essential readings
FOR THE MODERN CONSERVATIVE

A Condensation of Milton & Rose Friedman's

Free to Choose: A Personal Statement

Reprinted 2012 by
Alabama Policy Institute
Birmingham, Alabama

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ABOUT THIS SERIES

The Alabama Policy Institute commissioned "Essential Readings for the Modern Conservative" to provide busy conservative-minded individuals with a way to acquaint themselves with at least the rudiments of conservatism. A work like Milton & Rose Friedman's *Free to Choose: A Personal Statement* might seem too large to be worked into the corners of our schedule, but a condensed version could be read in a weekend or on a long flight. With such an abridged version, conservatives of all education levels will be able to read swiftly and concisely what the best minds in American conservative thought have had to say. This series is an attempt to capture the central message of the various authors and to express it in fewer, simpler words. We believe there are still men and women in sufficient numbers today who take their values seriously and who consider themselves to be of conservative principle but might be hard pressed to explain their political philosophy. This series is for them.

It is certainly true that these condensations were written in hopes of providing a rough familiarity with the ideas of leading conservative thinkers, but they were also written to whet the appetite enough to motivate the reader to tackle the main text as well. It is the nature of a summary to touch upon the main points of a text and omit the full beauty of the original prose; all of the illustrations and the humor — the personality of the author must be left behind in the primary source. These smaller versions of great works are far better reading than nothing at all, but who is satisfied with the appetizer when he can have the main course?

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CHAPTER ONE
The Power of the Market

Friedman begins by drawing a line between two opposing principles of organization in society. Usually, he observes, when someone goes to the store, the goods he wants to buy are there waiting for him. And, for a price, he can purchase whatever he wishes. We can also usually expect those goods to be there every time we return.

Friedman notes that coordinating the large number of people necessary to make such a system possible is called the command principle. Everyone receives their orders from a higher authority and gives orders to their subordinates. But even in a small organization, such as a family, some amount of voluntary cooperation and discretion is necessary for the work to be done. Everyone's every move cannot be dictated by another.

The Soviet Union is the classic example of an economy supposedly structured in command fashion (this book was last published in 1979, just before the downfall of the Communist regime). Self-motivated people do a little business on the side to make life a little easier. In this way Friedman illustrates that no society operates entirely on the command principle; human nature will not allow for it. Neither is there a society based wholly on voluntary cooperation, for there will always be a need for laws limiting actions for the sake of safety. (Friedman mentions drug laws). In the end, the issue is what the mix between free will and authoritarianism is in a given society — whether free exchange is secretive and illegal, though it keeps the command economy from collapse, or whether it is the dominant principle. Voluntarism by itself is insufficient for society to know freedom and prosperity, but it is certainly necessary.

Friedman fleshes out his conception of voluntary cooperation by recounting Leonard Read's story about the common pencil. The production of the schoolboy's writing instrument involves many different people in various parts of the world working together in just the right way. Not all of them even know what is being made with what they do. Loggers in Oregon require massive equipment to cut down and haul away the trees needed for the wood, and the equipment itself must be produced in an even more complicated process. The logs must also be milled down and made into pencil form. There is also the lead to consider, which really is not lead at all, but graphite from Ceylon. That bit of brass at the end — the ferrule — has to be made with zinc and copper and must be fashioned just so, and the eraser is a product of Indonesia. The amazing thing about it all is that the pencil is ever made in the first place, because there is no one sitting in a central office giving orders to all those involved in the making of a pencil. These people of different lands and tongues work together to produce countless products out of countless materials, and they do so without being told to do so. How?

Friedman gives us the answer: Adam Smith, the father of modern economics and the author of *Wealth of Nations.* If an exchange between two parties is voluntary, it will only take place if both parties benefit. Very well, but how does this principle account for the complex interaction of a worldwide economy? Friedman writes that the answer is the price system. Smith's great insight was that prices could coordinate the activity of millions of people because economic order emerges spontaneously as everyone pursues his own interest. The price system

performs three specific functions in organizing economic activity: first, it transmits information; second, it provides an incentive for people to use the most profitable methods of production for the most highly-valued purposes; and third, it determines the distribution of income.

If, for instance, there is a baby boom, and suddenly the population of young children rises appreciably, it follows that there will be a great demand for school supplies. Stores will be selling more pencils, and so they will order more from their suppliers, who will order more from the manufacturer, who will order more wood, graphite, brass, erasers, and so on. For the stores to induce producers to make more, they will have to offer higher prices for the pencils, and will in turn charge higher prices for them. Higher demand has a ripple effect from the retail store to the reaping of raw materials. The price system tells the logging company that someone is willing to pay more for wood, and will buy more of it, for a long enough time to make it worthwhile to meet the demand. The price system also ensures that only those who are involved in the process will be bothered with the information. The people in the system are motivated to seek out others who can use the information and complete the chain. Stores look for good deals from wholesalers, who look for the best suppliers, and so on it goes. The process can also work the other way. Suppose a forest fire consumes thousands of acres of land, or a liberal federal government decides to declare huge tracts of timber-rich land a national park or a wildlife preserve. All of a sudden, wood is less available, and the price of it goes up accordingly. The producer of wood will use less wood and make fewer pencils, and the store will have to charge higher prices for them, and the poor little student will realize it will benefit him to use his pencil down to a shorter stub or consider the switch to a mechanical pencil.

The same process holds true with crude oil. Friedman notes that the (unconstitutional) establishment of the Department of Energy as a response to the development of the Organization of the Petroleum Exporting Countries (OPEC) oil cartel, quadrupled petroleum prices in 1973 and prevented the price system from communicating the actions of the cartel, ultimately worsening the situation. United States consumers were not motivated to economize on their use of gasoline because the government mandated price controls. As a result, the OPEC cartel was strengthened and the federal government grew in size and waste.

Inflation, too, can introduce "static" into the information flow of the price system. If the price of wood goes up, for instance, producers do not know whether the rise is due to inflation or to greater demand/lower supply. Inflation makes it hard for the relevant people to know the relative price of one good to other goods; what they need to hear is drowned in static.

The clearest communication of information in the world, however, will do the economy no good if the right people lack an incentive to act. The producer of wood needs to find the motivation to respond to the news that the demand for wood has increased. The price system, thankfully, provides that motivation. This second function of the system is closely tied to the third, the distribution of income. If the price of wood had not risen, the producer would have had every reason not to make more of it, since his profit margin will decrease as he incurs more expense in producing more wood. A higher price shifts this margin, offering as much or perhaps more profit than before, if he will produce more wood. He now has the incentive to hire more workers and buy more machinery. Prices also provide an incentive to act with regard to efficiency. If one type of wood becomes more expensive or less

available, the producer is motivated to economize or use cheaper sources so as to keep his costs low. Friedman also explores how the price system provides incentive to workers and owners of resources. A higher demand for wood will tend to create a higher wage for loggers, since there is now greater demand for their labor. Workers who are not loggers but might have considered logging earlier now have more reason to learn those skills and to benefit from the higher wages. Young people entering the job market have more incentive to choose the logging industry. Here, too, however, the government can interfere, through the setting of minimum wages, cooperation with trade unions, or regulation, distorting the information being shared or preventing individuals from acting freely.

The third role of the price system is to manage the distribution of income in the market. Each person's income is determined by the price his labor brings or, if he is an entrepreneur, by the profit resulting from the market value of his ownership of human and material capital and by his ability to organize a business and meet a demand. Through a combination of chance and choice, writes Friedman, the market sets a price on goods and services. We may inherit great wealth, and we may choose to live in a community with a high cost of living. Frank Sinatra might not have been so prosperous had he been born in 20th-century India. A blacksmith today will likely not command the economic resources he might have had a few centuries past. The price system inevitably leads to inequality of income, which leads to dissatisfaction with the distribution of income, which can in turn lead to attempts to separate this last function of the price system from its other two. These attempts are doomed to failure. Modern governments, including our own, have denied this fact in recent years. Friedman delays his discussion of bureaucratic ineptitude to chapter five. He is quite clear here, however, that prices cannot transmit information and provide incentive to action without also affecting, if not completely determining, the distribution of income. If what a person receives does not depend on the price of his goods or services, why should he act on prices at all? Why work hard if it makes no difference in your paycheck? Why save? If prices do not affect income, they will be impotent for other purposes as well; "The only alternative is command."[1]

After this small lesson in economics, Friedman devotes most of the rest of the book to how the role of American government vis-à-vis the economy has changed in recent decades. Before he can go on to document the errors of politicians, however, he provides a norm for comparison. Just what is the proper role for government? Leaning on Smith, Friedman comes up with four duties. The first two are straightforward: the protection of individuals from coercion from within the country and from without and the administration of justice, which for Friedman certainly includes the protection of property rights and other rules that are needful for a free market to flourish. The third duty is the most troublesome. Although Smith thought it had a narrow application, the duty of government to preserve and strengthen a free society has been given wide interpretation in recent times. Highways and city streets, for instance, are too costly for an individual to build, but they are good for society, and so government may undertake their creation. (Government is defined as the collection of individuals who seek to accomplish a common goal.) A more subtle example of the state's duty here is the third party effect.

1 Friedman, p. 23.

Sometimes, a voluntary exchange between two parties has an unintended effect on a third party, a fact that becomes problematic when that effect is met with negative reaction. This is called a "market failure," because the third party has something imposed on him involuntarily. Government may be required to determine what compensation, if any, is owed to the affected third party. This might justify almost any government action, since almost every exchange has at least some effect on a third party. But it must be remembered that government measures also have third party effects. Government failure can occur as easily as market failure. It is just as difficult for the government to determine who is owed benefits or restitution, and the remedies employed may be worse than the problem. Moreover, government must raise taxes to finance its activities — another third party effect. The lesson Friedman would have us draw from this third duty of government is that the burden of proof should lie on the proponents of government action. A very clear balance of benefits over costs should be evident in any proposal for governmental response to a problem.

The fourth duty, one Smith did not mention, is that of government for the protection of members of the community who cannot be regarded as being responsible for themselves. (Friedman has in mind madmen and children.) He of course recognizes the uncomfortable ambiguity introduced by this idea and the care that must be taken in defining what constitutes a "responsible" individual. Children in the first instance will be the responsibility of the parents, as the family is the building block of society, but children are not property, and so have rights in and of themselves that must be guarded.

Even on the loosest interpretation of his duties for government, Friedman notes that much existing government intervention is ruled out. He looks for a modern, concrete example of limited government and finds it in Hong Kong. (It is helpful to remember that Friedman was writing well before the United Kingdom gave Hong Kong to China). With a population density 185 times that of the United States, Hong Kong's residents enjoy one of the highest standards of living in all of Asia. In contrast to the mother country, Hong Kong, though under the titular authority of the Crown, has followed policies allowing for free trade and low taxation. Another shining example of what the market can do if left alone is Japan following the Meiji Restoration of 1867. (Friedman discusses this time period in the next chapter.) Two more examples are Great Britain and the United States in the 19th century. Trade was free and economic growth was rapid in both countries until World War I.[2] He dismisses the lore that tells of this age as one of robber barons and economic exploitation of the masses. If this were true, he asks, why did immigrants keep flooding in, one wave after another? Why did the number of farmers increase? The price of their products declined, but this was due to new machinery and more land cultivation. In fact, the price of farmland rose steadily. And as for the heartless wealthy, Friedman points to the explosion of charitable organizations and philanthropic foundations that took place in the 19th century. Magnates of industry gave millions to fund education, hospitals, orphanages, missionaries, and the like. Art museums, opera houses, symphonies, and public

2 Friedman makes the mistake of viewing the Corn Laws' repeal in Britain in 1846 as a good thing. At least, Kirk would disagree with him. Friedman is looking through green lenses, while Kirk paid attention to culture and lifestyle. He tried to see with his "moral imagination."

libraries sprang up everywhere. Government spending was in check, not exceeding about 12 percent of the national income from 1800 to 1929, and two-thirds of that was spent by state and local governments. Friedman contends that American success was not due to open lands and abundant resources, nor to the sparsely-settled conditions of the time. Rather, it was due to the free trade and limited government that prevailed. Modern society does not necessitate a large bureaucracy any more than did the industrial age. We have proof that government can, if limited carefully, serve a society reliant on voluntary cooperation and economic freedom.

