# “Free to Choose”

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In 1962 Milton Friedman published *Capitalism and Freedom*, one of the most influential arguments for economic liberalism to appear in the second half of the twentieth century. *Capitalism and Freedom* has been in print for the past forty years and has been translated into no fewer than eighteen languages. At the time it was published, the book was not widely reviewed outside of the main academic journals.[1] But with the book’s publication, Milton Friedman staked his claim as a champion of economic liberalism at a time when the ideas of liberals (in the traditional sense) were distinctly unfashionable.[2]

Some twenty years later, in 1980, Milton and Rose Friedman made the case for economic freedom to a broader audience with the PBS television series and book *Free to Choose*. This book was highly successful, becoming the best-selling nonfiction book of 1980, and presented their agenda for reform. In the preface to the 1990 (Harvest) edition of *Free to Choose*, the Friedmans wrote of how surprised they were at the dramatic turning of the tide that had occurred in the 1980s. They were prompted to wonder whether the ideas in *Free to Choose* had become so much part of the conventional wisdom that the book was no longer relevant.

In 2003 the Federal Reserve Bank of Dallas organized a conference to take a retrospective look at *Free to Choose*. A large part of the motivation for holding the conference, over and above the desire to honor one of the twentieth century’s greatest American economists, was a concern that the United States and the world were possibly at another turning point, but this time away from small government and freer markets. Protesters against globalization have become increasingly strident in their denunciations of market capitalism and free trade. In some regions of the world, voters are asking whether market reforms of recent years have paid off. And the trend toward freer trade seems to have stalled as governments have chosen to put narrow domestic interests ahead of principle.

This essay provides an overview of some of the issues discussed in the papers that follow. I begin with a summary of some of the central ideas in *Capitalism and Freedom* and *Free to Choose*. Next I examine how the world looked in 1980 and how it has changed since then, paying particular attention to areas where the ideas expressed in *Free to Choose* have been influential. I then consider some threats to economic freedom that may lead to a rolling back of some of the advances of the past two decades.

## THE BASIC MESSAGE OF *CAPITALISM AND FREEDOM* AND *FREE TO CHOOSE*

*Free to Choose* is probably best summarized by this statement toward the end of the book: “Reliance on the freedom of people to control their own lives in accordance with their own values is the surest way to achieve the full potential of a great society” (Friedman and Friedman 1980, 309–10). In the economic sphere, this means relying on free private markets as the primary means of organizing production and exchange, with a minimal role for government. At a time when many were still in the thrall of state planning, the Friedmans took the distinctly unfashionable stance of arguing for minimal government involvement in the economy.

Both books make three key points. First, free competitive markets are the most effective way to organize production and exchange and to ensure that the wants of the people are met. The power of competitive markets to deliver desirable outcomes was Adam Smith’s great insight and remains as relevant today as it was when first articulated in 1776. Second, when the government intervenes to rectify a case of market failure, often the cure is worse than the disease. Many of the so-called failures of capitalism, especially the Great Depression of the 1930s, were due to misguided government policies rather than inherent weaknesses in the capitalist system. Third, free markets in conjunction with equality of opportunity allow individuals to attain standards of living previously thought unattainable. The gap between the rich and the poor tends to be greatest in societies where the free market is suppressed. Putting equality ahead of freedom will cost a society both; putting freedom ahead of equality is the surest guarantor of both.

The opening chapter of *Free to Choose*, titled “The Power of the Market,” provides the basic framework used to address a variety of issues. Competitive free markets consistently deliver what consumers want, at lower cost, than any other mechanism known to man. This is true whether the market is for breakfast cereal, cars or educational services. In his contribution to this volume, **Paul Peterson** reviews the evidence on school choice and shows that, along almost every dimension, schools are better at delivering what parents want when there is an element of competition in the provision of education. The exact form of competition—school vouchers or charter schools—is less important than the presence of competition. Markets for education work just as well as markets for agricultural commodities or foreign exchange. Speaking at the conference dinner, **Gary Becker** reiterated the key point of the power of competition.[3] Arguing that competition is probably the most important social contrivance of the last thousand years, Becker pointed out the key characteristics of competition: It drives down costs; it fosters innovation; it drives up quality; and most important, it economizes on information. Just as competition displays these characteristics when allowed to work in the market for consumer goods, so too will it lower costs, foster innovation, improve school quality and economize on information if allowed to work in primary and secondary education. Becker noted that it was no accident that the United States has the best third-level education system in the world, attributing this to the greater degree of competition in this segment of the education system.

