

The Economics of Milton Friedman



Still Relevant Today?

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The Economics of Milton Friedman

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“The central problem with government is that it forces people to act against their own interest to promote the supposed general interest. It imposes the values of others on individuals and hampers the strongest and most creative forces that men know of.”



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Who is Milton Friedman (1912-2006)?

1. Nobel Laureate Economist
2. Prominent figure in the conservative and libertarian movements of the late 20th century.
3. Founder of the Chicago School of Economics
4. Challenged the Keynesian theory of Economics (C + I + G + NFI)
5. Famous critic of the Federal Reserve System...blamed the Great Depression on fiscal mismanagement
6. Opponent to Paternalism: (Paternalism holds that individuals must have decisions made for them by the state because they are unable to take care of themselves.)
7. Despite the assertion that a libertarian is indifferent to the poor (the bad guy theory), Friedman advocates for an effective safety net to be available and more effective than the current welfare state.
8. Friedman views big government as a threat to individual liberty and argues that the increasing size of government threatens to destroy the fragile fabric of liberty.



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“Capitalism and Freedom”

--Written in 1962 to defend what Friedman calls “The Liberal”

1. Liberalism is not the philosophy of social freedom, and expansive social welfare programs.
2. Instead it is an older creed of those who first called themselves liberals in the 19th century.
3. Classical liberalism is akin to modern day libertarianism.
4. Liberals strongly defend limiting government, social creativity, individualism, constitutionalism and the rule of law.
5. A liberal argues for the decentralization of power and counts on the ability of men to fundamentally reform society.
6. Even though Friedman understood that that term “liberal” in the sense that Europeans (and now Americans) use it is confusing to audiences because the word has changed he refused to give up use of the word.

“A Liberal is fundamentally fearful of concentrated power by (The Federal Government)” - Milton Friedman



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Some of Friedman's Core Beliefs:

- A. The concentration of Government is liberty's greatest enemy.
- B. Government must be limited ---purpose is preserve our freedom.
- C. A Free-Market will check Government Power along with our classic rights of free speech, religion and liberty.
- D. Friedman argues that capitalism, operating through the markets is a necessary condition of political freedom.
- E. Government is needed for the “rules of the game”
- E. Now the enemies of “liberalism” have taken their name on its own to mean state management of the economy, the welfare state and the redistribution of income.



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Economist Milton Friedman
on Donahue
"Socialism vs. Capitalism"

The Role of Government in A Free Society

- A. The Market Creates outcomes that allow an individual to do as they like.
- B. However, this form of representation (the market) --doesn't work in some areas like National Defense.
- C. The government must act as an "umpire" in defining roles of property rights and establishing a monetary system. In short, govt. must do what markets cannot do.
- D. For instance, Governments should probably build most roads. We need public parks. (Government should probably build public parks)
- E. It can be a hard line to draw the line between government and markets—but it must be drawn.
- F. Government cannot be paternalistic about depriving individuals of the ability to learn from their errors and becoming capable of maintaining everyone's life.
(Paternalism=individuals must have decisions made for them by the state because they are unable to take care of themselves.Friedman believes paternalism is an offense of dignity to individuals)
- G. Problems with children are an exception.
- H. Government Intervention in most cases cannot be justified. Examples are:
1) subsidizing farm production, 2) Rent Controls, 3) Minimum Wages, 4) Social Security Programs, 5) Excessive Licensure, 6) Public Housing




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Fiscal Policy

"I know of no organized body of evidence which justifies fiscal policy"—Milton Friedman

- A. Friedman agrees that extensive evidence contradicts the Keynesian rational for government spending.
- A. Often Government rationalizes that extra government spending is needed to reduce unemployment.
- B. Government spending is often argued that it "balances" the economy and stimulates it with a multiplier effect which leads to economic growth.
- C. In fact what government is doing is simply pulling money out of the market.
- D. Friedman argues that for every dollar the government spends only about a dollar is added to income, not a wide multiplier that is often suggested. (bigger multiplier for private economy)
- E. However, cutting government spending is expansionary.
- F. In fiscal policy we simply do not know enough to be able to use deliberate changes in taxation or expenditures. In the process of trying to stabilize the economy we almost surely make matters worse (Lag effect).




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The Role of Monetary Policy

- A. The Federal Reserve over time has shown how unstable the economy can be by concentrating power in the hands of a few.
- B. Instead the Fed should rely on rules rather than authorities (the Committee)
- C. Friedman wants general rules of monetary policy which should be issued for the Fed System that are embodied in the Constitution for fair governance, not in the hands of an arbitrary authority that may act at the wrong time. Friedman believes the Fed should aim to achieve a specified rate of growth in the stock of money.
- D. One example is the money stock being increased between 3-5%. The target is less important than the stability.
- E. Friedman worries that the arbitrary authority will almost always act at the wrong time—a change in direction won't take effect until the problem is over—due to lag effects.

"The Great Depression in the United States is a testament to how much harm can be done by mistakes on the part of a few men when they wield vast power over the monetary system of a country"—Milton Friedman




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"The basic role of government in a free society is to provide the means whereby we can modify the rules, to mediate differences among us on the meaning of the rules, and to enforce compliance with the rules on the part of those few who would otherwise not play the game".

