

Liberal Read

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Friedman's Vision of a Modern State

BOOK REVIEW

Milton Friedman

Capitalism and Freedom

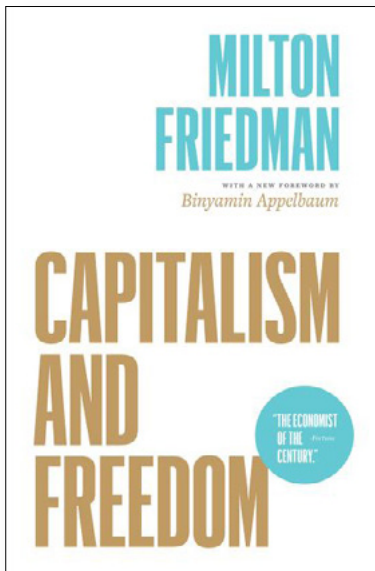
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By Adam Mazik

A series of crises has put many liberal ideas under question. Inspired by a popular commercial concept, Liberal Reads are packaged in an easily accessible format that provides key insights in 30 minutes or less. The aim of Liberal Reads is to revisit and rethink classical works that have defined liberalism in the past, but also to introduce more recent books that drive the debate around Europe's oldest political ideology. Liberal Reads may also engage critically with other important political, philosophical and economic books through a liberal lens. Ideological discussions have their objective limits, but they can still improve our understanding of current social and economic conditions and give a much needed sense of direction when looking for policy solutions in real life problems.

Liberal Read

Friedman's Vision of a Modern State



What is the proper role of the government? What economic system should we follow in order to prosper and progress in freedom and order? What are the key services a government needs to provide for a society? What is the best way to create a fair and innovative system of education? What is the government's role in monetary matters? And should we determine who is allowed to enter into a certain profession through the means of government? Shouldn't at least medical doctors be licensed?

Those and many other questions are answered in Milton Friedman's *Capitalism and Freedom* from 1962. In this important book, the great American economist delivers a crisp and engaging series of essays on the fundamental roles of government. He offers a solid and constructive critique of the flaws of the modern democratic welfare state and demonstrates

concrete solutions to the problems of the system.

The book is aimed at an interested audience, not at professional economists or philosophers. It is an overview of Milton Friedman's economic and philosophical beliefs packed into a short book of 243 pages.

Friedman is a firm believer in individual liberty and responsibility, as well as the powers of the market and its invisible hand. He sketches the importance of voluntary exchange and a competitive economic system which allows individuals to trade and cooperate with each other in pursuit of their individual goals.

The government and freedom

In public discussions, we often hear terms like "political freedom" and "economic freedom". Not many people stand in opposition to the first value: it is a broad societal consensus that political freedom is desirable. We understand the need for democratic institutions, like parliaments and representative governments acting under the rule of law, and universally criticise despots and authoritarians like Alexander Lukashenko in Belarus, Vladimir Putin in Russia, or Recep Tayyip Erdoğan in Turkey. We mourn the journalists jailed in Turkey and opposition politicians in Russia, and we all have stood with the brave protesters in Belarus, brutally attacked by the powers of their own government.

Economic freedom, however, is a very different story: for some reason, it is not as beloved as the other dimensions of freedom. While the need for political and personal freedom

is widely understood and supported, many people, particularly those nearing leftism and neo-Marxist ideology, are sceptical about freedom in economic matters. Capitalism has a bad reputation. The connotations that many of us associate with the word are “inequality”, “exploitation”, “neoliberalism”, and even “colonialism”. It is the essence of everything that is evil, shallow, and materialistic, supposedly the reflection of the worst traits of our society.

But... is that the truth? Does capitalism really bring out the worst in humanity? Is economic freedom a necessary evil which we need in order to live? Or is it possible to have political freedom without economic freedom?

Friedman would answer both questions with a decisive “No.” According to the economist, the system of “competitive capitalism”, as he calls it, is the reason for the greatest inventions in the history of humanity and the reason for an unprecedented explosion of wealth. It is also a necessary condition for political freedom.