The potential of free markets to raise living standards is only realized when individuals are free to specialize in doing what they do best and trade for their other needs. Trade through the medium of money is most efficient, and fiat monetary standards economize on the resource costs of monetary exchange. But fiat monetary standards come at a cost, that of inflation.[4] Through the 1970s and 1980s, inflation accelerated to rates that had not been seen in many countries. Friedman argued early that the government need only set some predetermined growth rate for the stock of money, thereby eliminating all discretion from the conduct of monetary policy, to control inflation and the real instability associated with discretionary monetary policy. In recent years, Friedman has come to accept that his preferred policy prescription of strict monetary targeting would not have worked very well if it had been widely implemented, and **Ben Bernanke** notes in his paper that this is the only part of Friedman's monetary framework that has not become part of the contemporary conventional wisdom on best practices in monetary policy. But Friedman has also noted that many central banks seem to have adopted his key policy prescription (and the central message of chapter 9 of *Free to Choose*) that control of the money stock is the key to control of inflation.[5]

Bernanke states that Milton Friedman's monetary framework "has been so influential that…it has nearly become identical with modern monetary theory and practice." One of Friedman's key insights was that while money may influence real activity in the short run, it has no effect in the long run. Monetary policymakers' failure to appreciate that insight contributed to the Great Inflation of the 1970s, which Bernanke describes as the second great monetary mistake of the twentieth century. The first, of course, was the Great Depression. In chapter 3 of *Free to Choose*, the Friedmans examine the Great Depression and restate the argument first developed in Friedman and Schwartz (1963) that the Depression was fundamentally due to errors on the part of the Federal Reserve System.

Bad monetary policy turned what otherwise would have been a run-of-the-mill recession into a major depression.[6] As testimony to how well the current Federal Reserve System has learned this lesson, in a panel discussion on the Great Depression at a University of Chicago event held in 2002 to mark Friedman's ninetieth birthday, Bernanke concluded with the confession: "You're right, we did it. We're very sorry. But thanks to you, we won't do it again."

The Friedmans argue that the greatest threat to economic freedom comes from the government. Government intervention in the economy comes in many forms, from regulation of some economic activities to prohibition of others, to monopolization of yet others and appropriation of resources through taxes and other levies. One of the most pernicious such levies in the United States for a long time was the draft of young men into the military, which Friedman campaigned against vigorously until its repeal in 1973. The draft is mentioned in chapter 2 of *Capitalism and Freedom* as one of fourteen activities undertaken by the U.S. government that was inconsistent with liberal economics. By the time *Free to Choose* was written, the draft had been abolished, due in no small part to the efforts of the Friedmans, but the presence or absence of conscription is one of the key components of the economic freedom indexes that have been developed in response to the Friedmans' work. **James Gwartney** pioneered the construction of indexes of economic freedom, and in his paper he documents the tight relationship between economic freedom and economic growth. Gwartney shows that those countries that maintain institutions and policies consistent with greater economic freedom also tend to have higher per capita GDP. Economic freedom enhances productivity both directly and indirectly by boosting investment. Gwartney finds that increases in economic freedom during the 1980s seem to have a statistically significant positive effect on long-run growth: specifically, a one-unit increase in the index of economic freedom during the 1980s enhanced long-term growth by 0.71 percentage point.