CHAPTER TWO
The Tyranny of Controls

In chapter two, Friedman more closely examines the consequences of restrictions on international trade and economic freedom. He begins by opposing the special interests of manufacturers and merchants to what is good for the great body of the people. Many companies have lobbied for tariffs, duties, and limitations on foreign trade in order to protect themselves from international competition. But Friedman believes that we as a country lose far more, on the whole, from catering to special interests than we may gain from meeting the consumers' needs. He begins his examination of the controls that have been placed on economic activity with a look at international trade.

Friedman notes the ubiquity of arguments favoring "protective" tariffs and "voluntary agreements" to limit imports of certain goods with an eye toward the bottom line of domestic manufacturers. He notices that one voice not heard in the battle over trade controls is that of the consumer's. He proceeds to consider and refute the common arguments advanced in favor of tariffs, beginning with the contention that jobs are what are needed. More jobs or safer jobs for the American worker are good in and of themselves, so the reasoning goes. No, says Friedman; our real objective ought not to be just jobs but productive jobs that will create more goods and services to consume. Another fallacy is the balance-of-trade argument: imports are bad, exports are good. We cannot eat, wear, or use what is sent abroad, Friedman observes, only what we keep, or receive. Our gain is what we import, and we want to pay as little as possible in exports to import what we want. In a private household, we would surely want to pay less for more rather than the other way around; the same holds true on the national scale.

The next argument in favor of tariffs is more complex and has greater emotional appeal: don't we need to protect the high standard of living of American workers from the unfair competition of Mexican or Japanese workers who accept a much lower wage? The fallacy here is the use of "high" and "low" to characterize wages. The key is that American workers are paid in dollars, Mexicans in pesos, and Chinese in yuan. What determines the exchange rate between these currencies? Just how many of each is high or low relative to the others? Let us suppose that 360 yen equal one dollar. At that rate, the Japanese yen can produce everything cheaper in Japan. All of our goods, from televisions and automobiles to ice cream, are made at a lower cost in Japan, so naturally we would try to buy all of our goods from them. This seems to be a nightmare, since we would be flooded with Japanese goods and could sell nothing to them, because they could get everything cheaper at home. But, Friedman says, we must keep going. We would pay the Japanese in dollars, but they would neither buy anything from us with those dollars because they can get it all cheaper at home or be willing to burn the bills. They would want something real in return for their goods. But they could not exchange those dollars for yen, because what is true for them would be true for everyone. Who would want to buy those dollars at 360 yen to the dollar if the yen could buy more in Japan than the dollar could in the U.S.? So the exporters, upon discovering their dilemma, become willing to accept fewer yen for their dollars, and the price of a dollar in terms of yen will decline. As that price declines, the price of Japanese goods in terms of dollars will increase while the cost of American goods in terms of yen will decrease, making them more attractive to Japanese consumers. The process would continue, says Friedman, until the dollar value of goods the U.S. buys from

Japan roughly equals the dollar value of goods the Japanese buys from the U.S.

Of course, real life is more complicated, but the principle is the same: "In the real world, as well as in that hypothetical world, there can be no balance of payments problem so long as the price of the dollar in terms of the yen or the mark or the franc is determined in a free market by voluntary transactions."[3] The system will, in the end, work out the inequality. Though particular American workers may be harmed if an imported good is offered at a lower price than they can offer, the situation is no different in Friedman's eyes than competition by another American firm. That is how the market works. It may be desirable to ease the adjustments that would need to be made, but we must be evenhanded with respect to foreign and domestic trade.

The advantage to letting the market work is that productivity increases. If the Japanese can make toothpaste more efficiently than American workers, we ought to buy it from them and let our own workers do what they do best. A lawyer may be somewhat better than his secretary at typing, but he is likely far better than she at law, and so he should be a lawyer and leave the typing to the secretary.

Another complaint against free trade is that it is not really free trade when foreign governments subsidize their producers. These subsidies enable the foreign producers to sell their wares in the U.S. below cost. Friedman contends that actually it is we who benefit. Other governments must tax their citizens to pay for the subsidies, and we get to buy their goods at a lower price as a result. Why complain about reverse foreign aid? Foreign citizens suffer a lower standard of living than we do because of this subsidy. It is true that if such a subsidy is introduced suddenly, U.S. industries will suffer. But that is one of the ordinary risks of doing business. A measure to ease the adjustment period may be desirable, as noted above, but they would need to be evenly applied. Furthermore, such disturbances are likely to be short-lived. If Japanese steel were suddenly heavily subsidized, its price would drop, and much more of it would be imported. Domestic steel would fall in price and put steelworkers out of a job, for a time. But the price of things made from steel would also decline, freeing up income to spend on other items, raising the demand for those items, and creating a demand for jobs in those fields accordingly. There would be, in the end, no net loss of employment.

Friedman moves on to an even more appealing argument — in the interest of national security, certain industries, like domestic steel, ought to be safeguarded. He disagrees, replying that only a small fraction of the steel used in the U.S. is needed for defense. Furthermore, it is inconceivable that free trade in steel would completely destroy the domestic steel industry. But if it became cheaper to buy all of our steel abroad, we could always stockpile steel, which is not perishable and takes relatively little space. We could keep some steel plants in mothballs, as we do ships. This alternative is but one in providing for national defense needs rather than legislating tariffs to protect the U.S. steel industry.

Friedman dismisses as an artificial problem the idea that the value of the dollar ought to be kept up relative to other currencies. Exchange rates settle at whatever level the market will bear if they are determined by the free market. The price system works in the exchange rate

3 *Ibid.* p. 44.

business. Information is transmitted, and incentives to act are provided. The furor that has been raised in the past over the "weakness" of the dollar was caused by government interference with exchange rates, not because of the market. From 1973 to 1979, the U.S. government managed to lose nearly $2 billion by trying to manipulate the price of the dollar. This manipulation was an attempt to hide inflation that was a result of incompetent domestic policy. Friedman is critical of government intervention in the market, and repeats this sentiment throughout the rest of the book.

In all the literature on the subject of free trade and protectionism, Friedman says, only four arguments of any validity have been brought forward in favor of tariffs or subsidies. The first is the national security argument, which was discussed above. The second is the "infant industry" argument, such as Alexander Hamilton's as used in his *Report on Manufactures.* The idea is that a new industry ought to be assisted by government until it is firmly established and able to compete with foreign companies. But the consumer does not benefit unless he gets a lower price from the domestic industry; this fact would defeat the purpose of the tariff of the subsidy. Do not businesses normally incur initial losses for a few years anyway? Friedman thinks that this argument is a smoke screen, because true infants have no advocates. Once imposed, tariffs are seldom eliminated, and the so-called infant industries never grow up.

The third argument is the "beggar-thy-neighbor" argument. A country that is a major producer of a product can charge an export tax on it, hurting other nations. Conversely, a country that is the primary purchaser of a good can force unduly low prices on the producers by imposing a tariff on its importation. To keep demand sufficient, the producer must sell at a low price. In practice, such approaches are likely to promote retaliation by other countries, and the actual political pressures for tariffs do not take advantage of such situations. The fourth argument, one made by Hamilton, is that free trade is all well and good, except that other countries do not play fair, and as long as they cheat, so must we. Friedman retorts that their restrictions may hurt us, but they will also hurt them; if we impose our own tariffs, we hurt ourselves even more. Retaliatory action, he believes, will only lead to escalation. We should instead assume a steady, principled stance of free trade with the nations of the world that will promote the freedom we value and will encourage American prosperity.

So much for the economic arguments supporting restrictions on international free trade. What then is to be made of the political case for or against it? Friedman believes free trade is good for political harmony since transactions will not take place unless both parties benefit. Cooperation, not conflict, becomes the rule. When governments intervene, however, private disputes become public. Every trade negotiation becomes a political matter, frictions develop, and conflict is the rule. Friedman looks back to the century from Waterloo to the first World War as an example of the peace and prosperity that can be had if governments will leave off tampering with the operations of the market. The use of trade as a political weapon makes the inevitable tensions of foreign policy even more difficult.

Our author concludes his consideration of international trade by turning to its relationship with internal competition. He notes that monopolies can seldom be established within a country without government assistance hampering free trade. General Motors, Ford, and

Chrysler would not have a chance of establishing monopolistic prices among them if they had to compete with all the automakers of the world. The OPEC cartel is an example of monopoly power relying on the collusion of government — in this case several of them. Even OPEC does not have long, Friedman believes, in the face of international competition.[4]

The next section in this chapter focuses on central economic planning. Friedman gives historical examples to prove his point that free trade is best for the common man on the street. Prosperity is spread more widely, opportunities to advance are more abundant, and individual freedom flourishes in countries that abstain from controlling their economies. East and West Germany furnish obvious examples.[5] Russia and Yugoslavia are also good examples, even though the contrast there is less extreme. Under Tito, Yugoslavia broke with Russia and began to decentralize and promote market forces. While still communist, it is a paradise when compared to Russia. Israel is yet another example of the salutary effects of a market economy. Though the government intervenes in the economy and holds to socialist philosophy, there is a vigorous market sector in Israel, and its citizens enjoy more political freedom and a higher standard of living than in Egypt, where control of economic activity is much more rigid.

The example dearest to Friedman's heart, however, is the comparison and contrast provided by India and Japan. India gained independence in 1947, while Japan, in the first 30 years of the Meiji Restoration of 1867, found itself similarly confronted with the modern world. Besides the lapse of 80 years, the circumstances of the two nations are very similar. Both had ancient civilizations, sophisticated cultures, and highly structured populations; both had experienced major political change; and both countries had an able group of dedicated leaders who took power. The major differences between them, Friedman notes, favored India. India had enjoyed considerable economic growth prior to World War I, had not been isolated from the West as had Japan, had leaders trained in other countries, had an excellent railroad system and a British-trained civil service, and possessed modern factories. Japan could boast of none of the above. India could call upon far greater physical resources than Japan, had far more land, and benefited from an enormous volume of foreign investment and gifts. Japan was on its own.

So what happened? Japan grew wealthy, and India languished in poverty. Why? Japan dismantled its feudal structure[6] and extended social and economic opportunity to all its citizens. The lot of the common man improved, and progress was made toward full political freedom. India, on the other hand, paid lip service to the elimination of the caste system but did little to eliminate it. Therefore, in India the gap between rich and poor grew wider, and while, like Japan, the population exploded, economic per capita output could not. What could explain the disparity between the two nations? Why did Japan prosper, while India, with all of its advantages, did not? Friedman dismisses the idea that the Japanese were industrious and enterprising while the Indians were slothful and fatalistic. Another important fact is that every country has a minority of

4 And yet, here we are, nearly thirty years after Friedman wrote, with OPEC still bedeviling us. Let us hope he is soon proved correct.