Friedman doesn't maintain that it is the only and therefore a sufficient condition. While he does see the possibility of a dictatorship in which the dominant economic system is capitalist, he also maintains that without economic freedom—a system in which individuals trade with each other voluntarily, a system in which people are allowed to accumulate wealth and property—political freedom simply would not be possible. According to Friedman, there is no freedom of speech, and there is no democracy in our modern understanding without competitive capitalism.

Why does Friedman believe that? One of the features of a free society in his view is “the freedom to advocate and propagandise openly for a radical change in the structure of the society”. The economist offers the example of an individual openly advocating and working to impose socialism in a capitalist society. As long as the activist only uses the means of peaceful argumentation and protest and doesn't use violence or coercion, in a capitalist society they are allowed to advocate for whatever they want. The only resources the activist needs are the support of others, especially financial support. If a socialist can gather funds from a group of wealthy individuals, the patrons who happen to share their beliefs can provide the needed resources for the propagation of the socialist system: they can buy the paper to print policy proposals and political messages; they can rent a restaurant to gather comrades; and, in more modern terms, they can pay for the promotion of their activities on social networks and through online advertising to reach their target audience.

Now let us imagine a liberal trying to advocate for capitalism in a socialist society. Friedman notes that a person needs to be able to earn a living in order to advocate for something. However, in a system in which all jobs, factories, and production are facilitated through the direction of political authorities,

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allowing a worker to argue against socialism would be an “act of self-denial”. But Friedman continues his argument: even if this act of self-denial could be achieved, the activist wouldn’t be able to raise the sufficient funds for their activism. While Friedman believes that in a socialist society there would also be individuals with high levels of wealth, he notes that they would most likely be high public officials, and it is unlikely that they would be able to support any anti-socialist activism.

But Friedman even goes a step further and imagines a socialist government both committed to political freedom and aware of the funding problem; he concludes that there is no way this socialist government could facilitate political activism. If the government were to create a bureau supporting anti-socialist activism, there still would be the problem of selecting which organizations to subsidise. Not everyone, after all, could receive funding; otherwise, the supply of activists would be unlimited, Friedman notes.

The conclusion is that even in a hypothetical socialist system, with a benevolent and freedom respecting government, political freedom simply is not possible to the same extent as it is under capitalism.

The reason for this facilitation of political freedom is an innate feature of capitalism: its competitiveness and limitation of government powers. Milton Friedman does not believe that competitive capitalism is a utopian system. He doesn’t believe that all corporations and individuals inherit their wealth because they “deserve it” or owing to some kind of “merit”. He is very far from the Calvinist ideas so often still reflected in many conservative political speeches. He believes that the government and the state have a set of limited functions, the combination of which makes our civilisation possible and facilitates political freedom. We can see this in the example of socialist activists in a free society: the fact that people in the capitalist system can accumulate wealth, and therefore can attain some kind of influence and power, makes their economic strength a check on the coercive powers of government.

Capitalism and discrimination

We have seen why Friedman believes that economic freedom is a necessary condition for political freedom, but we still have to explain why he also contends that the other arguments against capitalism are wrong.

After all, a lot of people in the 1960s were highly sceptical towards capitalism; many in our modern society still are too. Capitalism is supposedly an inhumane and exploitative system which leads to discrimination against minorities or those holding certain political views.

Wrong! According to Friedman, it is precisely capitalism and its competitive nature that have acted as tools against discrimination in the past.

The first time we encounter this kind of argumentation is when Friedman brings up the Hollywood blacklist in the first chapter of his book. From 1947 on, many artists and writers in the film industry were blacklisted for allegedly being communists. In today’s language, they were effectively “cancelled” for their political beliefs, often even without sufficient proof. Friedman brings up a Time article about a scriptwriter who used a pseudonym to escape the stigma of the wrong political beliefs and to be able to make money from his craft. When he was announced as the winner of an Oscar and the story came out to

the media, the blacklist effectively ended. However, that article goes on to say that even prior to that, about 15% of Hollywood movies were written by writers from the blacklist.

