regime. When rates of inflation reached 700 to 1,000% they had to do something. By accident, the only group of economists in Chile who were not tainted by a connection with the Allende socialists were the so-called Chicago boys. They were called Chicago boys because they consisted almost entirely of economists who had studied at the University of Chicago and had received their Ph.D. degrees at the University of Chicago. They were untainted because the University of Chicago was almost the only institution in the United States at the time in which the economics department had a strong group of freemarket economists. So in desperation Pinochet turned to them.

I have nothing good to say about the political regime that Pinochet imposed. It was a terrible political regime. The real miracle of Chile is not how well it has done economically; the real miracle of Chile is that a military junta was willing to go against its principles and support a freemarket regime designed by principled believers in a free market. The results were spectacular. Inflation came down sharply. After a transitory period of recession and low output that is unavoidable in the course of reversing a strong inflation, output started to expand, and ever since, the Chilean economy has performed better than any other South American economy.

The economic development and the recovery produced by economic freedom in turn promoted the public's desire for a greater degree of political freedom exactly what happened, if I may jump from one continent to another, in China after 1976 when the regime introduced a greater measure of economic freedom in one sector of the economy, agriculture, with great success. That, too, generated pressure for more political freedom and was one of the major factors underlying the dissatisfaction that led to Tiananmen Square.

In Chile, the drive for political freedom, that was generated by economic freedom and the resulting economic success, ultimately resulted in a referendum that introduced political democracy. Now, at long last, Chile has all three things: political freedom, human freedom and economic freedom. Chile will continue to be an interesting experiment to watch to see whether it can keep all three or whether, now that it has political freedom, that political freedom will tend to be used to destroy or reduce economic freedom.

In order to understand the paradox that economic freedom produces political freedom but political freedom may destroy economic freedom, it is important to recognize that free private markets have a far broader meaning than the usual restriction to narrowly economic transactions. Literally, a market is simply a place where people meet, where people get together to make deals with one another. Every country has a market. At its most extreme totalitarian stage Russia had a market. But there are different kinds of markets. A private market is one in which the people making deals are making them either on their own behalf or as agents for identifiable individuals rather than as agents of governments. In the Russian market, the market existed and deals were being made all over the lot, but people were dealing with one another not on their own behalf, not as representatives for other identifiable individuals, but supposedly as agents for the government, for the public at large. A private market is very different from a government market. In a strictly private market, all the deals are between individuals acting in their own interest or as agents for other identifiable individuals.

Finally, you can have a private market, but it may or may not be a free market. The question is whether all the deals are strictly voluntary. In a free private market, all the deals are strictly voluntary. Many of the cases of private markets that I cited before were not cases of free private markets. You have a private market in many of the Latin American countries, but they are not free private markets. You have a private market in India, but it is not a free private market because many voluntary deals are not permitted. An individual can deal with another to exchange a good or service only if he has the permission of the government. I may say a completely free private market exists nowhere in the world.

Hong Kong is perhaps the closest approximation to it. However, almost everywhere what you have, at best, is a partly free, largely hampered, private market.

A free private market is a mechanism for achieving voluntary cooperation among people. It applies to any human activity, not simply to economic transactions. We are speaking a language. Where did that language come from? Did some government entity construct the language and instruct people to use it? Was there some government commission that developed the rules of grammar? No, the language we speak developed through a free private market. People communicated with one another, they wanted to talk with one another, the words they used gradually came to be one thing rather than another, and the grammar came to be one thing rather than another entirely as a result of free voluntary exchange.

Take another example, science. How did we develop the complicated structure of physics, economics, what will you? Again, it was developed and continues to develop as a result of a free private market in which scientists communicate with one another, exchange information with one another, because both parties to any exchange want to benefit.

A characteristic feature of a free private market is that all parties to a transaction believe that they are going to be better off by that transaction. It is not a zero sum game in which some can benefit only at the expense of others. It is a situation in which everybody thinks he is going to be better off.