5 We remember again that Friedman was writing before the collapse of the Berlin Wall.

6 Not a conservative thing to do, but Friedman is primarily concerned with economics, not culture.

leading individuals that set the pace for the masses. There are certainly Indians in other countries that shame the natives for their diligence and entrepreneurship. The real reason for Japan's success and India's failure is that Japan relied on the model of Britain in 1947, a model of voluntary cooperation and free markets, while India relied on the model of Britain in 1867, a model of central economic planning. The Meiji government of Japan imported experts, sent citizens abroad for technical training, and gave industries a jump start with pilot plants and subsidies. It did not attempt, however, to control the amount or direction of investment, and Japan was prohibited by treaty from imposing tariffs for 30 years after the Restoration.

India, by contrast, embarked on a series of Russian-style five-year plans outlining detailed programs of investment. Government made the decisions, allocated resources, owned the capital, and controlled wages and prices. In short, India did not rely on the effects of the free market to spread prosperity through voluntary cooperation. But Japan, which did not coddle its own industry, grew strong through competing with the worldwide market.

Friedman concludes the chapter by noting that restrictions on trade carry graver consequences than a weaker bottom line. Economic freedom, the freedom to dispose of our income as we wish, has been eroded little by little in America. When Friedman wrote this book, over 40 percent of America's income was taken from us and disposed of by all levels of government. Though we vote for those in power, we have to choose a package deal in the voting booth, as Friedman puts it, rather than choose the candidates we want, and if we are in the minority, we simply have to endure.

Further, as consumers, we are not entirely free to spend our taxable income as we wish. Some products are forbidden to us. We are not free to buy an automobile without seat belts, for instance, and since Friedman's time, we are not free to choose whether to buckle up. The great issue here is that we are not free to use our resources in accordance with our own values. We cannot enter any occupation or buy and sell from anyone else on a voluntary basis. Our freedom to own property is also diminished, as government is a 46-percent owner of all corporations in America (in 1979, that is). The federal corporate income tax on all income over $100,000 makes Washington a burden on every stockholder in the country.

Restrictions on economic freedom have a way of spilling over to affect other freedoms, like the freedom of speech and of the press. The oil industry is an example that Friedman uses. In the late 1970s, oil executives were threatened with tougher regulation and anti-trust activity if they did not support the administration's tax on crude oil. There is an old adage that he who has the gold (or can take it) makes the rules. In Britain the unions had been belligerent with newspapers that intended to publish stories against them. The government now grants these unions immunity, and government has the power to shut down the presses. Amish farmers had their religious freedom undermined when their property was seized due to their refusal to pay Social Security taxes – or to receive the benefits – on religious grounds.

These examples, Friedman believes, demonstrate the interdependence of one freedom on others; "…freedom is one whole, that anything that reduces freedom in one part of our lives is likely to affect freedom in other parts."[7] The need today is to reclaim the freedoms we have lost.

7 *Ibid.* p. 69.

CHAPTER THREE
Anatomy of a Crisis

In this chapter, Friedman analyzes the Great Depression, a tragic event that unfortunately persuaded many that capitalism is an unstable system needing government intervention. The resulting rapid growth of central government has endured to this day. The Depression was caused not by a failure of the market but by a failure of the government to properly perform one of its oldest duties — the regulation of currency. Examining this historical crisis will shed light on the present-day ineptitude of our government in discharging the same responsibility.

Our author relates the story of how the Federal Reserve System came to be. In 1907, during a recession, the Knickerbocker Trust Company, the third largest bank in New York City, had to close because of a run on the bank. This event precipitated runs on other banks in the city and in other parts of the country. The banking panic was met with announcements by numerous banks of a "restriction of payments." There was a refusal by the banks to pay out currency to depositors who demanded a withdrawal. This cut caused the bank runs, but the panic and the shortage of currency that followed turned the recession into one of the most severe the U.S. had ever experienced. This event resulted in the passage of the Federal Reserve Act in 1913; the Federal Reserve System that emerged from the administration of President Woodrow Wilson has been ever since the key monetary authority for the country.

The idea of the System was to bolster the "fractional reserve banking system" in the United States. In practice, a bank does not simply take the monies deposited and store them in a vault until they are withdrawn. Banks keep a fraction of the deposit and lend out the rest, or buy a security, to profit from the interest earned. Banks are, after all, businesses. The system works as long as depositors remain confident they can withdraw their money when they want it. If too many withdraw their cash, the bank comes up short. It can borrow from other banks or call in loans to meet the shortfall, but if a run spreads to other banks, the problem is multiplied. One method of stopping such a panic is the restriction on payments by the banks. Banks stay open, but instead of paying out cash for withdrawals, they make bookkeeping entries to honor checks written from their bank or others. This method is severe, but it is effective in stopping a panic.

Another method is to enable sound banks to convert their assets into cash quickly through the availability of additional cash; that is, an emergency printing press makes more dollar bills to meet the demand. It is at this point that the Federal Reserve Board comes in. The Board is a supervisory power overseeing 12 regional Reserve banks that serve as "lenders of last resort" to commercial banks short of cash. The regional Reserve banks can make loans in Federal Reserve Notes (which they can print) or they can record deposit credits in their books with a flourish of the pen. A process called "open market operations" has become the prevalent method of adding or subtracting to the money supply. In this way, a Reserve bank buys or sells government bonds, paid for by the Reserve bank in Reserve Notes, to the commercial bank, or vice versa. In this way, the amount of currency in circulation can be manipulated. A Reserve bank buying bonds from a commercial bank increases the money supply; a commercial bank buying a bond decreases it. The Federal Deposit Insurance Corporation (FDIC) was established in 1934 to insure deposits upon failure of the Reserve System to do what it was originally intended to

do in the early 1930s. Fortunately, there have not been any serious bank panics since the advent of the FDIC, but Friedman proposes to examine one of the great failures of the system prior to the establishment of this safety net.

The end of World War I saw the United States replacing Britain as the center of the financial world. The Federal Reserve System had become a major player in shaping the global monetary structure and had learned how to use the printing press to increase subtly the quantity of money without alerting the public to the danger of inflation. The system enjoyed its high tide throughout the rest of the decade, after plunging the country into a brief but sharp recession in 1920 to correct the wartime inflation. This was in no small part because of Benjamin Strong, the first head of the Federal Reserve Bank of New York. With his passing, the Board in Washington, D.C., began to struggle for power over the other banks, power that had been in Strong's capable hands. The System was mired in deadlock and indecision. It was the eve of the Great Depression.

The stock market crash of October 29, 1929, "Black Tuesday," spread uncertainty among businessmen and consumers alike and whetted their appetite for currency, the most liquid of assets. Unfortunately, the behavior of the Reserve System exacerbated the effects of the crash. The Board, in a move to impose its authority on New York City, allowed the money supply to decline from 1930 to early 1933, despite the commercial banks' desperate need for currency. Still, the whole thing might have been nothing more than a severe recession until the autumn of 1930, when a series of bank failures in the Midwest and the South spread fear and led to massive withdrawals that culminated in the closure of the Bank of United States in December of that year. Though it was just an ordinary bank, the Bank of United States' name was highly regarded, and its failure was a serious blow to consumer confidence. The agreement among other banks and associations to save the bank fell through, and 352 banks failed in December alone. Had the Federal Reserve System never existed, another restriction of payments would have been the likely response to the crisis, and the panic might have been over by early 1931. But the System lulled the entire banking community into a false sense of security. The security was a sham, because the System twiddled its thumbs and let the crisis take its course rather than engage in large-scale open market purchases of government bonds to increase the cash supply of the strapped commercial banks. The System was idle again in the second banking crisis during the spring of 1931. In September, when Britain abandoned the gold standard, the Fed raised the interest rate for banks more sharply than ever before. The Fed feared its gold reserves would be drained by foreign holders of dollars after what Britain did, but the domestic effect of its action was to put further pressure on banks and businesses. Once, in 1932, the Fed did begin to undertake open market purchase under strong pressure from Congress. But when Congress adjourned, the Fed terminated its program.

The final episode of this sad story was the banking panic of 1933, which was also initiated by bank failures. At this point, the System itself panicked. President Herbert Hoover, in his last days in office, refused to declare a banking holiday, and his successor, Franklin Roosevelt, waited until March 6 to proclaim one. In mid-1929, at the peak of business, there were almost 25,000 commercial banks in business in the U.S. When the banking holiday ended 10 days after it began, fewer than 12,000 were permitted to open. The total stock of money equaled this drastic decline: for every three

dollars of deposits in public hands in 1929, less than two dollars remained in 1933. It was a monetary collapse without precedent.

Friedman contends that the monetary collapse was a cause before it was an effect of the economic collapse, and the monetary collapse was itself caused by the Federal Reserve System's incompetence.

> The evidence is by now all but conclusive that the System not only had a legislative mandate to prevent the monetary collapse, but could have done so if it had wisely used the powers that had been granted to it in the Federal Reserve Act…The System not only had the power to prevent the monetary collapse, it also knew how to use that power.[8]

The System was urged repeatedly to engage in open market purchases, "the key action the System should have taken but did not."[9] The struggle for power made the Board unwilling to accept the call by the New York Reserve Bank for those purchases. The alternative was confusion and indecision, even in the face of outside voices, like that of Illinois Congressman A.J. Sabath, who called for the Board to act. Friedman also points out that the Depression started here in the United States and spread to the rest of the world rather than the other way around, robbing the Fed of the alibi that its actions were a response to pressures from abroad. The fact that the U.S. gold stock rose from August 1929 to August 1931 indicates that holders of U.S. dollars used less of them abroad and more of them in this country, because such a shift would have produced an inflow of gold into the U.S. The rise in U.S. gold in the first two years of the contraction is evidence that the Depression began here. Had the Fed reacted properly, it would have increased the quantity of money to match the inflow of gold. Instead, it did the opposite.

What was the effect on the Reserve System's "perverse" monetary policy? A complete victory, Friedman replies; the Reserve Board cemented its dominance over the New York and other Reserve Banks. The resultant increases in power and prestige for the Board have sadly not been accompanied by an improvement in performance. Since 1935, the System has presided over — and greatly contributed to — a major recession in 1937-38, a wartime and immediate postwar inflation, and a roller coaster economy since. The System has not made the same mistake that it made in 1929-33, but it has made the opposite mistake of fostering an unduly rapid growth in the quantity of money and so promoting inflation. In one respect, the System has remained completely consistent throughout. It blames all problems on external influences beyond its control and takes credit for any and all favorable occurrences. It thereby continues to promote the myth that the private economy is unstable, while its behavior continues to document the reality that government is today the major source of economic instability.[10]

8 *Ibid.* p. 85.
9 *Ibid.* p. 86.
10 *Ibid.* p. 89 f.