But what does capitalism have to do with that? The incentive for Hollywood's studios and producers was always financial: ultimately, they did not care where the scripts came from. They did not care whether the writer was a Republican, a Democrat, an independent, or a communist. What matters in capitalism is the profit incentive. Enterprises aim to make as much money as possible, and features like political beliefs don't matter quite as much.

Friedman furthers his explanation through the era of McCarthyism. The market and system of private enterprises was ultimately the chance for many individuals who had been

accused of communist or socialist sympathies. Many of them landed jobs in trade, in small businesses, or in farming, Friedman notes.

"This illustrates how an impersonal market separates economic activities from political views and protects men from being discriminated against in their economic activities for reasons that are irrelevant to their productivity - whether these reasons are associated with their views or not."

The conclusion, therefore, is that capitalism is in no way a facilitator of discrimination. The market and its profit incentives, as well as its impersonal nature and competitiveness, are features that render the free economy anti-discriminatory and inherently progressive.

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The role(s) of government in Friedman's system

We have learned about the role of economic freedom in the facilitation of political freedom and freedom of opinion. We now know why Friedman believes that competitive capitalism is the system which, empirically speaking, gives people the most freedom and opportunities to live their lives as they wish. What we still haven't defined is what the government has to do in order to facilitate this system.

Milton Friedman was not an anarchist: he believed in individual freedom. However, he also believed that we need certain public institutions to preserve that freedom. While government remains a great danger for our liberty, Friedman maintains that it is needed, nevertheless.

Friedman believed in a limited and decentralised government. Its basic functions are: to maintain law and order (to protect its citizens from violence and fraud from within and from outside); to define property rights, which are an innate part of the capitalist system (as well as to provide a means to modify property rights and other rules of the economic game); to provide a system of courts to solve disputes and conflicts in a peaceful manner; to enforce contracts and property rights among members of society; to promote competition; to provide a monetary framework; to counter technical monopolies; and to overcome significant neighbourhood effects, as well as ensuring some basic social provisions, which we will talk about in a couple of minutes.

The main difference between Friedman and classical liberals, along with some of the more radical liberals of his time, is his opinion about how monopolies and neighbourhood effects should be handled.

Friedman is by no means a modern social liberal, or even an ordoliberal in the German tradition. He notes that monopolies are most often the result of government policies fostering special interests among certain groups through different kinds of regulations, quotas, and tariffs. He also notes that most collusive contracts between companies that try to rig the game and dictate prices through the regulation of output and other strategies are quite insatiable yet rare. In those cases, Friedman would enforce antitrust laws that exist in the US.

However, he still sees that monopolies can arise. This is because in some cases it is technically efficient to have just one producer. He sees three possible alternatives that may arise from this: a private monopoly, a public monopoly, or public regulation. All these outcomes are bad, as no single solution can satisfy Friedman fully. He concludes, albeit without very strong conviction, that of the three a “private monopoly” seems to be the best bad solution. The reason why he prefers the private monopoly to the other alternatives is his experience with the handling of such situations in the USA. The free market is a dynamic system in which changes happen in a comparatively fast manner. Through innovation and new products and services, as well as through other changes in the market, there is a high chance that a technical monopoly would not be able to survive for long. Regulation and a public monopoly, however, are a lot harder to dissolve and to change. Friedman brings up the example of the Interstate Commerce Commission that was created to prevent a monopoly in the sector of railroads. Yet much has changed since the 19th century: automobiles became more widely available, and so did trucks and methods for transporting goods. People can now choose to travel by car, by bus, or perhaps on an airplane. It would be absurd to fear any monopoly in the sector of transportation of goods and people today: there is plenty of competition.

The ICC did, however, still exist at the time of Friedman’s book, ironically becoming a tool used by the railroads to stifle competition from trucking companies and other means of transport.