In *Capitalism and Freedom*, Friedman devoted a chapter to exploring the relationship between economic and political freedom. As interest in this relationship has developed in subsequent years, it has become apparent that a third category of freedom needs to be added to the mix, namely civil freedom. Friedman himself has argued this need in a number of venues in recent years and again at the Dallas conference. Hong Kong under British rule was the prime example of a society that enjoyed a high degree of economic freedom and civil freedom (freedom of speech and freedom of association), but limited political freedom: The colony was essentially run as a benevolent dictatorship by the British Foreign and Commonwealth Office. A major challenge for the economic freedom project, in Friedman's view, will be to integrate measures of economic freedom with measures of political freedom and reconcile the two where they conflict.

When *Capitalism and Freedom* and *Free to Choose* were written, equality was one of the thorniest issues the Friedmans grappled with. It remains a difficult issue today. As the Friedmans note in *Free to Choose*, "A society that puts equality—in the sense of equality of outcomes—ahead of freedom will end up with neither equality nor freedom....[but] a society that puts freedom first will, as a happy by-product, end up with both greater freedom and greater equality" (148). Equality of opportunity is not directly addressed in any of the conference contributions but runs through many of them as a leitmotif. Perhaps the easiest way to improve equality of opportunity in the United States would be to promote competition in the K–12 education system, which would improve school quality and the range of educational opportunities available to all children. In his paper, **Raghurum Rajan** notes that elites in many societies tend to undermine equality of opportunity by opposing widespread access to markets, often by limiting access to finance. One of the keys to ensuring the political viability of free markets and the greater opportunities they create for all is to get the elites behind markets.

But free markets come with important prerequisites. In his paper, **Luigi Zingales** also emphasizes the importance of access to finance in allowing individuals to realize their full potential under the capitalist system. Zingales starts with the story of Sufiya Begum, a stool maker in an impoverished Bangladeshi village, to illustrate how a lack of access to finance can hinder the ability of individuals to advance even with free markets. For want of access to finance, Begum is effectively indentured to a single middleman who exploits his position of monopoly and monopsony power to limit her income. Zingales argues that access to finance is crucial to promoting competition and ensuring maximum economic freedom. An important corollary is that legislation limiting access to finance, whether intentionally or not, can have detrimental effects on the ability of individuals to realize the full benefits of free markets.

Critics of free market capitalism like to dismiss it as being too concerned with material things and detrimental to the development of culture. In 1993, the prime minister of France, Eduard Balladur, asked rhetorically, "What is the market? It is the law of the jungle, the law of nature. And what is civilization? It is the struggle against nature." This summarizes the view of many critics of free market capitalism, especially European critics. Many of these critics believe that capitalism is detrimental to the finer things in life. Yet as **Tyler Cowen** argues in his paper, the wealth and freedom that capitalism makes possible are a boon for the arts. Indeed, periods of greater globalization also tend to be periods of greater cultural diversity and creativity. The greater wealth that capitalist societies generate supports a greater range of cultural products and makes it easier to preserve the pasts of their own and other societies. While it may be too early to say how much of the art produced in twentieth century capitalist societies will be deemed great by future generations, it is noteworthy that much of the art that has survived the test of time was funded by private patrons living in wealthy societies. Cowen cites Renaissance Italy, the Dutch Golden Age, and the blossoming of French culture in the nineteenth century as examples. The antiglobalization protestors who pose such a threat to the liberal economic order rail against the McDonaldization of the world. They see the spread of American culture overseas but overlook the spread of foreign culture to the United States. As Cowen acknowledges, free trade may indeed reduce diversity across societies, but it invariably increases diversity within societies.

## THE WORLD IN 1980

How did the world look in 1980 when *Free to Choose* was published? Government was large, the Cold War was at its height and the Friedmans' ideas were still far removed from the mainstream. In the United States, total government expenditures at the federal, state, and local levels accounted for 30 percent of GDP. In other countries, the extent of government involvement in the economy was even greater—large sectors of the economies of the major Western industrial countries were under direct government control. In the United Kingdom, the steel industry, railways, coal mining, and a myriad of other sectors had been nationalized by various postwar governments. The Mitterand government that came to power in France in 1980 marked the last great push for greater government control in a major Western industrial economy.