CHAPTER FOUR
Cradle to Grave

With his fourth chapter Friedman takes a closer look at the massive entitlement programs that came about as responses to the widespread poverty of the Great Depression. President Franlin D. Roosevelt's New Deal, as it was called, enlarged the budget and power of the federal government to unprecedented proportions in an effort to control what was then perceived as an unstable capitalist economy and to alleviate the damage it had caused. Roosevelt was a fresh face, offering hope to the masses and promising, ironically, to cut government waste and balance the budget. His election to the presidency in 1932 was a watershed in American history, for it marked a major change in the public perception of the role of government and the actual role assigned to government. Roosevelt's "brain trust" of advisors was a group of intellectuals devoted to a centralized, powerful government that could protect individuals from the dangers of fortune and could direct the economy in the name of the "general interest." World War II interrupted the New Deal, but the war's effect on the public attitude toward capitalism and government was a mirror image of the effect of The Great Depression. "The depression convinced the public that capitalism was defective; the war, that centralized government was efficient."[11] Some of the socialist programs enacted under Roosevelt have affected the American economy to this day. Though the experience of other countries' experiments with socialism convinced Americans that detailed central economic planning and nationalization of industry were failures, the push for bigger government survived and has taken the form instead of welfare programs and regulatory activities. Instead of socializing the means of production, the government now seeks to socialize the results of production. Lyndon Johnson's "War on Poverty" added Medicare, Medicaid, food stamps, and a host of other welfare benefits to the scene. Though they, like the New Deal, have been failures, and expensive ones at that they, too, have become political sacred cows.

Social Security is the first of several of the larger programs Friedman chronicles. Enacted in the 1930s to enable working people to provide for their retirement and for temporary unemployment, the program's cost has skyrocketed. In 1978, more than 40 million recipients received payments under the program totaling more than $130 billion. Friedman castigates the bureaucrats for the false advertising and labeling of Social Security: the "contributions" are payroll taxes, paid by employee and employer alike under compulsion and the "trust fund" is a joke, amounting, in 1978, to less than half a year's outlays. The value of promised benefits to those covered by the program is in the trillions of dollars. No trust fund exists that can begin to cover such an obligation.[12] Workers paying taxes today can have no faith in a trust fund to cover their benefits after retirement. Their only hope is that future generations of workers will be as willing as they were to pay taxes in support of their parents' benefits. "Nine out of ten working people in the United States are earning protection for themselves and their families under the social security program."[13] Friedman retorts bluntly: "More doublethink.

11 *Ibid.* p. 94.

12 Interested readers can find up-to-date information on the state of Social Security and Medicare in *The Coming Generational Storm* by Kotlikoff and Burns.

13 *Ibid.* p. 104.

What nine out of ten working people are now doing is paying taxes to finance payments to persons who are not working."[14] Social Security is a wealth transfer program, pure and simple, from the young and working to the old and retired. He also notes that the payroll tax is regressive, weighing most heavily on those with low incomes because it is a flat rate on wages up to a maximum. Workers who earn over the maximum are not taxed on the surplus; workers with very little income pay at the same rate as the wealthy. "It is a tax on work, which discourages employers from hiring workers and discourages people from seeking work."[15] Friedman does not advocate changing the tax structure to drain more from the wealthy, however. He will give his proposal later. For now, he sums up the long-run financial problems of Social Security in this simple fact: the number of people receiving payments has grown to overbalance the number of workers paying taxes. Friedman also notes that such a compulsory system of support to the elderly weakens the family bonds that once would have served much the same function voluntarily. This program also diminishes the financial resources of those in the workforce with indigent parents, thereby making the program a moral as well as a social and financial failure.

Friedman's next target is welfare, listing its flaws immediately: the relief rolls have grown despite increasing affluence; there is a large bureaucracy devoted to shuffling paper rather than serving people; it is difficult to motivate people to get off the dole once they are on it; relief payments vary widely in different parts of the country, thereby encouraging migration; and there is widespread corruption and cheating. Leaving aside Social Security, the expenditure on these programs was in 1978 about $90 billion a year. If the estimates of the Census are used, this amounts to about $14,000 per family of four, which was twice the 1978 poverty level. Clearly, our author comments, much of this money is not going to the poor.

Government housing subsidies have also swelled since their humble beginnings in the New Deal years. A whole new department, the Department of Housing and Urban Development, was created in 1965. When Friedman wrote, it had a staff of nearly 20,000 persons and disbursed more than $10 billion annually. Its urban renewal programs have been failures. More houses are being destroyed than built, and many lower-class families are losing their homes to middle- and upper-class tenants. Even worse, public housing units often became slums, rife with crime and juvenile delinquency. Friedman recounts several anecdotes to support his point that urban renewal programs have not met their stated objectives. "The program well deserves the names 'slum removal' and 'Negro removal' that some critics gave it."[16] The beneficiaries of the program were not the poor, as was intended, but property owners and developers, the occupants of the shopping centers that were constructed, and the institutions that used the program to improve their neighborhoods. Low-priced rental housing was renewed out of existence.

Medicare is the latest site of government blundering. After Medicare and Medicaid were introduced in 1965, spending on health care mounted, reaching $68 billion by 1977, which was 4.5 percent of national income. The government's share of total spending on medicine reached 42 percent, and the

14 *Ibid.*
15 *Ibid.* p. 105.
16 *Ibid.* p. 111.

clamor for more coverage continues.[17] The cost of private health care has also increased apace, causing the government to respond by regulating medical procedures and trying to hold down medical fees, a trend Friedman fears could end in socialized medicine. He cites the growing problems of the British National Health Service as evidence that such a system is inherently flawed. The two major arguments offered in favor of socializing medicine are likewise unsound. The first, that medical costs are beyond the means of most Americans, is meaningless, since the people of this country will have to pay for the costs one way or the other. The only question is whether an expensive bureaucratic middleman should be involved. The second argument, that socialization will somehow reduce costs, Friedman dismisses out of hand, until someone can find an activity conducted more economically by government than by private enterprise. In any case, the cost of health care is well within the means of most American families; 90 percent of all hospital bills are paid through third-party arrangements. "There is no case whatsoever for socialized medicine. On the contrary, government already plays too large a role in medical care."[18] Modern medical costs have only reinforced Friedman's point that government intervention would only increase our tax burden tremendously.

Having looked into the murky depths of government largesse, our author steps back a few paces to consider why all these noble-minded programs have been such abysmal failures. His proposal is simple and convincing: welfare programs involve either spending someone else's money on oneself or spending someone else's money on someone else.

17 Even as recently as the Clinton administration, universal health care has been a recurring pipe dream for liberals.

18 *Ibid.* p. 115.

Legislators, and, indirectly, the voters who elect them, feel that they are spending someone else's money, that somebody else is footing the bill for welfare. Bureaucrats administering the programs are also spending someone else's money, so it is small wonder that the dollar amounts explode. There is little incentive for efficiency or honesty. Moreover, the poor tend to lack the skills necessary to get funds in the political scramble, a disadvantage explanatory of the tendency of many programs to benefit the well-off. Another consequence, Friedman explains, is that the net gain to the recipients is less than the total amount transferred. The cost of lobbying regulatory authorities and legislators, and of donating to political campaigns, is a waste of money that must be subtracted from the gross transfer to get the net gain. In the end, this may not be a gain at all. The creation of a dependent class by compulsion — by threat of force — is a harmful consequence of government meddling. "The use of force is…at the very heart of the welfare state."[19] Such programs threaten our freedom, as well as our wallets.

It is our author's belief that most of these programs should never been established. But now that they are entrenched, they cannot be abolished overnight. He proposes instead a transitional program that would provide a direction for future welfare reform efforts and a vision to guide what changes are possible. His program has two main components, the first more complex than the second. First of all, reform must begin with the current jumbled welfare system by replacing the various specific programs with one method of income supplements — a negative income tax. In brief,

19 *Ibid.* p. 119.

a negative income tax would work in a reverse manner to the positive income tax, which allows deductions from the amount of income owed. Also, his proposal would allow a certain amount of income to be made without paying any tax. That amount varies with family size, age, and deductions. If one's income exceeds his allowances, he pays a tax at rates graduated according to the amount of excess. The negative income tax would work much the same way. One would receive from the government a fraction of unused allowances, up to a specified maximum. Such a program would assure every family a minimum amount while providing incentive to increase one's income beyond the need for the benefit. Friedman provides a numerical example. If allowances amounted to $7,200 for a family for four and there were a negative income tax with a subsidy rate of 50 percent of unused allowances, the subsidy would amount to $3,600 annually. If members of the family found jobs and there was an income of $1,000, the subsidy would go down to $3,100 per year, but total income would have risen to $4,100. If earnings rise to $7,200, the break-even point, the subsidy reaches zero. Such a tax, Friedman cautions, would only be worthwhile as a replacement to all the accumulated entitlement programs, not an addition. Such a tax would have the benefit of targeting poverty directly, irrespective of age, ability, health, or location. It helps the recipient, because he has little income. If the subsidy rate is kept reasonable, it provides incentive to get a job. Perhaps just as important, such a program would allow for the disposal of most of the vast parasitic bureaucracy now administering the current programs. No longer would paper pushers run other people's lives. The monetary savings would be immense, and welfare would be streamlined.

Social Security has its place in Friedman's proposal: the trash heap. He wants to "wind down" the program by immediately repealing the payroll tax and continuing to pay all current beneficiaries the amounts to which they are entitled. Friedman also advocates giving every worker who has earned coverage a claim to those benefits in the form of an annuity or a government bond equal to the present value of his benefits. Also, every worker who has not earned coverage should be given a sum, in bonds, equal to the value of the taxes he has paid. Also, all further accumulation of benefits would be terminated, giving individuals the freedom to provide for their retirements as they wish. Payments for the above items would be made from general tax funds and an issuance of government bonds. If Social Security could be allowed to die, personal saving would increase, along with cap ital formation, and private pension plans could grow to benefit workers. More importantly, the government would be out from under its crushing multitrillion-dollar obligation.

Friedman recognizes his proposals are not politically feasible in 1978. Liberals demand too high a level of both subsidy and relief payments to make possible a program that provides incentive to work.

CHAPTER FIVE
Created Equal

Friedman's relatively brief fifth chapter is devoted to the various forms the idea of equality has taken since America's founding and the effects of those ideas on the course of public affairs. The first is equality before God, which he calls personal equality. Simply put, there is no respect of persons before God. All men are equally precious human beings, made in the image of their Creator. Personal equality recognizes that men are unequal with respect to abilities and characteristics and defends the sanctity of all human life. Such an ideal requires that different people be allowed to live their lives according to their own values and denies that any have an innate right to rule others. Thomas Jefferson was an advocate of the rights of minorities and individuals, and Alexis de Tocqueville saw equality as a defining characteristic of the young American republic. Of course, the practice of slavery gave the lie to this ideal; it was not until the War Between the States was won and lost that personal equality approached realization.

After that great tragedy ended at Appomattox, the emphasis in government and public policy shifted to the second form, equality of opportunity. The idea was that there should be no legal or social hindrances to a person's full use of his talents in pursuing the career of his choice. Only an individual's abilities should limit the opportunities open to him or her. Like personal equality, this form is important precisely because of the inequality of men, a theory amply demonstrated in the laissez-faire economic policy of the latter half of the 19th century. The explosion of wealth, and privately-funded charitable activity, was a development reflective of equality of opportunity's place as a dominant value of society. While obstacles remained, the rapid rise of various underprivileged groups revealed them to be surmountable.