Friedman doesn’t actually think that a private monopoly is the best solution in every situation—in some, a public monopoly can be justified. The reason for this is Friedman’s philosophy as a liberal. He is not a deontological liberal who believes that certain principles have to prevail, no matter the consequences. His philosophy is consequentialist, meaning that while he believes in freedom as a principle, he does so because the system of free enterprise brings us the best results. Friedman does, however, believe that freedom needs to be restricted in some situations in order to bring about some desirable result. Therefore, we need to weigh up the costs and the benefits of each solution, freedom being an important part of the equation.

Money

One of the roles of the government, according to Friedman, is the provision of a stable monetary framework, part of its role as a rule maker and enforcer.



MILTON FRIEDMAN

“A society that puts equality before freedom will get neither. A society that puts freedom before equality will get a high degree of both.”

Milton Friedman (1912-2006) was an American economist who won the Nobel Prize for Economics in 1976. In 1962 he published his book *Capitalism and Freedom*, in which he advocated a free market economy, negative income tax and school vouchers. He was one of the pioneers of monetarism, which had a major influence on central bank policy. Too much money put into circulation by the government leads to inflation, he observed. As such, governments should not interfere with the currency markets. As chairman of the Federal Reserve, Alan Greenspan pursued a monetarist policy that was consistent with the idea of the self-regulating capacity of the financial markets. Friedman was a strong proponent of far-reaching liberalisation, deregulation and privatisation. He called for minimal government intervention. His ideas were applied by Ronald Reagan and Margaret Thatcher.

Monetary policies are some of the most controversial topics among economists and politicians. There is no doubt that the monetary system has substantial influence on the whole economic system of a country, as well as on its trade relations with other nations.

Money should therefore be stable—we should have a system in which individual planning for consumption and investment is possible. There are many opinions for achieving that. Friedman picks two extremes: a fully automatic commodity standard (e.g., a gold standard) and a discretionary monetary authority (e.g., a central bank). Neither alternative is Friedman's preferred solution: he notes that although the full and automatic commodity standard is theoretically compatible with the free-market economy and liberal philosophy, it is neither feasible nor desirable. Commodities are never the only kind of money in circulation; besides, the costs of the production of money would be very high.

Instead of broad discretion and powers being given to a central bank, Milton Friedman proposes the legislation of rules for conducting monetary policy.

Friedman shows with multiple examples that although the commodity standard has been repeatedly tried, its ideal version could never be achieved—not in the USA, and not in other countries like Great Britain.

As a result of multiple financial crises in the late 19th and early 20th centuries, and following a bipartisan agreement, the Federal Reserve Bank was created in 1913. At that time, most important currencies in the world relied on a mixed gold standard. Therefore, the widespread belief in 1913 was that it would continue to limit the powers of the Reserve.

As a result of WWI, however, the gold standard was abandoned, thus leaving the Federal Reserve with a

lot of power, effectively giving it the competencies of a technocratic and discretionary monetary authority, which from then on was able to determine the quantity of money in the US.

The goal of the Federal Reserve was to provide stability. Friedman, however, notes that this goal has never been achieved. On the contrary:

"The stock of money, prices, and output was decidedly more unstable after the establishment of the Reserve System than before. The most dramatic period of instability was of course the period between the two World Wars which includes the severe contractions of 1920-21, 1929-33 and 1937-38."

Friedman's views about the reasons for the Great Depression in the '30s are particularly interesting. It is widely believed that the reason for the Depression was the inherently unstable capitalist free market economy. The economist rejects this premise and attributes its causes to government mismanagement—more precisely, the mismanagement of the Federal Reserve.

"All told, from July 1929 to March 1933, the money stock in the United States fell by one-third, and over two-thirds of the decline came after England's departure from the gold standard. Had the money stock been kept from declining, as it clearly could and should have been, the contraction would have been both shorter and far milder."

Friedman therefore argues that the reason for the Great Depression wasn't the private enterprise system but the tight money management of a few men with great power.

Friedman therefore rejects the system of the Federal Reserve:

"It is a bad system to believers in freedom just because it gives a few men such power without any effective check by the body politic—this is the key political argument against an 'independent' central bank. But it is a bad system even to those who set security higher than freedom."

