

Milton Friedman, Comparativist.

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Thank you, Kim, for the invitation to the 99th birthday party of Milton Friedman. I would like to think we do this for not just one more year, but for a hundred more.

Thanks as well to all of you who have supported the Free Market Institute from its inception. Very good to see David Strom here. When David started this project a few years ago the first event I remember of it was another birthday party for Professor Friedman. We talked at that time about his vision for school choice, and no place better to do that than in Minnesota with our rich heritage of government school choice and of charter schools. Craig Westover, John LaPlante and I were around then, and it's a great testament to this project that all are still around in one capacity or another.

I came to learn about Milton Friedman at a point where his school of macroeconomic thought, then called monetarism, was ascending. In my senior year of college, the fall semester of 1978, I read with three other econ majors at St. Anselm College the Friedman-Heller Debate that had happened a decade before. Walter Heller, as many of you know, was a famed economist of the University of Minnesota and head of the Council of Economic Advisers for Presidents Kennedy and Johnson. The debate was the best place to read how Keynesians and monetarists disagreed about the economy. I'll spare you macroeconomics tonight, but it's worth recalling the debate was largely whether you could fine-tune the macroeconomy using government spending and tax policies. Heller said yes, Friedman no.

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I mention this for something Friedman said in the debate: “The fascinating thing to me is that the widespread faith in the potency of fiscal policy... rests on no evidence whatsoever. It’s based on pure assumption. It’s based on a priori reasoning.” By the time I read it, an additional decade of data had proven him right. Not that you’d know by the fiscal policy of the last two and a half years!

I also mention this because for most of my generation of economists, what we knew about Milton Friedman was his macroeconomics. I absorbed all his monetary theory, as much as I could find. I even found out he wrote a book on microeconomics in the 1950s that was quite good. Read that too. But because I was in grad school and studying this stuff, the first showing in 1980 of *Free to Choose* missed me. *Capitalism and Freedom* missed me. *Essays in Positive Economics* missed me. The way we were trained was to gossip in algebra and argue in calculus and econometrics.

But the hint of what he was thinking was in that quote from the debate: Keynesianism – or better, interventionism – was based on pure assumption. The data did not support them. And to know this you had to see it. That’s why Friedman made “*Free to Choose*.” In their memoirs, Milton and Rose Friedman explained how the film was made in shots around the world.

The first scene of the film is set in Hong Kong. Friedman had first visited the island in 1955 when tens of thousands of refugees from the mainland were living in one-room cells, open in one direction, in conditions as squalid as any you can remember seeing in newsreels from the period. Britain was in its period of industrial socialism, but the treasurer of the colony of Hong Kong was a Scotsman named John Cowperthwaite. An advocate of the policies of his fellow Scot Adam Smith, Cowperthwaite had held down taxes and refused to impose tariffs on goods entering the island. Friedman tells us:

I met Cowperthwaite in 1963 on my next visit to Hong Kong. I remember asking him about the paucity of statistics. He answered, "If I let them compute those statistics, they'll want to use them for planning." How wise!

Nonetheless, there are some statistics, and in 1960, the earliest date for which I have been able to get them, the average per capita income in Hong Kong was 28 percent of that in Great Britain; by 1996, it had risen to 137 percent of that in Britain. In short, from 1960 to 1996, Hong Kong's per capita income rose from about one-quarter of Britain's to more than a third larger than Britain's. It's easy to state these figures. It is more difficult to realize their significance. Compare Britain—the birthplace of the Industrial Revolution, the nineteenth-century economic superpower on whose empire the sun never set—with Hong Kong, a spit of land, overcrowded, with no resources except for a great harbor. Yet within four decades the residents of this spit of overcrowded land had achieved a level of income one-third higher than that enjoyed by the residents of its former mother country.²

I was a little embarrassed reading the passage about statistics, since that is the method of most of my own work. But his method of finding natural experiments was inspirational. In case after case, those countries that followed the Friedmanite principles of free markets and liberty enriched the peoples of their countries far beyond those nearby. Let's try a few examples:

Post-war Germany: The allies had tried to impose the same price controls to combat hunger and shortages as they had used in their own countries during the war. In the East, of course, the Soviets imposed their own system. But the American sector of west Germany, run by General Lucius Clay, had decided to try to combat postwar hyperinflation with a currency reform, replacing the old reichsmark with a new deutschemark. Many German economists supported this. But a couple of them wanted to go further. Ludwig Erhard argued that de-Nazification of the German economy would mean getting rid of those price controls. While Gen. Clay was away one weekend in June 1948, Erhard signed an order eliminating most of the price controls on food. A journalist of the period tells the story that upon his return on

² Friedman, "The Hong Kong Experiment." *The Hoover Digest*, 1998, no. 3, July. <http://www.hoover.org/publications/hoover-digest/article/7696> last accessed July 25, 2011.

Monday, Clay confronted Erhard. “Herr Erhard, my advisers tell me what you have done is a terrible mistake. What do you say to that?” Erhard replied, “Herr General, pay them no attention. My advisers tell me the same thing.” Erhard also oversaw income tax reform that we would be familiar with, lowering marginal rates and broadening the tax base. One of its witnesses? A young lieutenant and economist named Walter Heller.³

Austria and Hungary. Or Austro-Hungary, if you will. Milton’s parents were immigrants from eastern Hungary, which was a pretty poor place in the late 19th Century. Austria wasn’t much better. In the 1820s Austria was about 40% richer than Hungary when comparing per capita GDP. That had grown by the 1870s to nearly 70%. It then stabilized and started to converge. This is important because both countries were part of the Austro-Hungarian Empire and thus had the same set of rules. One of the things we teach in economics is that if two countries are roughly alike in their institutional features, their per capita incomes should converge – the poor country should catch up to the rich one. By the 1900s this had begun to happen, and was still happening after WW I, when the empire separated the two countries. By 1929 the Austrian standard of living was under 50% greater than the Hungarian standard. WW 2 was undoubtedly tough on both countries, but that 50% gap remained in 1950, when Hungary had just adopted the planned economy model of its Soviet masters while Austria looked to the west.

You probably know how this turns out, but the difference is simply striking. I was invited to travel to Austria, Hungary, Slovakia and the Czech Republic in 1993, shortly after the last two of those countries had split up. It’s about an hour from the Vienna airport to the border with Slovakia, which enters directly into the capital Bratislava. The difference was astounding there and in Hungary. Hungarian per capita GDP in 1993 was \$5,507. Austria was now \$17,377. Rather than 50%

³ David R. Henderson. "German Economic Miracle." *The Concise Encyclopedia of Economics*. 2008. Library of Economics and Liberty. <http://www.econlib.org/library/Enc/GermanEconomicMiracle.html> last accessed July 25, 2011. Readers will note that tax reform was what Heller worked on in Germany, and despite his Keynesian influences Heller supported the Kennedy tax cuts that were later the model for Arthur Laffer and Ronald Reagan.

greater, living standards in Austria were now 215% greater.⁴ And it showed. Dirty buildings and poor roads replaced the well-kept countryside of eastern Austria. Food quality was lower. Though I loved Budapest and still do – it is my favorite city in eastern Europe – there could be no question traveling to Vienna was to enter a different time and place, even though the drive was about three hours by car, or 134 miles. So close, so joined by a common history, yet so far apart. And since the fall of the planned economics in Hungary has already returned towards convergence. In 2008 the gap between the standards of living fell from 215% in 1993 to 154% in 2008. And Hungary isn't even one of eastern Europe's stars! The Czech Republic, Slovakia, and Poland all grew faster.

In *Free to Choose* Friedman had observed that, of all the countries in eastern Europe:

"Hungary has been moving away from total state control for more than a decade. However, the government still owns most of the country's enterprises. Now that it is permitting private individuals to start up their own businesses, it wants to control them too. The Hungarians aren't alone in that. Nothing is harder than to give up power."

