Interview with Milton Friedman

In his new book, *Money Mischief*, economist Milton Friedman compares inflation to alcoholism; blames the rise of Chinese communism, in large part, on an inadequately controlled money supply; defines and describes MV=PT in four brief paragraphs; tells how three Scottish chemists ruined William Jennings Bryan's political career through their pioneering work with gold; and relates many other anecdotes befitting the book's subtitle, *Episodes in Monetary History*.

As the above examples illustrate, the Nobel prize winner is one of those rare academic scholars who is also able to convey his message beyond the academy. His publishing career includes many books that have been popularly successful, including *Free to Choose*, which also spawned an extended television run and is now available in video.

Of all his contributions, one of Friedman's most important is his part in deepening the understanding of the role of money in determining the course of events.

**Region:** Six Nobel laureates and 94 other economists recently called for increased federal spending to spur economic growth, even though it would add to the budget deficit. Among them are Arrow, Sharpe, Klein, Solow and Modigliani. Does this collective recommendation of world-class economists make sense?

**Friedman:** I do not agree with the view of the 100 economists calling for increased spending to spur economic growth. My disagreement is partly based on political considerations, partly on economic considerations. From the political point of view, increased spending may initially be designed to be temporary but few things become more permanent than temporary spending. Hence, the economists are in fact calling for a still higher level of government spending yet, in my view, reducing the scope of government is our most important single objective.

On a technical level, I believe that there is no persuasive evidence that, given the course of monetary policy and monetary aggregates, federal government deficits have any stimulative effect. They have a stimulative effect only insofar as they are
financed by a more rapid increase in the quantity of money than would otherwise occur.

However, even if I shared the view of the economists who signed this statement that an increase in budget deficits would be stimulative, it would be consistent with their technical view to recommend a reduction in taxes as a way to achieve an increased budget deficit. From their point of view, a reduction in taxes would have the same stimulative effect as an increase in spending, yet it would avoid the long-term adverse effect of increasing the role of government in the economy.

**Region:** In a *Region* interview with your friend and former colleague George Stigler, we posed a question about the quality of the Fed's economic research efforts. Stigler said, "I don't feel very confident commenting about that. I've been told by Milton Friedman that one of the perversities of history is that when the quality of the Washington staff is high, policy is pretty poor, and in the years when policy has been very good, the staff has been low quality. Now if you want to explore that, you'll have to interview him." Did George Stigler understand you correctly?

**Friedman:** I probably said some such thing in my discussions with George, but I've not made a systematic study. I believe that it was based on one major phenomenon that stuck in my mind. In my special field of interest of money, there is no doubt that a large fraction of all of the economists who work more or less full time on monetary research are employed by the Federal Reserve. Many of them have made important contributions to monetary analysis and theory going back to the 1920s, when Winfield Reiffler, Walter Stewart and Emmanuel Goldenweiser were all contributing to understanding monetary institutions. I have no doubt that the Federal Reserve has made a positive contribution to monetary research, which I suppose I ought to set off on the account as a credit against a terribly poor policy performance. If I were to make up a balance sheet for the Federal Reserve, I could name many credit items on the research side, very few on the policy side.

The interesting thing to me has always been that the most important contributions to understanding of monetary theory and monetary institutions have not come from Washington during the decades in which I've been active. The Federal Reserve Bank of St. Louis in the 1950s, '60s and '70s was by far and away the pre-eminent producer of significant monetary research within the System. More recently, several other regional banks, including your own, have joined them and have made important contributions. Certainly the Minneapolis bank, with the contribution of its personnel to the development of rational expectations, has been an important
contributor to monetary theory. All of the regional banks publish bulletins—required by law I guess. Some hardly ever publish material of general interest to students of monetary theory and policy, but most do, even if only occasionally. It would be invidious for me to mention names without a more careful study—though offhand, I can recollect such articles in the bulletins of four regional banks other than St. Louis and Minneapolis.

**Region:** In your early writings, you argued that deposit insurance was a worthwhile development. Here at the Minneapolis Federal Reserve we’ve taken the position that deposit insurance, now at virtually 100 percent, has a perverse effect and should be reformed in a way that would bring more market discipline. Where do you stand on the question of deposit insurance?