Instead of broad discretion and powers being given to a central bank, Milton Friedman proposes the legislation of rules for conducting monetary policy. Friedman notes that the usual answer to this proposal is "that it makes little sense to tie the monetary authority's hands in this way because the authority, if it wants to, can do of its own volition what the rule would require it to do, and in addition has other alternatives, hence 'surely', it is said, it can do better than the rule", and that the same can be said about the legislature. Shouldn't we decide about correct policies on a case-by-case basis?

The economist compares this situation to the case of free speech. The general American concept of free speech covers a variety of cases and different kinds of expression. But wouldn't it be more rational to decide on a case-by-case basis? Friedman notes that, given the opportunity, the vast majority would deny the right to free speech in most cases.

However, if we combine all those different expressions into a bundle, the majority would more likely vote in favour of free speech. People wouldn't want to restrict their own rights, after all. The second reason Friedman names is the fact that when a policy is enacted for a bundle of cases, the legislation's cumulative effects have to be taken into consideration, effects which cannot be easily foreseen in the application of singular cases.

A case-by-case examination is therefore the wrong approach, as it would most likely lead to the ignorance of cumulative consequences of each decision.

Friedman provides a practicable, moderate, and rational vision of a modern state, far away from the utopian dreams of some philosophers.

Friedman proposes a rule which would instruct the monetary authority to achieve a specified rate of growth in the stock of money. "For this purpose, I would define the stock of money as including currency outside commercial banks plus all deposits of commercial banks. I would specify that the Reserve system shall see to it that the total stock of money so defined rises month by month, and indeed, so far as possible, day by day, at an annual rate of X percent, where X is some number between 3 and 5."

Friedman, however, doesn't believe that this rule is the ultimate solution for the monetary politics of the US, either—he believes that better rules could potentially develop through experience.

Nor does he believe that it is enough to render the monetary system more stable and rational. Additional reforms would have to be performed in order to further restrict the discretionary powers of the Federal Reserve.

Concerning the international context of interchangeable currencies and prices thereof, Friedman proposes a system of freely floating exchange rates, determined by private transactions without governmental intervention.

Although Friedman's views on monetary policy have never been adopted fully by the US government, his advocacy for floating interest rates was quite successful. The US in 1971 and later other countries like Great Britain switched to a floating exchange rate system.

Social policy

But what does Friedman believe should be done in order to help the poor and disadvantaged? After all, not everyone has the luck of being born into a middle-class family. Not everyone has the abilities and talents to make a living. Not everyone has the means to provide for themselves or their families. People encounter grave difficulties like accidents or disease—surely the government needs to do something in order to help such individuals?

Friedman is not a radical libertarian and does see the necessity for a certain governmental social net that helps those who need it most. He is, however, critical about many measures taken by modern governments and sees them as not only inadequate but, in some cases, even counterproductive and harmful.

In *Capitalism and Freedom*, Friedman delivers a harsh critique of some of the measures undertaken by the American government, namely: the redistribution of income through a complex and ineffective tax system, public housing, minimum wage laws, farm price supports, and old-age and survivors' insurance.

Taxation

Friedman maintains that the progressive income tax system is the wrong measure to deal with wealth inequalities. Corporate taxation in particular facilitates the accumulation of wealth and capital gains in corporate hands. This system creates a set of incentives to use different kinds of legal loopholes in order to maximise corporations' profits.

Friedman therefore advocates for the abolishment of corporate taxation and a simplification of income taxes. In order to stop the redistribution of income into the hands of corporations, he argues, a variety of legal loopholes should be abolished. He explicitly names the percentage reduction on oil and other raw materials, the tax exemption for interest gained from state and local securities, the special treatment of capital gains, the coordination of income, estate, and gift taxes, and numerous other deductions. Corporations should be required to attribute their income to stockholders, who would be responsible for including that income on their tax returns.

Instead of a graduated and highly progressive income tax, Friedman proposes a flat rate, arguing that a rate as low as 23.5% on taxable income would yield the same revenue as the progressive rate (at the time of the book's publication). Due to a lower incentive to engage in tax optimisation, or even avoidance, Friedman suggests that the revenue most likely would be higher than under the progressive tax system.