Much of the high level of U.S. federal government expenditure was devoted to defense. The United States had some half million troops stationed in Western Europe, where it was engaged in a face-off with the Warsaw Pact countries. The Iron Curtain was tightly drawn across the face of Europe. Indeed, military spending was on the increase—the United States was in the process of stationing cruise missiles in Western Europe to counter the Soviet military threat, to much public (European) opposition. In 1979 the Soviet Union had invaded Afghanistan, the latest in a series of Soviet interventions during the postwar era to retain its grip on its satellite states (beginning with East Germany, Hungary, and Czechoslovakia). To many, the Soviet Union and its allies looked invincible.

Around the world, inflation was running at levels not seen since the end of World War II. In the United States, consumer price inflation was 13.5 percent in 1980, its highest level since 1947. Elsewhere in the industrial world, inflation was at or near the highs experienced during the 1970s. In many countries, wage and price controls remained the preferred approach to dealing with inflation. In the eleventh edition of his influential textbook *Economics*, published in 1980, Paul Samuelson wrote: "An 'incomes policy' is needed to supplement fiscal and monetary policy—in order to give the mixed economy a better long-run Phillips curve or natural rate....Benign neglect, governmental guideposts (voluntary or quasi-voluntary), direct wage–price controls, centralized collective bargaining, stop–go driving of the economy to cool it down, labor retraining programs to lower the natural level and range of structural unemployment—all these need study to retain the humane qualities of the modern order while achieving efficiency and stability" (Samuelson 1980, 781–82). The idea that central banks should be held accountable for inflation and could control it through control of the money stock was still being debated.

But, as the Friedmans noted in the closing chapter of *Free to Choose*, the tide was turning. Margaret Thatcher was elected prime minister of the United Kingdom in a landslide election in May 1979. With a solid majority in the House of Commons, Thatcher began a program of rolling back state involvement in every aspect of economic life in the UK. Large parts of Britain's industrial base that had been nationalized under earlier Labour and Conservative governments were privatized, starting with British Telecom in 1984 and followed by British Gas in 1986, British Airways and Rolls Royce in 1987, and a slew of others through British Rail and British Energy in the mid-1990s. The deregulation of the U.S. economy that had begun with airlines in 1977 accelerated under Ronald Reagan, who was elected president in 1980. Reforms had begun in China in 1978 under Deng Xiaoping's leadership, starting with a revival of private farming. Reforms were beginning in Latin America, with Chile leading the way in a number of areas.

These reforms were not exclusively the province of conservative parties. In New Zealand the Labour government of Roger Douglas embarked on a series of reforms that became a model for many other countries. New Zealand pioneered the idea of inflation targeting as a strategy for monetary policy that would focus central banks' policy deliberations and hold them accountable for inflation outcomes. This prescription for monetary policy has become increasingly popular in recent years and addresses many (though not all) of the Friedmans' concerns about discretionary monetary policy.

While inflation was close to a postwar peak in 1980, efforts were under way to bring it under control. In August 1979, Paul Volcker was appointed chairman of the Federal Reserve System, and the Fed embarked on a campaign to bring inflation down. By the time Volcker left office in 1987, inflation had fallen from 13.5 percent to 3.6 percent. Under Alan Greenspan's leadership, the Fed kept inflation under control and indeed lowered it further, to the point that by the beginning of the twenty-first century most commentators had stopped worrying about inflation and instead started worrying about deflation.

## THE WORLD IN 2004

In the two-plus decades since *Free to Choose* was published, the world has changed dramatically, and in most ways for the better. There is less government involvement in most aspects of economic life than there was twenty-five years ago, inflation is lower, global trade is freer, and by most measures more people enjoy more economic freedom than at any time in the recent past. Living standards have risen for most of the world's population. The great experiment of the twentieth century has ended: The liberal, free-market, democratic model won. The Soviet Union has ceased to exist, and communism is no longer viewed as a viable alternative to free market capitalism. Russia is in the process of becoming a free market democracy. China, while still ruled by the Communist Party, has opened further to the world and has grown at rates that will make it the world's largest economy within a couple of decades. In May 2004 the European Union expanded from 15 to 25 members, incorporating many of the former Eastern European vassal states of the Soviet empire and in the process becoming one of the largest free trade blocs in the world.