**Friedman:** Circumstances alter cases and I believe that both views are correct. Anna Schwartz and I in our *Monetary History* were discussing the situation after the financial collapse of the 1930s. We said then and believed then, and I still do, that the Federal Reserve had failed to do what it was originally set up to do. It had permitted a collapse of the monetary system, it had permitted perfectly sound banks to fail by the thousands because of liquidity problems, although it had been set up in 1913 with the objective of preventing that kind of a situation. And we argued in the book that since the Fed had failed and showed no sign that it was not going to continue to fail in pursuing its function, something else was needed to perform the function for which it had originally been established and that the Federal Deposit Insurance Corporation would serve that function. Interestingly enough, it did for some 40 years. From 1934 to the early ’70s, there were very few bank failures. And there were essentially no runs on banks because of liquidity problems. So it did serve a useful function for 40 years.

In my opinion, what destroyed the usefulness of deposit insurance was the inflation of the 1970s for which the Federal Reserve has to bear major responsibility. That inflation had the effect of destroying the net worth of financial enterprises, particularly the savings and loan institutions, which were borrowing short and lending long. They had mortgages and the like outstanding at fixed relatively low rates of interest. When the cumulative inflation of the 1970s inevitably led to a rise in the interest rates they had to pay, the result was to wipe out the net worth of the proprietors of those enterprises. Once the net worth of the enterprises was destroyed, deposit insurance did have a very perverse influence. In order for deposit insurance to work, there has to be some private personal incentive for safe banking. That incentive was provided by the net worth of the proprietors of financial
institutions. Eliminate that net worth and deposit insurance created a win-win position for proprietors of those enterprises to engage in risky activities.

**Region:** In your new book, *Money Mischief*, you discuss monetary union. What are your thoughts on Europe’s plan for one currency?

**Friedman:** I believe it will not come to an achievement in my lifetime. It may in yours, but I’m not sure that’s true either.

**Region:** Why is that?

**Friedman:** Because I do not believe that at the moment, a single European currency is either feasible or desirable. Let me restate that. It would be highly desirable if Europe could have a common money, a single unified money, just as it’s desirable for the United States that we have a single unified currency. But in order for that to be possible or desirable, you have to have a unified currency over an area in which people and goods move relatively freely, and in which there is enough homogeneity of interest so that severe political strains are not raised by divergent developments in different parts of the area.

Let me illustrate. In the United States, right now you have much more severe economic problems in New England, in the Northeast in general, than you have elsewhere. If the Northeast were a separate country with a different language from the rest of the country, with a supposedly national government, it would be very tempted to resort to devaluation. What prevents it from doing that now is that we are a nation with one language, one political structure, a recognition that one region or another may have difficulties relative to other regions. Some years ago it was the South that had this problem.

Now come to Europe. Will there be as much tolerance for that kind of an adjustment as between France, on the one hand let’s say, Germany, Italy, Spain, Sweden, and so forth? I’m very dubious that those preconditions for a successful unified currency exist on the European continent. That’s looking at the ultimate.

Now consider the process you have to go through to get to a unified currency. In order to have a truly unified currency, not a collection of separate national currencies joined by temporarily fixed exchange rates like the European Monetary System or the International Monetary Fund was in its earlier days - in order to have a truly unified currency, you either need to have no central bank, as with a commodity currency like a gold standard for example, or you need to have at most
one true central bank: one authority that can issue money. In the United States that authority is the Federal Open Market Committee of the Federal Reserve System. It's one. The Federal Reserve Bank of Minneapolis issues currency notes on which the bank's name appears, but you can't decide how much to issue. That decision is made in Washington by the Federal Open Market Committee.

In order to have a comparable situation in Europe, you have to eliminate the Bank of France, the Bank of Italy, the Deutsche Bundesbank, the Bank of England and so forth. You have to have one true central bank with full authority. The plans that are being made call for such a central bank, but it's a long cry from calling for it and having it. After all, the Treaty of Rome, which I believe was signed in 1957, called for eliminating all customs and tariff barriers among the Common Market nations. They still have not all been eliminated some 35 years later. So to call for something is one thing, to do it is a very different thing. And even the central bank that's called for is going to be run by essentially a committee of representatives from France, from Germany, from England, and so on. I cannot see that kind of institution as having the same ability to withstand political pressures internally in these various areas that the Federal Reserve's Federal Open Market Committee has.

**Region:** The New School of Classical Economics (among others, Sargent, Wallace, Prescott, Lucas) argues that the best way to study economics is within the general equilibrium models. They stress the importance of the institution's arrangements: the rules of the game. What is your view on this approach?

**Friedman:** I believe that the approach has much to offer us, but I also believe that its proponents, like all proponents of fresh approaches, tend to carry a good thing too far. I would say it has had too much influence up to date. It has made a real contribution, but it is by no means the only, or necessarily even the most useful, approach.