The third form of equality gained strength in the 20th century, first affecting Great Britain and Europe before migrating to America. Equality of outcome is now the passionately pursued goal of numerous organizations and the purpose of federal legislation. It is not enough that everyone should be free to run as fast as one may in the race of life; everyone ought to reach the finish line at the same time, too. Friedman is unsparing with his criticism of this last sort of equality. If everyone ought to have a "fair" share, who is to decide what is fair? "'Fairness', like 'needs,' is in the eye of the beholder."[20] Further, if one's rewards do not depend on a concept of fairness, why should one work hard and produce? Equality of outcome is fundamentally at odds with personal liberty, and thus Friedman is opposed to such equality. The only way to enforce some ideal of the "right outcome" is by force and by assigning jobs and limiting compensation for goods and services. It is also true that any standard of fairness that demands a similar or identical result from inherently different individuals will necessarily restrict the potential of the most able among them to the level of the common denominator. Is this fair to the talented? If it is unfair that some children have wealthy parents or high IQ's or physical beauty, is it fair to rob parents of the ability to leave their possessions to their progeny?

There are subtle ethical issues to be resolved, to say the least. These issues cannot be solved by a formula such as "fair shares for all." Life, as Friedman notes, is not fair. But that unfairness is really a boon for us. It may not be fair

20 *Ibid.* p. 135.

that very few women in the world have the qualifications to be a supermodel, but would we really prefer a world in which there is no ugliness and no great beauty either — only mediocrity? It may not be fair that some people can cook brilliantly while the rest of us do our best to follow recipes.

Friedman uses gambling as an example. A night at cards in which the winnings are distributed equally to everyone might be fun, but what gambler would keep coming back if he knew the results would always be the same? Life involves taking chances, making choices, and bearing the responsibility of those choices. Such a system has been with us for most of our history and has produced the Edisons, Fords, Rockefellers, and Einsteins who have benefited society. It may be unfair that some people prosper because of their ability while others wallow in penury. But if everyone is limited, no one can benefit from anyone's genius. Friedman reinforces his contention that the free market can comprehend broad social goals, and his case in point is the outpouring of private charitable endeavors in the 19th century. Charity was made possible, in large part, because of the fortunes amassed by a few. Such activity is an expression of a genuine desire to help others. By comparison, government programs often spend tax dollars — taken without consent, for the minority — on those it deems worthy. The first method is compatible with equality of opportunity and liberty, while the second seeks equality of outcome and restricts liberty.

However unsound the ideal of equality of outcome is, it still has adherents, and Friedman does not hesitate to take them to task. It is his conviction that for all the devout lip service given to equality, few truly support it. If the intellectuals who espouse equality truly believed in it, they would donate any income or assets of theirs above what they determined to be fair and give it to the poor. In 1979 dollars, that would mean giving away anything over $200, the average annual income per person worldwide. Perhaps then those who preach egalitarian doctrine would understand the full meaning of their dogma. They have failed to learn from the experiments with equality of outcome in other nations, such as Great Britain. The incredibly high taxes adopted there after World War II succeeded in redistributing income, but not equitably. Instead, new classes of privilege were created: the bureaucrats, the trade unions, and the new millionaires clever enough to find the loopholes. Friedman does not fault the British their measures or their administration for the failure to achieve an economic level. He faults their goal, the goal of all egalitarians, for opposing one of humanity's most basic instincts: the effort of every man to better his condition. When laws interfere with a person's pursuit of his personal values, he tries to find a way around those laws. "When the law contradicts what most people regard as moral and proper, they will break the law — whether the law is enacted in the name of a noble ideal such as equality or in the naked interest of one group at the expense of another."[21] Moreover, the drive for sameness in Britain drove out some of the best and brightest. There is also good reason to believe that this effort was responsible for the sluggish British economy in the 1970s.

Friedman concludes this chapter with a defense of capitalism as an improvement of the condition of the poor. The myth that capitalism is a system of the rich exploiting the poor is simply not true; wherever the free market has been allowed to operate, ordinary man

21 *Ibid.* p. 145.

has achieved marvelous levels of prosperity. However, when the market is controlled, the gap between the rich and poor only grows wider, such as in Communist Russia or China. The achievements of Western capitalism have chiefly benefited the ordinary man; the rich of all times have had servants to ease their physical labors, live entertainment, the best of all goods and services. Modern progress has made available to the masses conveniences previously exclusive to the wealthy. If a man cannot hire a live string quartet, he can listen to a CD. If he cannot employ a cook, he can order food and have it delivered. Capitalism has allowed human creativity to flourish and human industry to prosper more than any other system of economic organization. A society that pursues equality before freedom will get neither, for the use of force to achieve equality destroys freedom and benefits only the powerful. A society that pursues freedom will have greater equality as a by-product, asserts Friedman, though it is not an accident. The free market releases the energies and abilities of human beings to realize their aspirations and fulfill their potential. People are free to rise to the top, but they have to fend for themselves once there. Freedom does not institutionalize privilege; on the contrary, it allows it. Freedom "preserves the opportunity for today's disadvantaged to become tomorrow's privileged and, in the process, enables almost everyone, from top to bottom, to enjoy a fuller and richer life."[22]

22 *Ibid.* p. 149.

CHAPTER SIX
What's Wrong with Our Schools?

In chapter six, Friedman considers how the application of free market principles could improve the miserable condition of our education system. Taxpayers are groaning under their heavy burden, test scores are lackluster at best, many inner-city schools are physically unsafe for children, and teachers complain about their working conditions. The malady afflicting our schools is one and the same with the sickness of the other programs discussed throughout the book: too much government. Men have placed too much faith in their capacity to govern others, and power has gravitated to centralized control, at the expense of local and parental control. The atmosphere fostered by the increased role of the state has been harmful from the kindergarten class to the university campus. Friedman analyzes this problem.

Once upon a time, in the early days of the Republic, schools were a hometown affair that usually were supported and directed by a single village or town. Fees were paid by the students' parents, and attendance was voluntary. Even so, schooling was practically universal, at least among white children. Alas, such a system was not long to endure. In the 1840s, a crusade for "free" schools, a system wherein citizens were compelled to pay taxes to support an administrative staff that oversaw educators, was spearheaded by Horace Mann, "the father of American public education." By the middle of the 19th century, he had achieved a large part of his goal. Education became the sore thumb and the exception to the rule of freedom; it was "an island of socialism in a free market sea."[23] Reflected here is the importance attached to education more than the swing to collectivism among intellectuals. However, public education was not thought of as socialist but simply as American. In this era, when the Constitution still meant something to federal legislators, Washington took little part in the affairs of public schools, leaving them instead to the purview of the states, which in turn left control of schools to the cities and towns. The political authorities running the system were closely monitored by parents, whose demands were often fulfilled.

The Great Depression changed all that. School districts were consolidated, more power was granted to professional educators, and the public joined the intellectuals in a shameful faith in the power and virtue of central government. Local funds were increasingly supplemented by state and even federal monies, and parents were shown the door. Schools themselves changed; they now were expected to promote social mobility and racial integration, in addition to the three R's. As a result of all this meddling, the condition of schools declined. Friedman examines the five school years from 1971-72 to 1976-77, during which time the total professional staff in all U.S. schools went up eight percent and the cost per pupil increased 11 percent, after inflation. Input was clearly up. However, the number of students went down four percent, as did the number of schools, and exam grades took a dive. Output was clearly down. Friedman also notes that in an earlier fiveyear period, supervisors went up 44 percent while students only went up by one percent. We are spending more for less. What is to blame?

It is not the mere increase in the size of schools that is responsible for declining quality; it is the restriction of liberty. Consumers — parents and students — have lost their freedom to

23 *Ibid.* p. 154.

choose. With power in the hands of a distant and woefully inefficient central government, the individual is not heard, and his concerns are not recognized. Centralization has taken power from the consumers and has given it to producers, administrators, teachers, bureaucrats, janitors, cafeteria workers, bus drivers, and politicians who benefit from our tax dollars. The interests of the producers are served by keeping or increasing their power, not by giving ear to parents' complaints. Friedman sees this phenomenon wherever government robs us of that freedom to make choices, whether in the postal service or the garbage collection. And it is hurting the lower classes the most, those who are forced to send their children to the schools paid for by the money taken from their paychecks. With school districting, people choose where to live based on the schools there. The poor, who cannot afford to live in a wealthy neighborhood, are stuck with the schools of the inner city and the slums where education is abysmal and a far cry from public schools in exclusive suburban communities. This sad situation is a case study in injustice.

Friedman proposes a voucher system as the solution. His own experience with schools, chosen by cooperative parents, leads him to believe that such schools outperform those of the current system. Giving parents greater control over where their children attend school and what is taught there will bring tremendous improvement to the system, as parents generally take greater interest in and possess greater knowledge of their child's needs than any "professional." A voucher system would grant parents that control while retaining present sources of funding. In 1978, each taxpayer paid $2,000 annually, on average, for the schooling of one child. The government could grant a voucher of that or a lesser amount to parents who withdraw their children from public schools. The voucher would be redeemable at any school satisfactory of the current attendance laws. Parents could use the voucher to send their children to any private or public school they wished, forcing public schools to compete with one another. This plan would not relieve taxpayers of the burden of state education, but it would grant to parents greater freedom to choose what is best for their child. Friedman personally considers a voucher system only a partial solution; he favors going further by eliminating almost all public financing of education and abolishing compulsory attendance laws. He recognizes his dreams as politically infeasible, however, and so devotes his attention to the voucher plan.

If the government pays parents (albeit with their own money) to send their children to church-related schools, is the government violating the First Amendment? Friedman believes the Court would probably not allow such a plan, though he emphasizes that the vouchers would go to parents, not schools, and that the GI Bill has been used to send veterans to religious colleges without raising eyebrows.[24] It is also a contention that a voucher system would raise the total cost of education, but the ready answer is simply to make the voucher worth less than the total current amount spent on each child. Education would still probably improve dramatically; consider how parochial schools are able to educate children at a much lower cost than public schools. Friedman dismisses the third objection, the concern about fraud, by reiterating that the voucher would be redeemable only at an approved school; the voucher would have no cash value otherwise.

24 Friedman was thankfully proven wrong on this count. In 2002, the U.S. Supreme Court ruled in *Zelman v. Simmons-Harris* that use of voucher funds to pay tuition at religious schools did not violate the Constitution.

Those who worry that vouchers would exacerbate the racial segregation of schools are also mistaken because students and parents would choose schools appealing to them, not just those in their neighborhood, which is itself likely to be racially homogenous. Forced busing would disappear, as common interest in what a school has to offer overcomes racial geography.

A fifth divisive objection to vouchers is the contention that they would contribute to further "economic segregation," particularly because of the possibility of "add-ons." Parents could have the option of adding to the value of the voucher with their own funds and so send their children to higher-priced schools than they would have been able to. Low-income parents would not be able to afford to add to the voucher, and so egalitarians fret that economic classes would further separate, along with educational opportunities. Freidman believes that this objection is ridiculous. Why are liberals perfectly comfortable allowing parents to waste their substance on riotous living but seized with fear at the prospect of parents spending money on their children's education? A commitment to equality at the expense of children seems to be a perversion of egalitarian beliefs. Indeed, vouchers stand to improve the quality of education for the lower classes more than any other class, since it is indigents who are forced to live in areas that are unlikely to boast of fine educational establishments. Friedman is convinced that vouchers would develop a market where none exists today. The amount of money spent by all levels of government on elementary and secondary schools (nearly $100 billion in 1978) is more than enough to support an ample variety of schools, opening a vast market. As for the impact the voucher plan would have on public schools, Friedman is confident. The threat to the current system arises from its existing defects; strong rural schools probably would be unfazed, although children would likely be pulled out of slum schools. The beneficial effects of the private market would improve all schools eventually, because public schools would have to compete for children.