Living standards around the globe are dramatically higher than they were twenty years ago, helped by the rolling back of the state in many countries and the lifting of restrictions on domestic and international trade (globalization). The fraction of the world's population living on less than $1 a day has fallen from 31.5 percent to 23.7 percent. While the number of people living in poverty remains large, there is greater acceptance that the surest way out of poverty is the protection of property rights, rule of law, and freedom to transact.

But if there have been great gains around the world, here in the United States progress has been slow in an area desperately needing reform. As **Eric Hanushek** observes in his paper, it has proven easier to defeat the forces of communism than to overcome the education establishment's resistance to meaningful reform of the public school system. The idea that school choice is essential to improving school quality is central to both *Capitalism and Freedom* and *Free to Choose*. School choice is so important to the Friedmans that their foundation is dedicated to promoting school choice and nothing else.[7] In *Free to Choose* the Friedmans wrote, "We believe that vouchers or their equivalent will be introduced in some form or other soon. We are more optimistic in this area than in welfare because education touches so many of us so deeply. We are willing to make far greater efforts to improve the schooling of our children than to eliminate waste and inequity in the distribution of relief. Discontent with schooling has been rising. So far as we can see, greater parental choice is the only alternative that is available to reduce that discontent. Vouchers keep being rejected and keep emerging with more and more support" (*Free to Choose*, 175). In the intervening years, of course, the United States has undertaken a far more radical reform of the welfare laws than has been attempted in education. As Hanushek shows, the performance of U.S. public schools has at best been stagnant, despite a massive increase in the resources available to them. U.S. students continue to perform poorly against students in other countries on standardized tests. This must surely be a source of continued concern in our increasingly integrated global economy.

But there has been some progress. The first major voucher program in the United States started in Milwaukee in 1990, and by the end of the decade some

10,000 students were participating in the program. The only other major school voucher program began in Cleveland in 1996–97. In 2002 the Supreme Court upheld the constitutionality of the Cleveland program, but there is still considerable opposition to expanding such programs to other school districts. An alternative means for promoting school choice is the charter school movement. Since the first charter school was authorized in Minnesota in 1991, some 2,700 charter schools have been opened in 36 states. And the No Child Left Behind Act of 2001 will contribute to greater school accountability and transparency and further the cause of reform, not least by making more and better information available to parents.

None of the constitutional amendments offered by the Friedmans in the concluding chapter of *Free to Choose* have been adopted in the United States. In his contribution, **Allan Meltzer** counts some twenty-five specific policy proposals in *Capitalism and Freedom* and *Free to Choose*, some of which have been adopted and many of which have not. The unequivocal successes are the ending of the draft, the floating of the dollar, and the abolition of interest rate ceilings on bank deposits. There have also been partial successes in the lowering of tariff barriers around the world, deregulation of various industries, and the introduction of an element of competition in education. The Earned Income Tax Credit can be viewed as a step toward the negative income tax the Friedmans proposed as an alternative to the various welfare programs. Meltzer argues that free market solutions to various problems are more likely to be adopted if they have been articulated in advance of any crisis that might precipitate a major reform. This allows proponents of the policies to respond to criticisms and allows officials to acquire familiarity with proposals to the point of believing that they might work. And therein lies one of the most enduring contributions of *Capitalism and Freedom* and *Free to Choose*.