Government should basically stay out of the Economy. We should have Free Enterprise.




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The Role of Government in Education

- A. Arguments provide for government involvement in education:
 1. Government's involvement provides Social Benefits and parents may not always do the best for their children so government must get involved.
 - A. Government cannot exist without a literate and informed population.
 - B. Education can help as a result.
 - C. The Government can require education but it should not produce education itself.
 - D. Parents could/should pay for their school for their kids and in extreme cases could be aided with a subsidy.
 - E. In this solution government machinery for education control would be eliminated.
 2. Friedman understood that such a policy may not be feasible because as is now Government pays for minimum schools. School is paid for to benefit society as a whole.
 3. Government should not administer education, just subsidize it.
 4. Vouchers should replace the public school system. Government should ensure that education just meets minimum standards.
 5. Competition will help the school system. Increasing money spent won't help. The problem with teacher salaries isn't that they are too low but that are the same regardless of quality.



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Vouchers aren't fool-proof

- A. Some Church and State issues—parochial school funding.
- B. Biggest problem is the entire bureaucracy of our education system is opposed to having schools open to market competition. The school system is a public monopoly with no competition, where there is little chance for change and improvement.
- C. Financing of higher education with public funds is justified on the basis of the social benefits associated with higher education.



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Occupational Licensure

- A. Freedom of Occupation has been a key factor in the dramatic increase in wealth and freedom in the 19th and 20th centuries.
- B. Friedman always argues against licensure in general and medical licensure in particular.

Licenses are simply restrictions on who may hire who. Occupational licensure is spread across the economy and the arguments for control of the labor supply are typically given by those who benefit from the licenses.

Three Levels of Licensure:

- 1) Registration is simply forming a list of who engages in something (a means to make taxation easier)
- 2) Certification involves requiring individuals displaying skills to have a qualifying test. (Friedman believes the market can do this itself—retailers and merchants certify their goods)
- 3) Licensure requires a demonstration of competence and leads often to exclusion. Licensure deliberately blocks private contracts. Friedman is against many forms of licensure in medicine where he believes with fewer licensing laws would create an "intermediate" level of medicare to help bring down costs.

Each Level of Licensure is Worse. (j)—Wine Growers, Taxis, Hair Studios)



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Distribution of Income

- A. The Free Market distributes income according to the value of one's labor and the instruments one uses to produce goods and services.
- B. Many wish to see an equality of income regardless of productivity because they believe that means "equal treatment"
- C. Friedman believes there is no connection between "equal treatment" on one hand and "equal shares" of income on the other.
- D. Redistribution of income and wealth denies individuals the opportunity to engage in the competitive process, in a sense redistribution is a generator of inequality. It ignores the fact that some individuals have different natural endowments of ability.
- E. Equality is often a smokescreen for envy that others have more than you.
- F. The market allocates payment and equality and does not distribute it.
- G. Friedman argues that progress or graduated income taxes are unjust because their sole purpose is to restrict individual freedoms and redistribute income.
- H. Friedman likes a flat tax on income above an exemption level and with few deductions. The exemption would be graduated depending on income. A flat tax doesn't redistribute income and rewards people fairly for contribution.



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Redistribution of Wealth

How many of you want to pass something along to your kids?

How many of you are more concerned about your kids welfare then your own?



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Where does Friedman stand on Unions, The Minimum Wage, Social Security and Transfer Payments Public Housing, and the Alleviation of Poverty?



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Friedman on Unions

1. The gains that come from strong union wins for their members are primarily at the expense of other workers.
2. Simple economics come into play here.
3. Whenever the price of anything like labor is raised employers don't want to hire as many workers.
4. Union worker's higher wages act like minimum wages—the employer hires fewer workers when he must comply with union regulations.
5. Friedman rejects "right-to-work" laws which make it illegal to require union membership. (If an employer wants to have a closed shop why not)?
6. This interferes with freedom and economic liberty.
7. Big Unions should not have a monopoly power as labor markets work best on the basis of competition.
8. It is laws that give unions monopoly power that must be ended.



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Minimum Wage Laws

- A. Minimum wages actually tend to increase poverty by outlawing wage ranges at certain levels.
- B. Instead of simply paying higher wages, employers will fire people or hire few other people.
- C. Or, in cases like the State of Washington that imposed a \$15 minimum wage in Seattle, low income and jobs migrated to the suburbs almost immediately.
- D. Those without jobs can afford these minimum wage laws the least—especially minorities.
- E. Enterprises must be Free to Hire...this is Key to Economic Growth.



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Social Security

- A. Social Security is a vast invasion into our personal lives.
- B. It has no justification.
- C. Individuals can purchase old age survivors insurance if people want to.
- D. This income redistribution penalizes the productive and hurts the entire economy.
- E. There is no good argument for government monopolization of social security.
- F. The cost of this nationalized program is enormous and far reaching.
- G. These monies become monopolies of the bureaucrats controlled by congress hurting efficiency of the program.
- H. Social Security penalizes those who take care of themselves.
- I. Social Security is a regressive tax which is one that takes a larger percentage of earnings from lower-income groups. It also discourages the employer from hiring workers.