Of course, there are practical obstacles to any such plan ambitious enough to challenge the dominant educational bureaucracy. Teacher union members and liberal politicians know on which side their bread is buttered. Professional educators and administrators would enjoy less power and job security under a voucher system, and they have shown their will and ability to fight tooth and nail against the threat. They like to claim that they are more able than parents to determine and meet the needs of a child and ought to be left alone to do their jobs. In other words, the bureaucrats and educators do not want to give the customer, the parent, any say about the schooling of their own children. Parents see things somewhat differently, and our author expects that vouchers are on their way, despite the best efforts of the establishment.

Friedman next pontificates on the state of higher education in America. The problems at this level are twofold: quality and equity. However, since attendance is voluntary, the situation is much different from that of lower schools; accordingly, the problem of quality is eased, the problem of equity worsened. Quality is not so great a concern as it might be because, in a voluntary system, no college or university can long survive that does not meet the demand of its customers. However, the subsidy of state universities and land-grant colleges makes students second-class citizens, partly supported by the generosity of the taxpayer, and attracts young men and women for the wrong reasons, as well as for the right. For some, college is a cheap and pleasurable interlude, offering four or more years

of little work and much play. Taking tests and going to class are just the prices they must pay for the benefits. It should come as no surprise, then, that dropout rates are high at state-funded institutions, and the learning atmosphere often depressing. Good teachers and sober students become the exception, not the rule.

At private institutions, the situation is far different. Students must pay high fees to attend the college and have more incentive to show up for classes and stay the course all the way to graduation. Students are the primary customers, and they want to get their money's worth. Private institutions also sell monuments to donors, an activity facilitated by the students, who thereby contribute to the funds available for teaching, along with paying their own tuition. Some colleges and universities are a mix of public and private, receiving government funds while charging tuition and selling building names in return for "gifts." The larger the role of the market, our author finds, the better the institution performs.

Equity is the larger of the problems confronting higher education. Under this heading two justifications are offered for government financing of higher education. The first is that higher education yields "social benefits." The idea is that the entire nation gains by having more highly-skilled people in the workforce who raise productivity and help us compete in the global economy. All of these statements are correct, but none of them, for Friedman, indicate that government should pay for higher education. If higher education improves an individual's productivity, there exists an incentive to pay for higher education. Government assistance is not necessary to inspire him to seek to improve himself. Those students who only go to college because the government subsidizes it are precisely the ones who judge the benefits not worth the costs. The nation would not mourn their absence from the classroom. The mistake made in the social benefits argument, in this case, is in treating benefits that accrue to the educated persons as if they accrued to third parties (the nation).

The second justification is that tax money used to support higher education helps promote "equal educational opportunity." In other words, tax dollars can help ensure that poor people have a chance to go to college. But Friedman asks whether government subsidy has actually fulfilled that purpose. He finds evidence that casts doubt on the idea. A 1973 report found that 20 percent of college students from families with incomes below $5,000 attended private institutions. Government institutions by no means are the necessary havens for students from low-income families. Furthermore, students from middle- to upper-class families are two or three times as likely to attend college as poorer counterparts and tend to go to more expensive institutions for more years. As a result, students from wealthier families, not the poor, tend to benefit most from subsidies. Friedman cites two studies that support this argument.[25] For him, the facts are clear and show that government subsidy of higher education benefits those who do not need it more than it benefits those who do.

Few would deny that every young person intellectually capable of it should be able to get higher education, but our author points out that higher education is not a right for some to have and a duty for others to provide. There is a "strong case" for providing loan funds for

25 The reader may refer to Friedman, p. 182, for more information on these reports.

the disadvantaged. But, there is no case for subsidizing those who get higher education at the expense of those who do not. If government insists on operating colleges and universities, it ought to charge full price for the services provided.

Still, the total elimination of government largesse in higher education is at least as politically unpalatable as doing the same in secondary education, so Friedman proposes both his own alternative to government involvement and a middle way that could prove more acceptable. Instead of fixed-money loans from lenders and the government, which impose a heavy burden on those who do not end up with large incomes, there could be a sort of equity investment in a student's education. A lender would advance a student the funds necessary for his education in return for an agreement that he will pay the lender a specified fraction of his future earnings. In this way, an investor could recoup more than his investment from successful individuals, offsetting his losses with the less prosperous. Such agreements have not become common, perhaps due to the difficulty of enforcement over time, though their like have been proposed more than once.[26]

26 It is worth noting that Kirk, among many others, would have taken great umbrage at Friedman's treatment of education as an investment toward future profit. Higher education once was, and in some places is yet, concerned with the beautification of the soul, with the studies undertaken for their own sake-the liberal arts. Philosophy, theology, literature, Latin, Greek, rhetoric, and logic were not studied because they would guarantee a fat paycheck. They were studied because they fashioned their pupils into civilized human beings who could think. Kirk would likely have gone so far as to say that those who seek a college education for future pecuniary advantage do not belong there. Let them go to trade school and leave liberal undergraduate education to those still wise enough to seek it.

In any event, the voucher proposal is more likely to build steam with an effort to reform government involvement in higher education. The following words of Friedman need no condensation:

> Have all government schools charge fees covering the full cost of the educational services they provide and so compete on equal terms with non-government schools. Divide the total amount of taxes to be spent annually on higher education by the number of students it is desired to subsidize per year. Give that number of students vouchers equal to the resulting sum. Permit the vouchers to be used at any educational institution of the student's choice, provided only that the schooling is of a kind that it is desired to subsidize. If the number of students requesting vouchers is greater than the number available, ration the vouchers by whatever criteria the community finds most acceptable: competitive examinations, athletic ability, family income, or any of myriad other possible standards. The resulting system would follow in broad outline the GI bills providing for the education of veterans, except that the GI bills were open-ended; their benefits were available to all veterans.[27]

Friedman concludes his sixth chapter by iterating his belief that government intervention in the realm of education has led not only to enormous waste of precious taxpayer dollars but also to a far poorer school system than we could have had if voluntary cooperation played a larger role. Few institutions in this country are in a worse state than our schools. The educational establishment is entrenched in defense of its prerogatives and an count as allies public-spirited citizens of a collectivist

27 *Ibid.* p. 185.

bent. Test scores decline, violence rises, and racial tensions seem not to have gone away. Dissatisfaction is growing with the centralized bureaucracy's way of doing things. The proposed voucher system would grant parents the freedom to choose where to send their children to school. A new financing system for higher education would end the imposition of taxes on the poor to subsidize the education of the rich. A voucher for college would at least improve the quality of education and promote greater equity in the distribution of taxpayer money. Such proposals are visionary and faced with determined adversaries. Our author entertains no illusions of their swift passage, but a voucher system would provide greater freedom and true equality of educational opportunity.

CHAPTER SEVEN
Who Protects the Consumer?

Friedman's seventh chapter is a tug of war between the advocates of government regulation of industry in the name of consumer protection and free market philosophy. He begins with an admission that the market system is imperfect and that there are risks that consumers will be victims of shoddy workmanship or bothersome salesmanship. There can be little doubt as to who gets the better of whom. It is called to our attention that the pace of government intervention, as measured by the number of newly-created agencies, has increased enormously since the New Deal, and especially since the late 1960s. Government expenditures on agencies more than quintupled in the 1970s alone. During that same decade, economic growth in the United States slowed significantly, so that in the end productivity was actually declining. Friedman links these two trends in 1979 because all of the government measures and consumer movements of the past two decades have been "antigrowth;" that is, they have been opposed to new developments, to industrial innovation, and to increased use of natural resources and have thereby driven up the cost of doing business. Surely it is desirable that there be some mechanism in place to provide incentive to businesses to maintain high quality and integrity in their products and practices. But is there no better mechanism than massive, costly government involvement through unwieldy bureaucracies and showpiece legislation? Is big government our only hope of safeguarding the defenseless, innocent consumer from the wiles of grasping profiteers?

Friedman says no. He challenges us to ask ourselves what we think of the products and services of government or government-regulated industries, such as postal service, railroad service, and education. Our necessarily low opinion is not coincidental. Some of the industries that have shown much improvement in recent years, like household appliances, electronics, supermarkets, and malls have been the fruit of private enterprise left to its own devices. How have we been persuaded that the same bureaucracy that brings us our mail ought to be trusted with producing and distributing energy, protecting the environment, or meddling with our drugs? Friedman proposes to demonstrate how the laws governing government intervention in welfare hold true with state involvement in the marketplace by recounting the doleful tales of those great evils, the Interstate Commerce Commission (ICC), the Food and Drug Administration (FDA), the Consumer Products Safety Commission (CPSC), the Environmental Protection Agency (EPA), and the Department of Energy (DOE).

The competition in the postwar railroad industry was so fierce that the schemes among the companies to undercut their competitors or make up for losses irritated consumers to such a pitch that a campaign was mounted in the 1870s against the railroads. The result was government regulation in 1887 that established the ICC. It took a decade for the wheels to start turning at the ICC. The reformers had moved on by that time, leaving the railroad companies, whose interest in regulation of the railroad industry was understandably unwavering, to romance the members of the commission to their point of view. The businessmen decided to use the agency to their advantage by having it protect them from state and local governments and from low prices and new competition. Consumers saw rates rise promptly. What was worse was that the railroads were able to use the ICC in the 1920s to reign in the trucking

industry, which was flourishing to the point that threatened the comfortable position of the rail magnates. The Motor Carrier Act of 1935 gave the ICC jurisdiction over truckers — to protect railroads, not consumers. The railroad story was repeated for trucking: rates were fixed, routes were assigned, and entry into the business required application for and purchase of an elusive and expensive license, a "certificate of public convenience and necessity." Accordingly, the number of trucking firms declined, whether from mergers or failures or the rejection of new applicants, from over 25,000 in 1939 to 14,648 in 1974. However, the railroads did not enjoy success for long, because the increasingly rigid rules governing the industry left it powerless to adapt to competition from airplanes, private automobiles, and buses. The trucking industry took the reins of power in the ICC from the railroads, which today have dwindled and been nationalized to shadows of what they once were. Air travel, in its turn, repeated the railroad and trucking story.

"The ICC illustrates what might be called the natural history of government intervention," writes Friedman. There exists a progression from agitation for "something" to be done about a real or perceived evil, to Congress passing a law doing "something" about the problem, to the interested parties going to work to get cozy with the new power. When the effects of the intervention become precisely the opposite of what was originally intended, something else must be done. Next, the established agency, being surrounded by special interests and employees, causes Congress to pass more legislation to deal with the problems caused by the original legislation. Who knows what might have happened with the ICC? Railroads had been forced to compete with other forms of transport. Trucking firms could offer lower fares and better service. The same might be said for the airline industry. Indeed, had the government not stepped in to control prices and limit competition, "the whole shape of the transportation industry might be radically different…."[28] If market forces had just been allowed to work, no service would have survived that users did not value highly enough to pay for.