In the wake of 9/11, defense and security spending has increased significantly in the United States. Airport security, once the province of private firms, is now in the hands of a federal agency, the Transportation Security Administration. Just how big should government be? The Friedmans have always accepted that there is some limited role for government. In *Free to Choose*, they quote from Adam Smith's *Wealth of Nations* to define the appropriate tasks of government as being

> first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because

> the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society. (*Free to Choose*, 28–29, quote from *Wealth of Nations*)

Indeed, as Raghurum Rajan emphasizes, the absence of government can be just as anticompetitive and detrimental to free markets as too much government. Governments today perform a much wider array of functions than those listed by Adam Smith. Government is intimately involved in the education system, in the provision of health care, and in the provision of income security through unemployment and social security programs. A key argument in *Free to Choose* was that government had grown well beyond the size necessary for the protection of liberties and needed to be scaled back. **William Niskanen** takes up the issue of the appropriate size of government in his paper. Niskanen's primary focus is on the economic burden of taxation, but as an aside he calculates that the optimal size of government relative to GDP in the United States is about 10 percent. At present, government expenditures account for more than 30 percent of GDP.

I have already alluded to the widespread belief in the 1930s that capitalism had failed as justification for greater government involvement in the economy. The response in the United States came in the form of the New Deal, which included the creation of the Social Security (Old Age and Survivors Insurance) program. This program is now the largest single item in the federal budget and accounts for more than a fifth of all federal spending. The changing demographics of the United States (falling birthrate and rising life expectancy) have made the system unsustainable in its current form. For a long time the issue was regarded as the third rail of U.S. politics, but there are signs that more politicians are willing to address the issue of the Social Security system's long-term solvency. In his paper, **Thomas Saving** and his co-authors document the size of the funding problem and analyze the costs and benefits of a transition from the current system to the Friedmans' preferred system of private accounts. Transitioning from the current publicly funded system to a privately funded one would make the country as a whole better off by enhancing the nation's capital stock. But such a transition will come at a cost in the form of lower consumption during the transition period.

By far the most dramatic development internationally since the publication of *Free to Choose* has been the collapse of almost all communist regimes in place in 1980. In his paper, **Peter Boettke** discusses the importance of the Friedmans' ideas in the reform process in the former communist societies. Many of the leading reformers had studied Friedman's work. The mass privatizations that took place in many of the former communist countries were inspired by Friedman's ideas. President Vaclav Klaus of the Czech Republic has acknowledged the importance of Friedman's ideas and intellectual courage to the reformers in Eastern Europe and has credited him with providing them "a clear vision where to go and a pragmatic strategy how to get there."

The expansion of economic freedom in China over the past quarter century is the subject of **Gregory Chow**'s paper. Chow documents the growth of economic freedom in China since the reform process started in 1978 and argues that this has contributed to an increase in political freedom as well. Government is still present in many areas of economic life, but its role is much diminished. Social insurance that was previously provided through guaranteed jobs in communes or state enterprises or health care through the same has been replaced by explicit programs providing unemployment, health, and old age insurance. Chow claims that there is probably a greater degree of freedom of choice in education in China than there is in the United States. He cites figures showing that some 40 percent of all spending on education in China comes from private sources versus an average of 12 percent for all Organization for Economic Cooperation and Development countries. Chow argues that "there appears to be no serious infringement of economic freedom in China, with the exception of the one-child policy," although according to the most recent report of the Economic Freedom Network (Gwartney, Lawson, and Emerick 2003), China ranked 100th out of 123 countries considered, with a score of 5.5 out of a possible 10. Hong Kong has consistently ranked at or near the top of all rankings of economic freedom. Chow comments on inflation's role in the Nationalist government's downfall in 1949 and in the unrest that culminated in the Tiananmen Square protests in 1989. One aspect of Friedman's thinking influenced policymakers in China even before the 1978 reforms: Apparently even the Marxian economics textbooks used in China's universities contained the quantity equation.

