



Contraditório think-tank

Book Review

Capitalism and Freedom: Milton Friedman's Centenary | Luís Faria and Pawel Szczygieski

This year we are celebrating the 100th birthday anniversary of one of the greatest liberal thinkers of twentieth century – Milton Friedman. We think it's a great opportunity to remind the world about major achievements of this Nobel Prize laureate. We shall also compare how his timeless ideas defending liberty apply to modern world. For that we go back to his masterpiece "Capitalism and Freedom", a book that should not be forgotten by present and future generations.

Biography and Education

Milton Friedman was born on 31 July 1912, in Brooklyn, N.Y., to a family of Jewish immigrants from former Austro-Hungarian Empire. He grew up over his parents' store in Rahway, NJ and despite his sometimes difficult upbringing he never gave up his ambitions to go to college. Through hard work, perseverance and talent for making right friends, he managed to study at

Rutgers University, intending to become an actuary, but his interest shifted to economics. Therefore he made his next steps in the University of Chicago, one of the few great universities that welcomed Jews in those days. His intellect and respect for highest standards of research started earning him recognition.

His Work

His work experiences and insights were without a doubt instrumental in laying foundation for his future works. Through jobs at National Bureau of Economic Research, as well as U.S. Treasury Department he was able to do research on income, monopoly, business cycles and taxation. In 1976, the Nobel Prize in Economic Sciences was awarded to Milton Friedman "for his achievements in the fields of consumption analysis, monetary history



and theory and for his demonstration of the complexity of stabilization policy".¹

Professor Emeritus George Tolley recalls that "I was an assistant professor and the lone person teaching Keynesian economics". "In spite of his strong feelings...Milton insisted that students have thorough knowledge of Keynesian economics".²

Milton Friedman was also a tireless propagator of free market ideas. Through series of lectures, television shows, books published and service to his country as an economic advisor to President Ronald Reagan, he committed his life to educating broad public about the benefits of freedom – and threats of government controls.

Personality

Milton will be remembered as an economist. Without a doubt, this was the background he was coming from. But it is equally important to note that he was a careful and inquisitive observer of society, with a deep understanding of human nature and our motivations. That is why he was able to

explain in such a brilliant, clear way the mechanisms of human behaviours.

While for some capitalism may seem a brutal and ruthless ideology, Milton did a great job at showing why it is so important to give true power to the people – meaning freedom to choose, work and spend. It is the freedom to enter into mutually beneficial exchanges that serves as backbone of democratic, wealthy societies. He understood that very well and devoted his life to praising those values around the world.

Timeless Ideas

All of Milton Friedman's ideas contained in "Capitalism and Freedom" are somewhat related to his previous research experiences. He is clearly knowledgeable about the topics, and whenever he did not feel entirely competent about a matter – he would state that very clearly. What is rather impressive, though, is his ability to link all the topics covered together. Like any liberal, he would see a person as the 'default' unit of society. Every person, except "children and madmen", should be able to make his/her own decisions and accept the consequences. With deep respect for human ingenuity, he would see average person as capable of making

¹ "The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1976". Nobelprize.org. 31 Jul 2012

http://www.nobelprize.org/nobel_prizes/economics/laureates/1976/

² Sanderson (2012)



informed decisions and taking care of oneself. Government was only supposed to facilitate functions related to well-being of society as a whole.

Another striking feature of his book is the timelessness of the ideas. First coined by classic liberals in the XVIII and XIX centuries, these were popularized and defended by him even before the first edition of “Capitalism and Freedom” went to print in 1962. And yet, reading the book half a century after it was published, it feels as if it was written to address issues of politics and economics nowadays.

Ideas on “Capitalism and Freedom”

Milton really cared about propagating the right understanding of the term ‘liberalism’ and ideas that follow. It is unfortunate that understanding of term ‘liberal’ in the US has drifted from its original XIX century meaning of ‘free choice and respect for individual’ towards ‘welfare’ and so-called ‘egalitarianism’. Friedman bluntly refused to surrender the term ‘liberalism’ to ideas and groups so disconnected from its original meaning.