A free private market is a mechanism for enabling a complex structure of cooperation to arise as an unintended consequence of Adam Smith's invisible hand, without any deliberate design. A free private market involves the absence of coercion. People deal with one another voluntarily, not because somebody tells them to or forces them to. It does not follow that the people who engage in these deals like one another, or know one another, or have any interest in one another. They may hate one another. Everyone of us, everyday without recognizing it, engages in deals with people all over the world whom we do not know and who do not know us. No super planning agency is telling them to produce something for us. They may be of a different religion, a different color, a different race. The farmer who grows wheat is not interested in whether it is going to be bought by somebody who is black or white, somebody who is Catholic or Protestant; and the person who buys the wheat is not concerned about whether the person who grew it was white or black, Catholic or Protestant. So the essence of a free private market is that it is a situation in which everybody deals with one another because he or she believes he or she will be better off.

The essence of human freedom as of a free private market, is freedom of people to make their own decisions so long as they do not prevent anybody else from doing the same thing. That makes clear, I think, why free private markets are so closely related to human freedom. It is the only mechanism that permits a complex interrelated society to be organized from the bottom up rather than the top down. However, it also makes clear why free societies are so rare. Free societies restrain power. They make it very hard for bad people to do harm, but they also make it very hard for good people to do good. Implicitly or explicitly, most opponents of freedom believe that they know what is good for other people better than other people know for themselves, and they want the power to make people do what is really good for them.

The recent absolutely remarkable phenomenon of the collapse of communism in Eastern Europe raises in acute form the issues that we have been discussing. There is much talk in those countries about moving to a free market, but so far very limited success. In the past, free markets have developed in all sorts of ways out of feudalism, out of military juntas, out of autocracy and mostly they have developed by accident rather than by design. It was a pure accident that Hong Kong achieved a free market. Insofar as anyone designed it, it was the colonial officials who were sent there; but it was a pure accident that they were favorable to, or at least not hostile to, a free market. It was an accident that a free market developed in the United States, nothing natural about it. We might very well have gone down a very different road. We started to go down a very different road in the 1830s when there was widespread governmental activity in the building of canals, in the building of tollways, and the taking over of banks; there were state banks in Ohio, Illinois, and so on. What happened is that in the Panic of 1837 they all went broke, and that destroyed people's belief that the way to run a country was by government. That had a great deal to do with the subsequent widespread belief that small government was the best government.

While free societies have developed by accident in many different ways, there is so far no example of a totalitarian country that has successfully converted to a free society. That is why what is going on in Eastern Europe is so exciting. We are witnessing something that we have not seen before. We know and they know what needs to be done. It is very simple. I tell the people in Eastern Europe when I see them that I can tell them what to do in three words: privatize, privatize, privatize. The problem is to have the political will to do so, and to do so promptly. It is going to be exciting to see whether they can do so.

However, the point that impresses me now and that I want to emphasize is that the problem is not only for them but for us. They have as much to teach us as we have to teach them. What was their problem under communism? Too big, too intrusive, too powerful a government. I ask you, what is our problem in the United States today? We have a relatively free system. This is a great country and has a great deal of freedom, but we are losing our freedom. We are living on our capital in considerable measure. This country was built up during 150 years and more in which government played a very small role. As late as 1929, total government spending in the United States never exceeded about 12% of the national income about the same fraction as in Hong Kong in recent years. Federal government spending was about 3 to 4% of the national income except at the time of the Civil War and World War I. Half of that went for the military and half for everything else. State and local governments spent about twice as much. Again, local governments spent more than state governments. In the period between then and now, the situation has changed drastically. Total government spending, as I said, is 43% of national income, and two thirds of that is federal.

Moreover, in addition to what government spends directly, it exercises extensive control over the deals that people can make in the private market. It prevents you from buying sugar in the cheapest market; it forces you to pay twice the world price for sugar. It forces enterprises to meet all sorts of requirements about wages, hours, antipollution standards, and so on and on. Many of these may be good, but they are government dictation of how the resources shall be used. To put it in one word that should be familiar to us by now, it is socialist.

The United States today is more than 50% socialist in terms of the fraction of our resources that are controlled by the government. Fortunately, socialism is so inefficient that it does not control 50% of our lives. Fortunately, most of that is wasted. People worry about government waste; I don't. I just shudder at what would happen to freedom in this country if the government were efficient in spending our money. The really fascinating thing is that our private sector has been so effective, so efficient, that it has been able to produce a standard of life that is the envy of the rest of the world on the basis of less than half the resources available to all of us.