**Region:** If you were advising the Federal Reserve, what would you say are the unsolved economic problems of the day?

**Friedman:** One unsolved economic problem of the day is how to get rid of the Federal Reserve. The most unresolved problem of the day is precisely the problem that concerned the founders of this nation: how to limit the scope and power of government. Tyranny, restrictions on human freedom, come primarily from governmental institutions that we ourselves set up.
Abraham Lincoln talked about a government of the people, by the people, for the people. Today, we have a government of the people, by the bureaucrats, for the bureaucrats, including in the bureaucrats the elected members of Congress because that has become a bureaucracy too.

And so undoubtedly the most urgent problem today is how to find some mechanism for restructuring our political system so as to limit the extent to which it can control our individual lives. You know, people have the image, have the idea, that somehow "we the people" are speaking through the government. That is nonsense. You cannot tell me that the consumers of the United States would have approved a policy which in fact led to everyone paying about $2,000 or more a year per automobile purchased. Yet that was the effect of the policy of imposing so-called voluntary import quotas on Japanese cars.

Nobody will tell me that the people of this country really favor paying two or three times the world price for sugar. Nobody will tell me that the people of this country believe it is desirable to spend money to provide water to farmers at less than cost in order to enable them to produce crops which the government buys up in part at more than the world price and then has to dispose as surpluses. You cannot explain those activities of government, and there are hundreds more, as reflecting the will of "we the people." They reflect a system in which concentrated vested interests have been able to obtain great power and impose costs on a diffused consumer interest.

Region: On a recent McNeil/Lehrer interview, you made the point that ironically we urge emerging eastern European countries to privatize, yet here in the United States we tend to move in the opposite direction: toward a more socialized state, and you gave health care as an example.

Friedman: Direct government spending in the United States amounts to about 42 percent of the national income. I'm putting it a little elliptically. Government spending equals a sum which equals 42 percent of the national income. In addition, there is much spending, which is classified as private spending, effectively mandated by the government. It would make no difference whatsoever in your life if the antipollution equipment you have on your car were provided to you without charge by the government but you had to pay a tax equal to the amount that you spent on those. You wouldn't know the difference. And yet if that were done, it would be counted as government spending.
Numerous other private expenditures are mandated by the government in a host of different ways. The cost of farm subsidies is included in the 42 percent, but the higher prices you pay for agricultural products because of the farm policy are not included in recorded government expenditures. Yet they are in effect mandated by the government and represent command over resources subject to government control and direction. Similarly, building codes impose costs that you might not privately want to engage in, wage and hour laws—and on and on. So I believe that easily more than 50 percent of the productive resources available in the nation are allocated by governments—federal, state and local. How those productive resources are used is determined not by the private interests of the individuals who dispose of them but by governmental mandates.

Of course, some of that is desirable. I’m not in favor of no government. You do need a government. But by doing so many things that the government has no business doing, it cannot do those things which it alone can do well. There's no other institution in my opinion that can provide us with protection of our life and liberty. However, the government performs that basic function poorly today, precisely because it is devoting too much of its efforts and spending too much of our income on things which are harmful. So I have no doubt that that's the major single problem we face.

**Region:** In Minnesota, the state government handed a massive support package to an airline to encourage it to build a facility in the state and promise not to leave. What are your thoughts on such state development packages?

**Friedman:** I believe they’re terrible. If you read the Constitution, it specifies that there shall be no tariffs or restrictions or hindrances to trade among the states. Just as we speak of non-tariff restrictions on international trade, I regard the kind of thing you're talking about as non-tariff restrictions on internal trade. I’m not a lawyer, but I would like to believe that a strict interpretation of the Constitution would render such actions by individual states illegal.

**Region:** Going back to your new book, *Money Mischief*, you predict in the epilogue that "the world will see more episodes both of high inflation and full-fledged hyperinflation within the next decade." What leads you to that conclusion?

**Friedman:** What leads me to that conclusion is the enormous changes that have occurred in the economic structures of countries around the world. Obviously, part of it was inspired by the Eastern European countries in which I doubt very much that all of them will get through without going through episodes of hyperinflation. They
seem to be on the verge of it in Russia right now. Similarly, Latin America has been a great breeder of such episodes, and while some countries in Latin America, like Mexico and Chile and maybe Argentina, at the moment are following better economic policies, that's by no means true of all of them.

Region: As a founding member of the Mont Pelerin Society, what would you say was the organization's original purpose and how has it evolved over the last four decades? (The Mont Pelerin Society is an international organization of free-market economists and scholars from colleges, universities and businesses; formed in 1947 by—among others—Friedrich Hayek, George Stigler and Friedman.)