In his book Friedman compares two alternative ways of organizing an economy: top-down (where government imposes its

decisions on people) versus bottom-up (where individuals freely choose what they believe is best for them) or central planning and control versus private market. Undoubtedly, the capitalism that Milton Friedman defended could be characterized as a bottom-up approach in a private market framework. The comparison between these two economic systems is made by real world examples: Hong Kong and Taiwan versus mainland China; West Germany versus East Germany; South Korea versus North Korea. These examples demonstrated the success of the market-oriented policies. We are enthusiastic defenders of freedom and pro-market policies and we have written about the importance of economic freedom in increasing prosperity and liberty. In “Capitalism and Freedom”, Friedman underlines the link between economic freedom and political and civil freedom, and how this have led to increased prosperity. In Friedman’s words “competitive capitalism and freedom have been inseparable”³.

Economic and Political Freedom

Accepting welfare and equality as responsibilities given to someone external – namely, the government – gives quiet

³ Friedman (2002), ix, Preface 2002



permission for building a powerful, expensive and concentrated bureaucratic machine. Friedman insistently reminds us that the great threat to freedom is the concentration of power which is always extremely difficult to dismantle afterwards. Convincing people to give up their rights, part of their freedom and income - in return for false sense of security has been possible in times of turbulence in XX century, and is being repeated nowadays. Both economic depressions and wars are effective at convincing people to accept stronger governments. Times of hardship always result in more emphasis being put on welfare than on freedom. For many, this is fine – until the day comes when they discover they are being limited from achieving their true potential by the government that was supposed to be instrumental. And since political and economic freedoms go hand in hand, one cannot expect to bear the fruit of one's work under coercive government.

Conversely, economic freedom gives people space and capabilities necessary for building personal independence, leading to freedom in general – and, in effect, keeping the government in check. Political and economic freedoms reinforce each other and this cannot be overstressed. Friedman mentions that history suggests capitalism is a

necessary condition for political freedom, however it is not a sufficient condition.

However, the need for true liberty will keep coming back. It is visible in the few historical cases where attempts to limit people's rights resulted in defiance so powerful that it actually led to widening of individual freedom. Historical fluctuations in amount of power being granted to authorities should be seen rather as a perpetual struggle between power-hungry and freedom-hungry groups, resulting in a constant search for a system that will organize society in an acceptable way.

We believe in a system of free choice based on solid and credible institutions safeguarding essential rights and executing social contracts. To achieve such a system, individuals need to be able to make informed, independent choices about how they would like to be governed, and most importantly, govern their lives personally.

In a free market exchange, both parties are informed enough to be willing to enter into voluntary cooperation and exchange that is mutually beneficial. Similarly, in a political process, the representatives need to be accountable before their voters. Voters need to understand and monitor activities of their representatives, having sufficient power to



hold them responsible. Just as ‘enterprise’ and ‘money’ act as facilitators of markets, the ‘institutions’ and ‘votes’ act as facilitators of social contracts.

For people to have an open, free environment in which everyone can do his/her best to follow a vocation, both economic and political systems need to be safeguarded from monopoly and collusion.

Government in a Free Society

As stated above, Friedman was adamant in saying that government is necessary for a society to function, but there needs to be a clear understanding of what it is supposed to do – and what isn’t. It has the duties of setting up rules through legislative process, enforcing them through executive powers and providing an independent judicial system. That is already a lot, so there is hardly any need for more centralized power or coercion. Friedman defended that “government was essential both as a forum for determining the “rules of the game” and as an umpire to interpret and enforce the rules decided on. What the market does is to reduce greatly the range of issues that must be decided through political means, and thereby to minimize the extent to which

government need participate directly in the game”⁴

We should be very careful about what rights we give to our representatives and ensure power stays on a local level as much as possible. This has to be done through careful cross-checking of institutions, balancing the power and supporting independent watchdogs. Concentration of power is the power to coerce, thus a threat to individual freedom.

Why is individual freedom so important? Why shouldn’t we settle for so-called security and welfare? While there are many reasons, one is particularly obvious. Our tastes differ greatly, so letting someone else decide what is best for all of us is bound to fail. Therefore, it should be kept to minimum. We need to decide for ourselves. Our appetite for risk and redistribution differs greatly with age, income and personality. So free market seems like the only alternative giving individuals the power of expression in terms of savings rate, amount of work, entrepreneurial ambitions.

There are only so many leaders while majority of people choose to remain employees, but the decision whether to become one or the other (employer vs. employee) has to be open and easy to make in terms of bureaucracy and market entry

⁴ Idem, p. 15



conditions. We should also be free to decide on health insurance and retirement plans, regulated by the government but existing in a free market. Otherwise, we are bound to experience a system in which people working and paying taxes today have no certainty whatsoever of receiving a retirement money in the decades to come. And this is how situation looks like in Europe nowadays. Pension plans are being indirectly plundered to pay for excessive spending of governments. Little is left for future generations. It is yet another proof that an individual concerned about his personal future and safety will be more farsighted than a bureaucrat acting on his behalf.