The major problems that face this country all derive from too much socialism. If you consider our educational system at the elementary and secondary level, government spending per pupil has more than tripled over the past thirty years in real terms after allowing for inflation, yet test scores keep declining, dropout rates are high, and functional illiteracy is widespread. Why should that be a surprise? Schooling at the elementary and secondary level is the largest socialist enterprise in the United States next to the military. Now why should we be better at socialism than the Russians? In fact, they ought to be better; they have had more practice at it. If you consider medical care, which is another major problem now, total spending on medical care has gone from 4% of the national income to 13%, and more than half of that increase has been in the form of government spending. Costs have multiplied and it is reasonably clear that output has not gone up in anything like the same ratio. Our automobile industry can produce all the cars anybody wants to drive and is prepared to pay for. They do not seem to have any difficulty, but our government cannot produce the roads for us to drive on. The aviation industry can produce the planes, the airlines can get the pilots, but the government somehow cannot provide the landing strips and the air traffic controllers. I challenge anybody to name a major problem in the United States that does not derive from excessive government.

Crime has been going up, our prisons are overcrowded, our inner cities are becoming unlivable all as a consequence of good intentions gone awry, the good intentions in this case being to prevent the misuse of drugs. The results: very little if any reduction in the use of drugs but a great many innocent victims. The harm which is being done by that program is far greater than any conceivable good. And the harm is not being done only at home. What business do we have destroying other countries such as Colombia because we cannot enforce our laws?

It is hard to be optimistic about how successful we can be in preserving our relatively free system. The collapse of the communist states in Eastern Europe was the occasion for a great deal of selfcongratulation on our part. It introduced an element of complacency and smugness. We all said, " Oh my, how good we are! See, we must be doing everything right." But we did not learn the lesson that they had to teach us, and that lesson is that government has very real functions, but if it wanders beyond those functions and goes too far, it tends to destroy human and economic freedom.

I am nonetheless a longterm optimist. I believe that the United States is a great country and that our problems do not arise from the people as such. They arise from the structure of our government. We are being misgoverned in all these areas but not because of bad motives or bad people. The people who run our government are the same kind of people as the people outside it. We mislead ourselves if we think

we are going to correct the situation by electing the right people to government. We will elect the right people and when they get to Washington they will do the wrong things. You and I would; I am not saying that there is anything special about them.

The important point is that we in our private lives and they in their governmental lives are all moved by the same incentive: to promote our own selfinterest. Armen Alchian once made a very important comment. He said, "You know, there is one thing you can trust everybody to do. You can trust everybody to put his interest above yours." That goes for those of us in the private sector; that goes for people in the government sector. The difference between the two is not in the people; it is not in the incentives. It is in what it is in the selfinterest for different people to do. In the private economy, so long as we keep a free private market, one party to a deal can only benefit if the other party also benefits. There is no way in which you can satisfy your needs at the expense of somebody else. In the government market, there is another recourse. If you start a program that is a failure and you are in the private market, the only way you can keep it going is by digging into your own pocket. That is your bottom line. However, if you are in the government, you have another recourse. With perfectly good intentions and good will nobody likes to say "I was wrong" you can say, "Oh, the only reason it is a failure is because we haven't done enough. The only reason the drug program is a failure is because we haven't spent enough money on it." And it does not have to be your own money. You have a very different bottom line. If you are persuasive enough, or if you have enough control over power, you can increase spending on your program at the expense of the taxpayer. That is why a private project that is a failure is closed down while a government project that is a failure is expanded.

The only way we are really going to change things is by changing the political structure. The most hopeful thing I see on that side is the great public pressure at the moment for term limits. That would be a truly fundamental change.

I want to close on a slightly optimistic note. About 200 years ago, an English newspaper wrote: "There are 775,300,000 people in the World. Of these, arbitrary governments command 741,800,000 and the free ones ... Only 33 1/2 million... On the whole, slaves are three and twenty times more numerous than men enjoying, in any tolerable degree, the rights of human nature" [cited in Forrest McDonald, *Novus Ordo Seclorum* (Lawrence: University Press of Kansas, 1985), p.9]. I know of no such precise estimate for the present, but I made a rough estimate on the basis of the freedom surveys of Freedom House. I estimate that, while slaves still greatly outnumber free people, the ratio has fallen in the past two centuries from 23 to 1 to about 3 to 1. We are still very far from our goal of a completely free world, but, on the scale of historical time, that is amazing progress more in the past two centuries than in the prior two millennia. Let's hope and work to make sure that that keeps up. Thank you.