Because the Hungarian government had continued to control all the buildings and tried to control the transition, Friedman observed, "the people who do the planning will make sure that they end up on the top and the little man is on the bottom." To find the real free market you had to go to back alleys, out of sight. It is no wonder they grew slower.

In a very famous interview with Phil Donahue, when provoked by Donahue's question of whether "greed's a good idea to run on" in the face of maldistribution of wealth, Friedman replied in part:

The great achievements of civilization have not come from government bureaus. Einstein didn't construct his theory under order from a bureaucrat. Henry Ford didn't revolutionize the automobile industry that way. In the only cases in which the masses have escaped from the kind of grinding poverty you're talking about, the only cases in recorded history are where they have had capitalism and largely free trade. If you want to know where the masses are worst off, it's exactly in the kinds of societies that depart from that⁵.

So it had been in Hungary and the rest of Eastern Europe.

⁴ All data in this section are from Angus Madisson, Contours of the World Economy, 1- 2030 AD. Oxford University Press, 2007.

⁵ Viewable on YouTube: http://www.youtube.com/watch?v=RWsx1X8PV_A

Chile. Perhaps no other place has captured both the attention of market liberals and the ire of the Left as has Chile under General Pinochet. For the simple fact that he had had a 45 minute meeting with Pinochet in 1975 and gave a talk there, he was pilloried in many journals and on TV. His Nobel Prize ceremony the next year was marred by a heckler who had used his father's ticket to make a scene. The heckler succeeded, but so did Chile.

Her history is worth reviewing. A country dependent on copper, Chile had enjoyed a lower per capita GDP than its neighbors in Argentina and Uruguay; in the former case, living standards were almost a third lower. After a lackluster decade of economic growth in the 1960s, the country turned to a socialist president, Salvador Allende in 1970. He nationalized the copper mines almost at once. Strikes broke out as inflation rose to over 1000% in 1972. Allende responded with price controls; empty stores and black markets resulted. Devaluation of the peso led to crushing foreign debt service. In response to social unrest punctuated with banging pots and pans from apartment buildings in Santiago, the military took over the country in a coup that claimed Allende's life. I am no expert on Chilean politics and so will not get into the debate over the coup; suffice to say that was what had motivated the heckler.

At first Pinochet's economic policy was no better than Allende's. The economy continued to ratchet down. Because of his political repression, Pinochet initially received no help from Friedman and his colleagues at Chicago. But many professors at Catholic University of Chile had trained in Chicago (through a USAID grant in the 1950s and 1960s) and they continued to write to their old professors seeking advice for a troubled economy. Friedman had twice been invited to receive honorary degrees but declined because he did not want to be seen supporting the Pinochet regime. When he finally did come to give lectures at Catholic University (along with colleagues Arnold Harberger and Carlos Langoni, and his meeting with Pinochet, he insisted that his lectures not be at all censored.

Out of the meeting with Pinochet came a letter that recommended shock treatment for the inflation that still gripped the country. "The key to both ending inflation and

economic recovery,” Friedman wrote later in his memoirs, “was a drastic cut in government spending, since the inflation was clearly being driven by the need to print money to finance a major government deficit.” The deficit had reached 20% of GDP, and Chile was cut off from international borrowing. Only money creation remained to finance the deficit spending.⁶

Pinochet took the advice and the results were astounding. After a deep recession much like the one that happened in the U.S. a few years later with Ronald Reagan and Paul Volcker, the Chilean economy took off. Inflation fell to under 10%; unemployment was sharply reduced while real wages rose. From a position of 50% lower per capita GDP than Argentina when Pinochet took Friedman’s advice, Chilean standard of living passed Argentina by 1992 and is now a third greater (even after significant reforms had greatly improved Argentina in the late 1990s and sped up their economic growth.) There are significant bumps in the road – Pinochet had not taken Friedman’s advice to float the peso and ended up with a currency crisis in the early 1980s; and Pinochet never did denationalize the copper mines. But the markets had done their work.