Public housing

Friedman criticises public housing programmes for worsening the situation of the poor in the sphere of housing. According to him, more dwelling units have been destroyed in order to facilitate the building of public housing than new ones have been constructed. As a result of that, the number of persons per unit has increased. Besides, contrary to the intention of the project, a high concentration of “broken” families in subsidised public housing units has led to a higher concentration of young delinquents. Had these families instead been subsidised by cash payments, the families would be spread more proportionally across cities.

Minimum wage laws

Friedman argues that minimum wage laws harm the poorest and weakest parts of society. Individuals whose work on the market is worth less than the minimum wage more often become unemployed. In fact, because of that effect, the problem of poverty becomes greater: it is precisely those individuals who effectively are forbidden from working, who are the poorest and most disadvantaged in our society. The economist also notes that the pressure for minimum wages quite often reflects the lobbying of unions and special interest groups, for example, “northern trade unions and northern firms threatened by southern competition favor minimum wage laws to reduce the competition from the South”.

Old-age and survivors’ insurance

Friedman argues that the coercive imposition of governmental social security schemes not only imposes an unfair redistribution of wealth from the relatively young to the already retired, but it also creates significant costs which cannot be justified in any other way.

For Friedman, there is no need to nationalise social security and insurance schemes. The compulsory programme has a negative impact on competition and innovation in the insurance industry and has additionally created a complex and growing bureaucratic system.

What shall we do instead?

Instead of the hundreds and thousands of complex and ineffective measures, Friedman proposes a system of negative income taxes.

Any person earning less than a certain threshold in such a system would pay a negative income tax—they would receive a certain cash subsidy.

This system should function outside of the market system and be constructed in such a way that its recipients are not disincentivised from reaching higher levels of income.

The system is aimed directly at the alleviation of poverty. It could replace hundreds and thousands of costly and ineffective programmes.

Because the system would operate within the income tax system, the administrative costs and associated problems would be manageable. The entire cost, according to Friedman, would very likely be lower than the contemporary welfare measures in place.

Education

In most modern democracies, education and schooling is financed and administered by the central government. While private schools are allowed to operate, the majority of children generally attend public schools. A private school imposes additional costs on parents: they still need to pay the taxes required for financing public schools and their administration, even if they decide to send their children to private schools.

What are Milton Friedman's views on education? Does the state have to administer schooling? Do we need government-run schools? And should we subsidise education at all?

Friedman argues that a stable and democratic society would not be possible without a minimum degree of literacy and knowledge as well as a certain common set of values. The education of children doesn't only contribute to the welfare of the child and the interests of parents. The positive effects of education are experienced by every single person in society. This neighbourhood effect of education, according to Friedman, justifies the imposition of a minimum required level of schooling, as well as the financing of schooling by the state. It does not, however, justify the administration and nationalisation of educational institutions.

Friedman proposes a voucher system. Parents would be given a redeemable voucher which could be used in any approved private school. In this system, they could use those funds and any additional funds they wish to pay out of their own pockets in an approved institution of their choice. This would drastically widen the supply of schools and models among which parents and children could choose according to their needs. The result would be more than just a variety of different models and therefore the possibility for innovation. Schools would depend on market forces to a higher degree, giving parents more say in their children's education. In that sense, the market becomes a democratic device—parents would be able to vote for and against certain models by choosing the ones that fit both them and their child.

Conclusion

With his book *Capitalism and Freedom*, Milton Friedman provides a great introduction for anyone interested in politics and economics. His clear and simple argumentation leads the reader through topics ranging from political philosophy, monetary theory, and education to problems such as the effective alleviation of poverty.


This book is much more than the gateway drug for libertarians. Friedman provides a practicable, moderate, and rational vision of a modern state, far away from the utopian dreams of some philosophers. He demonstrates the importance of freedom and markets in the system of competitive capitalism and formulates a variety of policy recommendations for democratic governments around the world.



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