Friedman spends considerable time on the other paragons of government involvement in the market. The FDA and the CPSC were both directed to regulate industry to protect the consumer from unsafe products, but the wiser course of action would have been to allow the market to provide the incentive — as it surely would have — for producers to police themselves on quality control and consumer safety. Who could doubt that the massive legal liability faced by a drug company responsible for unexpected, harmful side effects of some new drug would not be a motivation to place stringent requirements on themselves? Indeed, what businessman in any field does not comprehend that it will not pay him to manufacture something that consumers fear to buy? These two agencies have stifled research and development of new drugs and driven up the cost of new goods in the name of safety, the achievement of which did not require their existence. The story has been much the same with the EPA and the DOE. Friedman makes the common-sense observation that pollution is a fact of industrialized life, and if consumers want it cleaned up, they will have to pay for it, one way or another. Consumer demand for products, the making of which pollutes the environment, is responsible for the filth in the first place, and consumer demand ought to be

28 *Ibid.* p. 202.

responsible for cleaning up after itself. What the EPA attempts to do, with much waste of taxpayer dollars and manpower, could be done quite efficiently, Friedman believes, by charging a tax to businesses that pollute, a tax scaled to equal the amount of pollutant. Such a tax would provide an incentive to that business to find the cheapest way to decrease emissions. While the added cost would be passed along to the consumer, that cost would be lower than it would be with the involvement of a massive bureaucracy. The DOE, for its part, is to blame for the 1970s energy crisis, according to Friedman. "There has been an energy crisis because government created one."[29] If the price system had been allowed to operate as it normally does and if the price of crude oil had not been capped by law, there would have been no long lines at the gas station, no stations out of gas, no confusion and disorganization, and no need for red tape. The OPEC cartel still would have quadrupled prices in 1973, but if those prices had been passed along to the pump, the demand for gas would have declined. Friedman doubts that cars would have had to hunt around for gas stations that still had fuel. "There is one simple way to end the energy crisis and gasoline shortages tomorrow — and we mean tomorrow and not six months from now, not six years from now. Eliminate all controls on the prices of crude oil and other petroleum products."[30] Prices would have been very high, but, people would have found ways to limit their consumption of gasoline and life would have gone on. And the true price of fuel would have been lower without the DOE, because the total must include the cost of driving around in search of a supplied fuel station and the $10.8 billion budget of the DOE (in 1979). In the end, the lesson the DOE teaches us is the same as the lesson of the other four examples of Friedman's thesis: government intervention, even with the best intentions, is more costly and less effective in protecting the consumer from the risks of capitalism than the natural operations of the free market. Friedman's conclusion about the DOE illustrates this principle nicely.

The bottom line is that come what may, we the people shall pay for the energy we consume. And we shall pay far less in total, and have far more energy, if we pay directly and are left free to choose for ourselves how to use energy than if we pay indirectly through taxes and inflation and are told by government bureaucrats how to use energy.[31]

29 *Ibid.* p. 219.

30 *Ibid.*

31 *Ibid.* p. 222.

CHAPTER EIGHT
Who Protects the Worker?

This chapter debunks what Friedman believes would be the most popular answers to the question of what has caused the dramatic improvement of the condition of workers in advanced Western society over the past two centuries. The first of these answers, "labor unions," is carefully shown to be wrong for several reasons. First of all, unions are not representative of the entirety of the working population. In 1979, over 75 percent of the workforce in America was non-union. Even in Britain, where unions have been far stronger, most laborers were not members of a union. Secondly, it is also a mistake to conflate the interest of the union with the interest of its members. Union officials have been known to act in their own interest at the expense of their members, either legally or illegally.

Such loose use of language contributes to the mistaken impression that labor unions are a modern development. They are nothing of the kind. Unions, in fact, are a throwback to feudal times, to the Europe of guilds and craftsmen and apprentices. Friedman believes he can trace the union back 2,500 years to ancient Greece and cartelizing of the practice of medicine following the death of Hippocrates. For our author, the agreements reached and sworn to by members of the medical profession, from Greek antiquity to the modern American Medical Association (AMA), constitute market-sharing agreements and come close to a "closed shop." In other words, the AMA is a glorified union. It provides important services to its members, to be sure, but it is a union just the same. For quite some time now, says Friedman, it has succeeded in holding down the number of physicians, kept up the cost of medical care, and prevented competition with the "duly apprenticed and sworn" doctors by those outside the union — all done in the name of helping the patient, of course. AMA leaders have no doubt been sincere in their belief that such practices help the patient, but, as Friedman reminds us, "by this time we are familiar with the capacity that all of us have to believe that what is in our interest is in the social interest."[32]

As evidence for this claim, we are directed to examine who actually benefits from the efforts of labor unions, the medical union among them. The high wages of physicians is typical of the situation of members of powerful unions. Contrary to popular belief, the most successful unions in terms of pay are those of occupations demanding skill and which would likely garner high wages without a union. Lawyers, airline pilots, carpenters, plumbers, government workers, and educators have all demonstrated the strength of their unions to limit job openings and maintain high levels of compensation. But which came first, the wages or the strength? Are wages high in strong unions because of their strength, or are unions strong because of their members' high pay? Friedman states that a little of both is true, but he is careful to contradict the claim that universal union membership would raise all wages. On the contrary, the gains unions win for their members come at the expense of other workers, and, let us not forget, the consumers. We must not overlook the most basic law of economics, the law of supply and demand. The higher the price of a product or service, the less of it people will be willing to buy. Therefore, as the price of labor in a given profession increases, the smaller the market will be for that type of labor. That is, there will be fewer people able or willing to afford to pay for such labor. Therefore,

32 *Ibid.* p. 231.

there will be fewer career opportunities in that field. Raise the wage of lawyers, and there will likely be fewer lawsuits.[33] That is what unions do. Union leaders may make noises about raising wages at the expense of profits, but we will not listen. Corporate profits only account for about six percent of the national income, after taxes in 1979. There is little leeway left for higher wages, since profits must provide for new investment in capital and development of new products and services while also providing an income to the shareholders or owners of the company. Taking higher wages from profits would be killing the goose that lays the golden eggs. In reality, higher pay comes at the expense of other workers, who are from professions with weak unions or low pay. And consumers, we note, pay a price as well. High union wages drive up prices on finished goods and force skilled laborers, denied by a union a job in the field of their training, to take a position where they are less productive. "The total basket of goods available to all of us is smaller than it would have been."[34]

It might be asked how a union can enforce a high wage rate. One method, tried and true, is to resort to violence. Union workers can threaten to harm employers' property, or the employers themselves, or harm workers who dare to offer their services without joining the union or participating when the union has called a strike. More often, however, unions have garnered the aid of government, which is why union leaders expend so much time and effort on lobbying. If Congress can be persuaded to pass laws regulating membership in a given profession or wages for that profession, the unions have won an easy victory. Government can also pass minimum-wage laws, which, though passed off on voters as helping the poor, actually hurt them by forcing employers to hire only those people skilled enough to warrant the legally-enforced wage. The poor, unskilled teenager, whose abilities in the estimation of a prospective employer does not deserve the current federal minimum wage of $5.15 per hour, will not be hired. He will not have a chance to work for less than the minimum wage and gain skills that will enable him to earn more. Friedman believes unions push for such laws to protect their members from having to compete with those who are willing to work for less than their members. Likewise, unions can enforce a wage rate by restricting the number of those who may pursue a given occupation. When there are many employers in a profession, this method is easier than direct enforcement of a legal wage floor. Here, too, government help is required, and given. State governments, for example, require that a man who wishes to offer his services to treat the sick or injured must obtain a license from the state to practice medicine. Not surprisingly, only licensed physicians are considered qualified to grant licenses in the medical profession. The AMA has power over medical schools as well. Only schools "approved" by the AMA can graduate students acceptable to the board, and sometimes applicants must intern at an "approved" hospital. Sadly, at times, a school's approval by the AMA has required limiting the number of students admitted.[35]

Government has helped unions achieve their goals, but businesses themselves have also colluded with union officials to fix prices or

33 Come to think of it, that might not be such a bad idea.

34 *Ibid.* p. 235.

35 The reader may refer to Friedman, p. 324, for his source for this contention.

control markets in ways that would be illegal for the businesses alone under the antitrust laws. Workers can strike by arrangement to keep the price of a good at a certain level, as was the case with the United Mine Workers in the 1930s. Unions are exempt from the Sherman Anti-Trust Act, and so they are in a unique position to take advantage of this loophole to their benefit. Friedman qualifies his criticism of unions by noting their useful services to their members. But he insists that they, having not relied on strictly voluntary activities and agreements to promote their own good, have used the government to achieve gains in prices and wages at the expense of other workers and consumers. Unions, in large part, have had a net harmful impact on the American economy.

Government is also guilty of passing laws intended to protect workers in general, not just union members. Minimum wage has already been listed, but there are also workmen's compensation laws, child labor laws, affirmative action laws, equal opportunity employment laws, Occupational Health and Safety Administration (OSHA) regulations, and others too numerous to mention. Some measures have had a favorable effect on working conditions, as was intended, but most have simply embodied in law what was already common practice in the free market. Others have had a decidedly negative effect on the market, as in the case of the parasitic OSHA. Many regulations have simply provided jobs for bureaucrats and driven up the cost of doing business. As in so many things, the efforts of government to protect workers have been, on the whole, wasteful, misguided, ineffective, and expensive.

The most reliable and effective protection for workers is not government action or union membership; it is other employers — the market solution to the employment problem in question. How can a worker be protected from abuse or exploitation by an employer without the involvement of the state or a union? By being employable elsewhere, Friedman replies. Competition for one's services is the best safety for a person's working conditions. That competition may be strong or weak, easy to locate or hard to find, and certainly imperfect, but it is still the best protection for the largest number of workers that has yet been found. The principle is the same for the worker as the consumer. A buyer is protected from exploitation by a seller by the existence of other sellers; in like manner, a worker has security from bad employment in the possibility of other employment. When workers get higher wages and better benefits through union restrictions on employment or government mandates, those wages and benefits come at the expense of the taxpayer and consumer. When workers get a raise because of firms competing for the best workers and workers competing for the best jobs — in other words, because of the free market — the raise comes at nobody's expense. It comes from higher productivity, greater investment, and more skills. The whole pie is bigger, so there is more for everyone. That is the secret of the tremendous improvement of the employee's lot over the last two centuries.

CHAPTER NINE
The Cure for Inflation

Having discussed the dire consequences of reducing the money supply below what is needed, as in the Great Depression, Friedman directs his attentions to the more common but just as damaging mistake of a surplus in the amount of currency in circulation, a precursor to inflation. Unlike times past, currency today is a legal fiction maintained by and manufactured at the direction of government. So, as one might imagine, currency is liable to problems if the government cannot restrain its appetite. The title of this chapter promises a solution to the nemesis of inflation, but first Friedman digresses to consider the cause of the problem. Why is it that governments seem unable to keep their printing presses under control?