‘Freedom of expression’ also depends on free market to provide means for meaningful political debate. One cannot expect to successfully convince common citizens to a given matter or principle without sufficient means of communications – such as mass media, producing educational material, etc. While these are relatively easy to obtain in a free market environment, the same cannot be said about heavily controlled and planned economies – even if in theory freedom of expression is warranted!

In ‘Capitalism and Freedom’, Friedman made an interesting observation – namely,

that the sum of political power seems fixed. So the cake can only be cut up in so many ways, but it will not get any bigger. Economic power, on the other hand, can grow and shrink just as the economy itself.

It is impossible to have a wide consensus on a variety of matters in a group, let alone whole society. We do however need to agree on common principles. In democracy, this effectively means a wide enough consensus, but it is a rule of majority nonetheless. That is why it is not only easier, but safer for minorities to leave as much as possible to govern on the level of capitalist market and local government. Free market allows particular groups to satisfy their needs without a political process requiring support of the majority. Similarly, local governments allow citizens to test various solutions and choose one that is personally attractive. Voting with one’s feet is probably the best testimony of the appeal of particular system.

Every time a government asks for a blank check to intrude into our lives, we need to carefully examine the reasoning behind it, as well as possible outcomes. It is much harder to take the power away from the bureaucrats than to grant it in the first place.



Control of Money

Similar argument can be applied to monetary policy. Friedman provided ample evidence that monopoly in monetary policy can do more harm than good. He went on as far as suggesting that Federal Reserve was responsible for plunging the US into Great Depression. While this view may be unpopular, there is much supporting evidence⁵. Today is no different – “Mistakes, excusable or not, cannot be avoided in a system which disperses responsibility yet gives a few men great power, and which thereby makes important policy actions highly dependent on accidents of personality”⁶ And this is happening again even in the existence of clear rules. Milton Friedman suggested increasing the monetary base at the pace of GDP growth as a sufficient rule to stabilize the prices. Thus, the supply of money should follow economic growth; doing it the other way round is putting the horse before the cart.

Milton did realize that return to a proper gold standard nowadays is not possible. Again, gold standard is a secondary solution following a free banking system. In order to gain customer trust and credibility, banks would resort to keeping metal reserves. In

monetary policy, the knowledge of few men means that supply of money is no longer being regulated automatically by market forces but by a group of individuals trying to “get the feel” of where the economy is going, with their personal characteristics and external pressures blurring the picture. Giving a central bank a dual mandate of controlling both the inflation rate and unemployment, as is the case with the Federal Reserve, is pie in the sky. These goals will be contradictory most of the time. What is more, failing to act on these powers can do even more harm – just as during the Great Crisis.

International Trade Agreements

When you’re being told that we live in a world of economic freedom unknown to previous generations, stop for a while. True, there are international trade agreements governing economical relations between states facilitating the markets. But they also create zones or clusters of countries that enjoy those privileges – while for the outsiders, the barriers of trade actually increase. Probably the closest we got to a free trade system was during XIX century dominance of the British Empire.

When countries or economic areas resort to trade barriers, tariffs, quotes and superficial

⁵ Schwartz & Friedman (2009)

⁶ Friedman (2002), p. 50



norms, this may seem as a natural defense mechanism to protect industry at home from new entrants. But in the long term, this is actually hurting the country or economic area in question – by weakening the competitiveness of local businesses, preventing from optimal capital allocations, use of human resources, etc. Also capital controls, paired with fixing or defending foreign exchange rates had had bad results in the past. Moreover, history teaches that such attempts seriously inhibit personal freedom.

For instance, gold possession was prohibited in the US during F.D. Roosevelt's reign and this cannot be defined as anything but state appropriation of personal property. It had nothing to do with securing the dollar's stability. Similarly nowadays, the government obliges its citizens to report any valuables held both in the US and abroad. This is a clear intrusion into personal life, done under the guise of counter-criminal and terrorist measures. Looking at the appropriateness and scale of these measures, it can be viewed as an abuse of power.

Summing up, international free trade agreements should be made the norm including all countries by default, not on a selective basis. Similarly, exchange rates need to be free to adjust to market situation. Trying

to prevent it will only cause a more sudden and potentially painful change later on.