Friedman: There's no doubt what its original purpose was. Its original purpose was to promote a classical, liberal philosophy, that is, a free economy, a free society, socially, civilly and in human rights.

I believe that it has made an important contribution to that purpose. It has made that contribution not by propaganda but by offering a place where people of like mind could get together, discuss their problems, and resolve difficulties they had about both philosophy and policy.

It is hard at this distance to recall what the intellectual climate of opinion was immediately after World War II, in the 1940s and throughout the '50s. It was a climate in which those of us who believed in free markets and in a socially and politically free society were a tiny, very much beleaguered minority. Collectivism—economic, social, political—was very much in the ascendancy. During World War II, governments everywhere had largely assumed control of the economy. And it was simply almost taken for granted that they would have to continue to do so in the postwar period. The origin of the meeting really goes back to Friedrich Hayek's book *The Road to Serfdom*, which was regarded at the time as a strange, minority point of view. In that kind of an intellectual environment, the opportunity to meet a group of people year after year—able people, intellectuals for the most part, though also people who were involved in the political, social, financial business world—on an occasion where you didn't have to be looking to see if somebody was trying to stab you in the back, in which you could feel free to express your doubts and disillusionments and the like made a very real contribution.

Region: And the Mont Pelerin Society of the 1990s, has it been...

Friedman: The world has changed, the intellectual climate has changed. The ideas of a very small beleaguered minority in the '50s have become much more widely
accepted, although they're still far from being fully embedded in actual public policy. But at the moment the Mont Pelerin Society has a renewed function: to provide a similar opportunity for education, discussion, illumination to people from the former Communist world.

**Region:** I attended a Mont Pelerin Society meeting in Montana last year and they were expressing concern about radical environmentalism and the role of government and were proposing some thoughts along the line of free market environmentalism.

**Friedman:** That is a continuation of its traditional function. But you should also note that last year there was a regional meeting held at Prague which was pursuing what I've now described as its new role.

As an amusing footnote, one of the major benefits that I personally derived from the first meeting of the Mont Pelerin Society in 1947 was meeting Karl Popper and having an opportunity for some long discussions with him, not on economic policy at all, but on methodology in the social sciences and in the physical sciences. That conversation played a not negligible role in a later essay of mine, "The Methodology of Positive Economics," which has probably led to more pages of subsequent print by others than anything else I've written. It just shows how nature and science works in wondrous ways.

**Region:** We understand that most often you sport an Adam Smith necktie. What is the origin of that fine tradition?

**Friedman:** As I understand it the first Adam Smith necktie was produced at the suggestion of Ralph Harris when he was teaching at St. Andrews University in Scotland near Adam Smith's birthplace. It then caught on and Adam Smith neckties were produced by various groups in Britain, including the Institute of Economic Affairs which Ralph Harris later joined and of which he became director, now retired. In the United States, Don Lipsett started producing and distributing Adam Smith neckties. More recently, the Fraser Institute in Canada has also done so. So much for production.

I cannot say how the practice grew of wearing the tie, except that somehow or other it became a mark of political ideology. To tell an amusing incident, when I did our TV program "Free to Choose," I wore an Adam Smith necktie whenever I wore a necktie. The summer after it had been shown on TV, I received a letter from representatives of a group of teachers who had been using the program in their summer course.
They sent me a necktie, saying they had discovered in watching the program that I apparently had only one necktie and they thought I ought to have another.

**Region:** Thank you Mr. Friedman.

—David Levy

## More About Milton Friedman

- Nobel prize for economics, 1976.
- Currently, senior research fellow at the Hoover Institution at Stanford University.
- Following an academic career that included a stint at the University of Minnesota in 1945-46, joined the University of Chicago as an assistant professor of economics in 1946; became a professor of economics in 1948 at the University of Chicago and remains professor emeritus at the university.
- Recipient of John Bates Clark medal from the American Economics Association; founding member and later president of the Mont Pelerin Society; president and/or board member of many economics associations and independent think tanks.
- Publications include *A Theory of the Consumption Function* (1957); *Price Theory: A Provisional Text* (1962); *A Monetary History of the United States, 1867-1960* (with Anna J. Schwartz, 1963); *Monetary Statistics of the United States* (with Anna J. Schwartz, 1970); *Free to Choose* (with Rose D. Friedman, 1980); *Monetary Trends in the U.S. and the United Kingdom* (with Anna J. Schwartz, 1981).
- Doctorate, Columbia University, 1946; master's, University of Chicago, 1933.