Green economics was just on the horizon when *Free to Choose* was published. In their autobiography, the Friedmans write that they had contemplated including "Pollutions" as one of the topics to be addressed in the TV series on which the book is based. Chapter 7 of *Free to Choose*, titled "Who Protects the Consumer?", has a brief discussion of environmental issues, and the Friedmans observe that the environmental movement has been behind a lot of the growth in government intervention in the economy. In the years since, the environmental movement has gathered strength, and environmental issues usually top the list of concerns of antiglobalization protesters. In their papers, **Terry Anderson** and **Richard Stroup** address environmental issues from a free market perspective. Anderson points out that countries with greater economic freedom and rule of law tend to have higher environmental standards (as measured by water pollution and so on) than countries in which the rule of law is weak. Indeed, the great level of wealth that economic freedom makes possible is itself a contributor to better environmental standards. There appears to be a Kuznets curve relationship between environmental quality and per capita GDP: At low levels of output, environmental quality deteriorates as countries trade off environmental quality for faster growth, but as output rises, societies demand and can afford cleaner environments. Contrary to the beliefs of many environmentalists, it is not necessary to have the government involved to ensure a better environment. Well-defined property rights and rule of law are all that is necessary to protect the environment from "tragedy of the commons" outcomes. Stroup explains why government regulation to achieve environmental objectives typically does worse than private property rights and free markets. To begin with, regulators typically will not have access to the information generated by and available to participants in free markets. And regulators will have little incentive to obtain that information by other means. Second, Coasian bargaining will generally ensure that a property right will flow to the highest-value user, but such exchange is often prohibited in a regulatory setting. Third, decisions made in the public sector are public goods, and there is limited accountability. Finally, competition leads to better quality goods, whether in education, as we have already seen, or in the environment. Public-sector entities that are not subject to competitive pressures will be less inclined to innovate than private-sector entities producing the same goods.

## IS THE TIDE TURNING AGAIN?

The last chapter of *Free to Choose* is titled "The Tide Is Turning," and there is no doubt that the last quarter of the twentieth century saw a significant increase in economic freedom around the world. But many are now wondering if the tide is turning yet again, this time toward less economic freedom. Above, we noted that New Zealand was one of the first countries to fully embrace the idea of the need to roll back government intervention in the economy. Despite widespread pro-market reforms, since 1984 New Zealand has experienced one of the slowest growth rates of per capita GDP in the developed world. The sense that the market reforms had failed to deliver contributed to the election of a government that in 1999 started to roll back some of the previous decade's reforms. Trade unions have been given more power in wage negotiations, and the top income tax rate has been increased.[8]

In the decade following the publication of *Free to Choose*, U.S. government purchases as a percentage of GDP hovered in the 20–21 percent range. However, following the collapse of the Berlin Wall in 1989, government purchases as a fraction of GDP began a steady decline and bottomed out at 17.4 percent in 1998. Since then, the fraction of aggregate output absorbed by the government has increased each year, rising to 18.4 percent by 2003. Government expenditures as a fraction of GDP (which include transfer payments in addition to spending on consumption and investment) displayed stronger growth over the entire postwar period, peaking at 32.4 percent in 1992 before beginning a steady downward trend for much of the 1990s. However, this trend was also reversed in 2000. These are but two very crude measures of the government's overall impact on the U.S. economy. Other measures tell a similar story: The number of pages in the *Federal Register*, which Friedman has often used to gauge the extent of government involvement in the U.S. economy, reached an all-time record of 75,606 pages in 2002, an increase of about 9 percent over 2001.

Signs indicate that the enthusiasm of some countries for market-friendly reforms is waning, especially in Latin America. After a decade of significant rollbacks of the state in many Latin American countries, recent years have seen a backlash against so-called neo-liberalism. Brazil, Latin America's largest democracy, elected an avowed populist in 2002, as did the electorate of Argentina. The collapse of the convertibility plan in Argentina is seen as discrediting many of the reforms pioneered by former President Carlos Menem and his erstwhile finance minister Domingo Cavallo. Many in Latin America now talk of "reform fatigue." In some cases this is because the reforms were in name only, carried out less to spread private property as widely as possible than to enrich established interests.

The success of some countries that have grown rapidly as they have become more integrated into the global trading system has begun to provoke a backlash in the more developed countries. In recent years, there has been a growing outcry against outsourcing of jobs from the United States and Europe to countries such as China and India. Large sectors of the economies of the advanced industrial countries were previously thought immune to foreign competition because their products were nontradable across national borders. As more countries open to trade and as technology makes many services internationally tradable, workers are finding that employment in these sectors is less secure. Increasingly, white-collar workers are joining blue-collar workers in questioning the benefits of free trade.