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Public Housing

- A. It would be more effective to give cash rather than housing as a means of helping poor people.
- B. Public housing can only be justified on grounds of paternalism; that the families being helped "need" housing more than they need other things.

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Poverty

- A. We should have a program directed to helping the poor
- B. We must make use of the market while doing this.
- C. Friedman prefers a negative income tax where individuals who fall below a certain level of exemption receive increasing compensation in the form of cash.
- D. We should not eliminate individuals incentive to raise their incomes or we have failed.
- E. Welfare discourages the work effort.



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Friedman much prefers a negative income tax which would set a basic amount of allowance to help people that need help. If income is above a certain amount, the individual pays income tax. If income is below this amount, the individual would receive a transfer. This would indirectly pay to help people give them money to let them make their own decisions. Such a system would be much more easier to administer.

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Free To Choose (1980)

Concentrates on themes of human freedom, economic freedom and equity. What happens when these three concepts are ignored.

Markets relay information through prices. Prices must be free to reach their own levels based on buying preferences of the consumers and selling preferences of sellers. In this way market participants will receive correct information.

This is Adam Smith's *invisible hand concept*. All market participants will do what is best for the economy while acting in their own self interest.

(Definition: The unobservable market force that helps the demand and supply of goods in a free market to reach equilibrium automatically is the invisible hand. Description: The phrase invisible hand was introduced by Adam Smith in his book "The Wealth of Nations")

The role of prices is central to the functioning of a market economy. The basis of the market economy is that both parties engaging can benefit from that activity or it will not take place.



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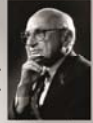
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Pencils

Let's say consumers decide they want to purchase more pencils. Stores find they are selling more pencils and order more from their suppliers. This causes the pencil manufacturers to order more supplies to make pencils. The result is an increase in the price of supplies, including labor. No one know when/how the price of inputs increase, they just know that the buyers are willing to pay higher prices and pay more for pencils. Information is transmitted through prices.

The government is supposed to provide rules for the economy. It is supposed to guarantee personal freedoms. Situations where third parties affect transactions are called market failures. Sometimes when government intervenes in a market it can cause a market failure.



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Equality of Outcome (Free to Choose)

1. Equality of outcome is the belief that everyone should receive their fair share.
2. Any governmental attempt to ensure fair shares for everyone results in an infringement on liberty.
3. Many countries have policies based on equality of opportunity.
4. These policies transfer wealth from the rich to the poor.
5. The prevailing myth is that the disparity results from capitalism. That Capitalism is the problem...
6. The facts are that the disparity is greater in societies that don't use free markets—Soviet Union, China, Brazil—marked disparity between rich and poor.
7. Societies cannot have equality as a higher priority than freedom.
8. History has shown that societies that use force end up with neither equality or freedom.



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Friedman on Taxes

1. A low flat tax rate—less than 20 percent—on all income above personal exemptions with no deductions except for occupational expenses would yield more revenue than the present unwieldy structure.
2. Taxpayers would be better off because they would be spared the costs of sheltering income from taxes.
3. The economy would be better off—because tax considerations would play a smaller role in the allocation of resources.
4. The only losers would be lawyers, accountants, civil servants and legislators.
5. The corporate income tax is highly defective. It constitutes double taxation of corporate income (once to corporation, once to stockholder when income distributed). It penalizes capital investment and thereby hinders productivity growth.

(Imagine if Friedman found the US Corporate Tax is the highest now in the world—up to 34-35%)



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Friedman on Health Care



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Friedman on Trade

Trade based on comparative advantage (one nation having advantages in one item that another nation may not have an advantage of results in the greatest efficiency for the trading nations. When Governments try to subsidize their producers, they introduce a distortion into the market, and their citizens have a lower standard of living.




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Often these distortions are called tariffs. The Far Eastern countries like Singapore, Malaysia, Taiwan, Korea, Japan and Hong Kong have strong, thriving economies because of their reliance on markets.

- Friedman ideally wants us to move to Free Trade unilaterally.
- Free trade substantially promotes the cause of freedom at home and internationally.
- Friedman was an advocate for Floating Exchange Rates—where any currency is convertible into any other means of exchange (system was somewhat established in the 1970's)
- Friedman felt that a gold standard is consistent with a free society but it has problems.

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What About Drugs? Legalization? Penalties?




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What leads you to believe drugs should be legalized?

Summary

- Many of Friedman's proposals have been influential and form the foundation for Libertarianism.
- Today the flat tax is advocated and has spread throughout former communist countries --China, Russia, The Baltic States, Ukraine
- Floating Exchange Rate are used throughout the world
- School Vouchers and education alternatives are becoming more widespread.
- Friedman's approach to Money Supply (except for 0 interest rates has been followed)
- Friedman's Defense of Capitalism serves as a basis for Conservatives today. What will you do with his ideas?



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The day Milton Friedman met a very young Michael Moore (yes, that Michael Moore)




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"Our minds tell us, and history confirms, that the great(est) threat to freedom is the concentration of power"

--Milton Friedman



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