And most remarkable of all, political liberty followed. The currency devaluation and recession in the early 1980s finally eroded the political base Pinochet enjoyed.

When he tried a second time to extend his presidency in a plebiscite, he lost – *and he agreed to the result*. Quietly another president came, and economic liberty had begotten political liberty. The story has repeated itself many times since. And even more notable than that: Governments in Chile from both the left and the right have kept in place nearly every reform from the Chicago Boys, and the country has today the highest living standards in South America.

Free to Choose was updated in the early 1990s with the story of eastern Europe’s emergence from the Soviet sphere, though it didn’t make PBS this time. All of those

⁶ Milton and Rose Friedman, *Two Lucky People*. University of Chicago Press, 1999, pp. 399-400. Friedman also noted that the connection between Catholic U and Chicago was mostly through Harberger; Friedman’s Nobel Prize, however, provided a useful stage for the protests.

countries looked in one way or another at what had gone on before, particularly the shock therapy program of Chile. The book inspired Mart Laar, a very young man who had never read economics before (or since, he says.) Laar became prime minister of Estonia, a country with living standards the equivalent of its western European neighbors. I could point to others.

But the point I would conclude with from all these examples is that Milton Friedman's greatest contributions were, for a broad range of economists trained in the 1960s and 1970s – and many into the 1980s, far more narrowly regarded than they should have been. His message of freedom was heard less in his own country than in others. Even today his program for economic freedom and its contribution to political freedom is maligned by leftist writers, as it was 35 years ago at his Nobel ceremony. I won't go into detail on this tonight – Naomi Klein can go spoil someone else's birthday party, she won't get to this one. But it was in his lifetime and by his efforts as much as any single man that the belief that government ownership of the means of production would lead to a better society ended on the ash heap of history.

Think a moment, please, about the following fact. In Asia and in particular in China and India, a middle class is developing that rivals in size and significance the first middle class formation of Europe in the early 19th Century. There are now more members of the bourgeoisie that call Asia home than they do America and Europe combined. 57% of the world now lives with middle class incomes, compared to only 1/3rd in 1980.⁷ For whom should they thank? Who should China thank for the decline in poverty there: the World Bank and the IMF? Or Wal-Mart?⁸

⁷ See Surjit Bhalla, Second Among Equals: The Middle Class Kingdoms of China and India. Washington: Petersen Institute for International Economics, 2009, and Martin Ravallion, "The Developing World's Bulging (But Vulnerable) Middle Class." Washington: World Bank Policy Group Research Paper #4816, 2009. Viewable at <http://go.worldbank.org/4X2EWOLIT0> last accessed 28 July 2011.

⁸ See Michael Strong, "Forget the World Bank, Try Wal-Mart." TCS Daily, August 22, 2006. http://www.ideasinactiontv.com/tcs_daily/2006/08/forget-the-world-bank-try-wal-mart.html last visited 28 July 2011.

Late in his life Friedman observed, “The true test of any scholar's work is not what his contemporaries say, but what happens to his work in the next 25 or 50 years. And the thing that I will really be proud of is if some of the work I have done is still cited in the text books long after I am gone.” It is up to us to make sure his works are not forgotten, his writing not marginalized. And the reason for this he gave 35 years ago. This is perhaps the most important quote of Friedman in my own life, the imperative that keeps us working to keep free markets and Milton Friedman’s birthday remembered as long as we breathe.

There's a strong argument to be made that a free society is a fundamentally unstable equilibrium, in the language of the natural sciences.... we may regret this but we've got to face up to the facts....How often and for how long have we had free societies? For short periods of time. There was an essentially free society in 5th-century Greece. Was it able to survive? It disappeared. Every other time when there's been a free society, it has tended to disappear.⁹

We can get 57% of the world to live lives that are no longer resigned to a life of poverty, but understand that can go backwards as well as forward. He did. And to keep his work remembered for the next 25-50 years, so should we. Thank you.

⁹ “An Interview with Milton Friedman.” *Reason*, December 1974.