In short, we cannot take for granted the progress toward greater economic freedom that we have seen over the past two decades. There is nothing inevitable about such progress, and history teaches us that the process can be reversed, with dire consequences. The liberal economic order that existed in most of the world before World War I was destroyed in the turmoil of the interwar years, and it took decades for markets to be reopened.[9] While goods, services, and capital can now flow between countries with the same ease as in the pre-World War I period, the same is not true of people. There are still large barriers to international migration (except within the European Union), due in part to the postwar creation of welfare states in most of the advanced economies. The voices of the critics of economic liberalism grow louder every day, and in his paper, Raghurum Rajan notes the need to "engage dissident economists and demagogic activists in fruitful dialogue, instead of letting them dominate the public arena." Unfortunately, few contemporary academic economists are willing to take up this challenge.

## CONCLUSION

In his remarks to the conference, **Alan Greenspan** repeated the famous quotation from John Maynard Keynes' *General Theory* on the power of ideas: "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back." The influence of Milton and Rose Friedman on the course of the late twentieth century is testimony to the power of ideas and the ability of two individuals to make a difference. Friedman was the dominant figure in the University of Chicago's economics department for thirty years, and to many he is the figure most closely identified with what came to be known as the Chicago school.

But his influence extends well beyond economics. Former Secretary of State George Shultz has described Milton Friedman as the individual who has had the most impact on the modern world. Friedman's enormous influence on public policy stemmed not just from the quality of the scientific work for which he was awarded a Nobel Prize in 1976, but also from the fact that he was willing to go out and argue in public forums for the benefits of free market capitalism at a time when it was distinctly unfashionable to do so. Milton and Rose Friedman describe themselves in their autobiography as two lucky people. They were on the right side of the great debate of the twentieth century, and they had the good fortune to see their arguments vindicated by the course of experience.

## NOTES

1 *Capitalism and Freedom* was reviewed by John Hicks in *Economica*, Paul Baran in *Journal of Political Economy*, and Abba Lerner in *American Economic Review*.

2 In 1972 a group of Friedman's former students organized a conference at the University of Virginia to re-examine the ideas in *Capitalism and Freedom* to celebrate Friedman's sixtieth birthday. The conference proceedings were subsequently published as *Capitalism and Freedom: Problems and Prospects. Proceedings of a Conference in Honor of Milton Friedman*, ed. Richard T. Selden, University Press of Virginia, 1975. Two of the participants in that earlier conference also participated in the Federal Reserve Bank of Dallas conference thirty years later (William Niskanen and Gary Becker).

3 Becker's speech is not included in this volume.

[4] Friedman (1986) provides an interesting perspective on the resource costs of fiat monetary standards.

[5] See also Friedman's interview with the *Financial Times*, June 5, 2003, and his opinion piece in the *Wall Street Journal*, August 19, 2003.

[6] It is interesting to reread some of the Friedmans' commentary on the run-up to the Great Depression in the light of recent economic history: "The high tide of the [Federal Reserve] System was undoubtedly the rest of the twenties. During those few years it did serve as an effective balance wheel, increasing the rate of monetary growth when the economy showed signs of faltering, and reducing the rate of monetary growth when the economy started expanding more rapidly. It did not prevent fluctuations in the economy, but it did contribute to keeping them mild. Moreover, it was sufficiently evenhanded so that it avoided inflation. The result of the stable monetary and economic climate was rapid economic growth. It was widely trumpeted that a new era had arrived, that the business cycle was dead, dispatched by a vigilant Federal Reserve System" (*Free to Choose*, 78).

[7] For information on the Milton and Rose D. Friedman Foundation, see www.friedmanfoundation.org.

[8] See "Can the Kiwi Economy Fly?" *The Economist*, November 30, 2000.

[9] A good reference is James (2001).

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