Fiscal Policy

With the dawn of welfare state, the governments also assumed responsibility for employment rate (or rather – promised to tackle unemployment). Whether the government should be touching this issue is an important question. It definitely has the responsibility of setting up legal and tax frameworks optimal for growth of economy.

Too often, however, this has gone in the direction of taxation as a means of 'fair' redistribution of income and inflating state' budget with spending. Creating new jobs is always on politicians' official agendas, as it is a catchy phrase. But it is always done at a cost to all taxpayers, which effectively means paying out of your own pocket for the welfare of others. And looking at track record of such 'job creation' efforts, they are always more costly, less sustainable and competitive than those done through a free market mechanism.

Yet, somehow, this escapes the public' attention. Almost every time government promises to do something that could be solved through natural demand and supply balance, it is a waste of capital and leads to



misallocations. There is another absurdity connected to this issue. Every time there is talk of cutting this government spending, there is fear that this will actually create unemployment and slow down the economy. Reduction in spending aimed at propping up the economy, paired with reduction in tax burden, will lead to the opposite. Milton Friedman mentioned that even in case of accepting a view that the government budget should be and can be used as a “balance wheel”, there are another solutions. The tax side is just as available as expenditure side. More funds freely available to entrepreneurs and households mean better allocation and more competitive industries. Conservative fiscal policy should entail reduction in tax burden, less coercion and more freedom to choose retirement and health plans. At the same time ‘switching on’ competitive market forces in huge service industries.

Government in Education

Milton Friedman attributed a more relevant role to the government regarding education comparing to other policies. Friedman accepted that both the imposition of a minimum required level of schooling and the financing of this schooling by the state could be justified by the impact of education in

building a stable and democratic society. However, Friedman didn’t see this role as a justification for government to get involved in the administration of educational institutions. The financing of schooling should be done by giving parents vouchers and that would give them the freedom and make them responsible to spend this sum on purchasing educational services from an "approved" institution of their own choice.

The role of the government would then be limited to insuring that the schools met certain minimum standards, such as the inclusion of a minimum common content in their programs. Denationalizing schooling would widen the range of choice available to parents.

Friedman also demystified the idea that government-conducted schools are necessary to avoid class distinctions. Nevertheless, what Friedman stressed in the book, and the actual educational context shows, is that stratification of residential areas effectively restricts the intermingling of children from decidedly different backgrounds while, at the same time, parents are not prevented from sending their children to private schools. This scenario clearly justifies the introduction of the vouchers’ system that would help breaking this stratification that gives only a highly limited class the access to private schools.



We have been defending freedom to choose in educational system. We fully support the introduction of a voucher system already with very good results in the US and the denationalization of the administration of educational institutions. This, we believe, would be the greater empowerment that could be given to poor families.

Capitalism and Discrimination

In this chapter Milton Friedman explains the surprising paradox of minority groups opposing capitalism. Looking in a retrospective historical analysis Friedman refers to the serfs, Jews, Puritans, Quakers and African-Americans as some of the examples of the religious, racial and social groups that have benefited from the freedom granted from a capitalist society.

Like nowadays movements – e.g. Occupy and Indignados – they have tended to attribute to capitalism the restrictions they experience rather than to recognize that the free market has been the major factor enabling these restrictions to be as small as they are. But today if something is to blame is crony-capitalism not free markets. Cronyism occurs when businesses collude with government to obtain special benefits. So if this is the case to

allow government more power would hardly be the solution. On the contrary, giving government more power to control and regulate the economy would benefit the more affluent, vocal and influential.

We have always supported the deserving minorities who praise work ethics, responsibility and freedom. At the same time we will always oppose the collusion of government, business and special interests at the expenses of the taxpayer, the consumer and the entrepreneurs with the will to enter and compete in a free-market.

Monopoly and Social Responsibility

Friedman stressed that the essence of a competitive market is its impersonal character. On the other extreme, monopoly violates this. Therefore Friedman mentions the urgent necessity of the elimination of those measures that contribute to the destruction of property and that interfere with private activities. And it is interesting to notice the steps proposed by Friedman to reduce the power of monopolies - by abolishing the corporate tax. All the earnings and dividends should then be reported on individuals' tax returns. For Friedman few measures would do more to promote effective



competition.

Milton Friedman referred that in a free economy there is one and only one social responsibility of business – to increase its profits and to make as much money as possible to their stockholders, so long as it stays within the rules of the game, without deception or fraud. To think otherwise “is a fundamentally subversive doctrine” as whether any individual could decide what the social interest is. Any contribution should then be made by individuals, the ultimate owners of property in our society.