Of course, government officials will not admit to their ineptitude in causing inflation. They would rather blame bad weather, natural disaster, greedy oil magnates, spendthrift consumers, grasping trade unions, or anything else plausible. But weather is never reliable, disasters happen, oil magnates have always been greedy, consumers regularly overspend, and trade unions have not suddenly become more demanding than normal. Moreover, none of these factors could possibly produce rising prices for goods across the board. None of them can print money, and since, in Friedman's words, "inflation is a printing press phenomenon,"[36] government and government alone is ultimately responsible for the falling purchase power of the dollar. Before he explores why governments fall to this temptation, our author takes a moment to drive home his point that inflation is a monetary phenomenon. He explains that if the total quantity of goods and services for sale (output) were to increase at the same rate as the quantity of money, prices would be rather stable. Inflation occurs when the amount of money in circulation significantly outstrips output, and the greater the disparity, the greater the inflation. Output is limited by the physical limitations of human and material resources and can usually only grow fairly slowly. Modern paper money, however, is subject to no such limit, because it can be printed at will by the government. While history indicates that there is not a precise oneto-one correspondence between the rate of monetary growth and the rate of inflation, history does indicate a sure link between them. There is not one example of a substantial rise in either without the other following close behind.

Unions have made as little difference in countries where they are strong, like the United Kingdom, as they have in nations where they are barely tolerated, such as Brazil. The same is true for businessmen, the influence of inflated foreign currency, low productivity, and high prices in a particular resource, such as oil. All have had little impact on the rate of inflation historically.[37]37 Inflation is primarily a monetary phenomenon, caused by a more rapid increase in the money supply than in output. We must now ask the next question: why does the money supply grow excessively?

The answer has already been given. In the United States, such irresponsibility has taken place for three reasons, the first of which is rapid growth in government spending. Now it is true that higher spending does not necessarily

36 *Ibid.* p. 254.

37 Friedman includes several charts illustrative of this historical argument. They may be found on pp. 257-61.

lead to inflation, because the extra expense could be financed directly by raising taxes or indirectly by placing the public into more debt. The first method is politically very unattractive and the second only slightly less so.[38] The only other way to finance the spending is to make more money, to print dollar bills that did not exist before. This method is politically quite appealing, since it allows the president and Congress to spend more money without raising taxes or adding to the national debt.

The second reason for government stupidity has been, and was in 1979, the push for "full" employment. Such a goal is ambiguously defined at best, but it is clear that government spending can be represented as adding to employment and taxes as adding to unemployment. Therefore, such an employment policy reinforces the tendency to increase spending while cutting taxes[39]and finance any resulting deficit by printing more money rather than borrowing it from the public. Such a policy has not succeeded in producing full employment, Friedman notes, but it has certainly succeeded in inflating the currency.

The third reason for federal fiscal folly is the mistaken policy pursued by the Federal Reserve Board in the late 1970s. The Fed has attempted to overstep its authority with regard to interest rates and has thereby succeeded in contributing to the roller coaster ride of the inflation rate. Inflation has risen and has fallen, but each succeeding decline leaves it above the previous low. Spending, too, has risen faster than tax receipts, and so the deficit has also been rising over time as a fraction of income.

38 It seems to be working like a charm for the current Administration, however.

39 The reader must experience déjà vu upon reading this, if he has witnessed the last several years of federal fiscal policy.

So exactly what benefit or benefits does the government derive from printing more money? It gets revenue, and it gets it three ways. First, of course, is the money itself, which the government can use on whatever pork barrel project it pleases, except that once the road is built, for example, all the holders of money in the country have paid for that road. Printing money can seem like magic; everyone has more money, and a new road exists where there was not one before. However, like a sarcophagus, the beauty is all on the outside. Sooner or later, the price system transmits the higher money supply throughout the economy, and prices go up on just about everything. At that point, the money people are holding will buy less than it would have bought before the road was built. The extra money printed is essentially a tax on all current money.

Inflation also yields revenue indirectly by effectively raising tax rates. As people's dollar incomes rise with inflation, they are pushed into higher tax brackets. "On the average, if income rises by 10 percent simply to match 10 percent inflation, federal tax revenue tends to go up by more than 15 percent — so the taxpayer has to run faster and faster to stay in the same place."[40] Such a nasty little secret gives the lie to politicians who make noises about "cutting" taxes. All they are really doing, Friedman insists, is keeping taxes from going up as much as they would have otherwise.

The third way inflation pays the government is by devaluing its debt. Thanks to inflation, the dollars the government pays back are worth less than the dollars it borrowed. For the most part, government has not paid a sufficiently

40 *Ibid.* p. 269.

high interest rate on its debt to make up for inflation, so government sees a net gain. Savings bonds are an example of how inflation can benefit the government in this way, at the expense of taxpayers. By the time a bond is cashed in, if inflation has been severe enough, the money received, interest included, buys less than the original cost of the bond. The bondholder has paid for the privilege of lending to his government.

So what can be done about inflation? What is the cure Friedman has promised us? Simple — as too much money caused inflation, the right amount will cure it. Government caused the problem, and therefore government must solve it by reducing the rate of monetary growth. Some money will always have to be printed to replace money that wears out in use, but if the rate of growth stays close to the growth of national output, inflation will fade into memory. Stating the cure is easy. Accepting it is another matter, because, as is the case with some medicines, the cure has some unpleasant side effects. Remember the story of the pencil from Chapter One? When the money supply is inflated, spending increases. After all, there is more money to spend. Retailers and manufacturers at first interpret the higher spending as higher demand for their products, and so they produce more and may raise prices. But since there is more spending in total, there is no decline in demand for the pens to offset the higher production and sale of pencils. Eventually, the producers of pencils and their suppliers realize their mistake, and when they realize the higher demand was not unique to their product, they raise prices and wages still further to enable them to pay the higher prices their suppliers will now charge them. This beginning of a price-wage spiral is an effect of inflation, not a cause. If the process is reversed and the money supply contracts, demand is interpreted as falling, and output and employment successively falls. Fewer workers are needed to make pencils, make timber, work in the stores, and so on, and spending decreases overall. These reductions are the withdrawal pains of ending inflation. In sum, employment numbers will drop, and output will fall. But, Friedman asserts, there are ways to mitigate these side effects, and well that there are. There must be hope of ending inflation before the supporting politicians are removed from office.

The end of inflation will be accompanied by slow economic growth and higher than usual unemployment. Such is the testimony of history. The key to lessening the severity of those effects is to slow inflation gradually and steadily, by a policy announced in advance and adhered to steadily. People will then have a chance to react to the news and anticipate a drop in the money supply and a rise in the real value of money. Contracts for employment or loans can be re-negotiated and adjustments made. "Escalator" clauses can be included in contracts that automatically adjust prices as the inflation rate changes. This clause makes agreements more resilient to changes in inflation and less likely to harm the borrower or lender. Such a clause also reduces the time delay between slowed monetary growth and the subsequent change in wages and prices. These make the migrating efforts transition period from the end of inflation to the coming rise in economic growth shorter.

Friedman ends the chapter by summing it up into five truths: inflation is caused by a more rapid increase in the money supply; in today's world government determines the quantity of money; the only cure for inflation is a lower rate of monetary growth; it takes time (years, not months) for inflation to develop; and some unpleasant side effects of the cure are

unavoidable. Germany after World War I is only one example of what hyperinflation can do to a society. America never has experienced the full weight of uncontrolled inflation, but we have so far failed to exercise the financial restraint and patience needed to eliminate inflation. The ball is in the government's court.

CHAPTER TEN
The Tide Is Turning

At the very end of the 1970s Friedman believed he saw a turning of the tide of public opinion — a turning against big government and its waste, and against ridiculous taxes and socialist programs. He also believed, though, that the enthusiasm for lower taxes was not matched by a zeal for eliminating government programs and reducing the size of government in general. Friedman believed that the predominant intellectual atmosphere of "Fabian socialism and New Deal liberalism" was on the way out, and it may be that the succeeding wave will bring us back to the old ideals of personal freedom and limited government that held sway in the nineteenth century. Public opinion will precede political action ,but before the shackles of too much government can be thrown off, people must first understand how the present situation has come about and what must be done about it.

Friedman is sure that the assemblage of special interests and factions in Washington, D.C., have prevailed over true general interest to the detriment of us all. The only weapon powerful enough to cut through all the various claims and counterclaims of lobbyists, political action committees, political parties, and all other organizations and powers with a vested interest in the status quo is the constitutional amendment. Only a tool of that magnitude has a chance of preventing Congress from adding to the Department of Energy, whose charge it is to research ways to reduce the consumption of energy, and the Environmental Protection Agency, whose task is to preserve the environment and whose methods often expend a great deal of energy. "No doubt," Friedman adds, "within each agency there are subgroups working at cross-purposes."[41] The entire situation might be amusing if it were not for the breathtaking expense taxpayers must strain to meet. Ours is a democratic system that operates by enacting detailed and specific legislation, and therefore small groups that have highly concentrated interests tend to exercise disproportionate political influence in pursuit of their own goals. Each group is concerned only with its narrow field of costs and benefits and usually lacks the inclination or resources to research and respond to the numerous other special interests jockeying for favor.

To make matters worse, the more government becomes centralized and bureaucratic, the more distance is placed between the elected officials and the citizens to whom they are supposedly accountable. The majority of citizens no longer possess the time required to keep a close eye on what their leaders are doing from one day to the next, but special interest groups can make a full-time job of it. Further, the power of legislators diminishes as more and more of the responsibility for seeing the laws administered passes to the fourth branch of government — the bureaucracies. Congressmen cannot conceivably read all the legislation upon which they must vote, let alone consider its merits, and so they come to lean on their staff members or some outside source, such as a special interest group. Politicians come and go, but civil servants typically come and stay, a fact granting them great ability to impede legislation they oppose. Even the federal courts have abandoned their traditional role as interpreters of the law in favor of an active role. Power has spun out of control.

41 *Ibid.* p. 292.

Only a series of constitutional amendments is capable of turning back the 'whelming tide of too much government. "We need…the equivalent of the First Amendment to limit government power in the economic and social area — an economic Bill of Rights."[42] Friedman knows that all the amendments in the world will do little good if public opinion is not behind them. But he thinks a series of well-constructed amendments designed to trim the fat from the federal hog is the most effective single step in the right direction. The process of forming the amendments would probably stimulate discussion and could favorably impact the public, and the amendments themselves are far more effective at incarnating that opinion than the current legislative procedure. Although Friedman wrote in 1979, the thrust of his arguments is to require the federal government to limit itself to a fixed budget and to prevent it from meddling in the operations of the free market. A balanced budget amendment, in particular, would not only be effective at reducing the expenditures of the federal budget but also would "require the special interests to compete with one another for a bigger share of a fixed pie, instead of their being able to collude with one another to make the pie bigger at the expense of the taxpayer."[43]

Friedman suggests seven amendments in his last chapter, all of them thoughtful and all of them in keeping with the principles he has endeavored to explain and defend throughout his work, the principles of the unhampered operation of the free market, a limited role for government, and the freedom for individuals to live their lives as they see fit. He believes we are at last waking up from the fantasy in which we grant more and more power to concentrated government; we are at last beginning to realize the dangers of big government and the possibility of corrupting our own good objectives with bad means. At the very end, Milton Friedman, having done his best to lay before us the alternatives of a society shorn of its prosperity and felicity by taxation and bureaucracy, and a society filled with free individuals living according to their own values and benefiting their fellow men as they follow their own pursuits, just as Adam Smith instructed us, leaves us where we began — free to choose.

42 *Ibid.* p. 299.
43 *Ibid.* p. 303.