Occupational Licensure

Given the complexity of economic interactions it comes obvious the impossibility of any individual or government conceiving of all the possible actions and outcomes. This is according to Friedman the great argument against both central government planning and professional monopolies. Defending freedom means giving customers and not the producers the power to decide what will serve them best. Unfortunately what we see is special interest groups capturing the government and guaranteeing protection for their economic sectors, once more at the expenses of taxpayer and the consumer.

The Distribution of Income

Since Adam Smith that economics has dealt with ethical issues as one of its core subjects. The XX century was the period of the development of collectivist sentiments, mostly due to the two world wars and the effects of the Great Depression. Friedman discussed in both ethical and scientific grounds whether or not equality of income should be a social goal for the state to promote and what has been the effect of the measures actually taken?

For Friedman using coercion to take from some in order to give to others conflicts with individual freedom and in liberal grounds he sees no justification for graduated taxation to redistributive purposes. Friedman also suggested a flat-tax on income above an exemption and the elimination of numerous deductions. Basically, he defended a broad simplification of the tax code reflecting higher absolute payments by persons with higher incomes. However, it would avoid a situation where the majority could vote to impose on others taxes that did not also affect their own tax burden. But Friedman is not insensible to the need of social action, he just believed that that goal should not be achieved through taxation. He agreed that much of the



inequality derived from imperfections of the market, so we should aim at striking at the sources of inequality rather than simply alleviating the symptoms. As we've mentioned before the distribution of income is another area in which government is doing more harm than good.

Social Welfare Measures and the Alleviation of Poverty

Friedman posed a rhetorical question of whether a subsidy from the general taxpayer could be justified if it is required. His answer was clear: "I see no grounds on which such a subsidy can be justified"⁷. Friedman accepted that someone could wish helping poor people, but he considered arbitrary redistribution "helping people whether they are poor or not because they happen to be a certain age"⁸. For Friedman, the most desirable alternative would be private charity but he also presented the negative income tax as an alternative to reduce the 100 per cent effective marginal tax rate that welfare beneficiaries receive.

As a liberal Milton Friedman tirelessly defended his belief in the dignity of the individual, in his freedom subject to not

interfering with the freedom of others: "My freedom to move my fist must be limited by the proximity of your chin"⁹. This idea inevitably implies that each person has an equal right to freedom – belief in equality -, but because people are different they most likely will want to do different things with their freedom – belief in inequality. Friedman compares this liberal approach to an egalitarian one which will accept taking from some to give to others justified on grounds of justice. However, this principle collides with freedom and this makes Friedman conclude that "one cannot be both an egalitarian, in this sense, and a liberal"¹⁰

Nowadays

In this day and age, it is easy to confuse wealth and power acquired through non-democratic processes with sustainable, diversified and healthy economy. Take China as the most notable example. Agreed, China has achieved tremendous growth and development, lifting many people from poverty into middle class, at the same time breeding a huge group of millionaires and billionaires. But this was not achieved

⁷ Idem, p. 184

⁸ Idem, p. 184

⁹ Idem, p. 26

¹⁰ Idem, p. 195



through centrally planned economy. Whatever China managed to achieve, it was done thanks to liberating the economy and trading with the rest of (capitalist) world. The newly-made millionaires are entrepreneurs, leaders of what we can see as gradual dismantling of centrally planned economy. Milton Friedman was able to observe this transition on his three trips to China in 80' and 90'. Again we confirm that economic freedom is a necessary condition for political freedom but not a sufficient condition.

Contrary to forcing people to act against their will and interests, the virtue of a free society is that allows each and every one, including small minorities, not to subordinate to a supposedly general interest.

Milton Friedman tried to educate about the benefits of such system. Free market, little taxation in the way, accountable political process, governing on a local level and security are instrumental. And these can only be realistically achieved with a widespread support of the public. Otherwise, there will always be special interest groups looking to collect power. The government cannot – and will not – provide us safety and welfare over the long term. And as the short term benefits of welfare state and crony-capitalism are rapidly approaching expiry date, we need to take action. But there is enormous inertia – a

tyranny of the status quo. However the change is inevitable and the actions that will be taken depend on the prevalent ideas. For that we shall be able to persuade our fellow citizens that free institutions are the alternative to the coercive power of the state. The first step is knowing what is good for you. “Capitalism and Freedom” is a good starting point for making up your mind.

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