Choosing Freely: The Friedmans' Influence on Economic and Social Policy

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At Milton Friedman's sixtieth birthday conference, in 1972, George Stigler, the dinner speaker and Milton's friend and colleague, discussed economists' or academics' influence, particularly Milton Friedman's influence. As I recall the lecture after more than thirty years, Stigler began by noting that Milton Friedman was among the most influential of all economists. Then he asked how influential that might be. The implicit answer was that maximizing individuals recognized their self-interest and acted accordingly. There was limited room for influence or persuasion. Influence had, at most, the modest role of hastening the adoption of better solutions.

To bolster his argument, Stigler chose the role of economists in repealing the British Corn Laws. With his typical irony, he drove home the point: "How heartening a tale! Economists turned a great nation from error to truth, from inefficiency to maximum output" (Stigler 1975, as quoted in Schwartz, 1993, 207). Stigler then gave his own explanation of the repeal of the Corn Laws. Economists' defense of free trade had a modest role.

I found this argument unpersuasive and, in fact, more than a little strange. It was made by an academic, a person whose life was devoted to teaching and research. These activities are useful only if there are ideas that are not known to students or not yet discovered or facts that are misperceived or misinterpreted. It was written by a superb essayist who spent much of his life trying to persuade, even influence, others. And it was based on a model of the political process that denigrated the role of ideas, particularly new ideas, in political campaigns.

Stigler's comments went unchallenged for two decades. On Milton Friedman's eightieth birthday, Anna Schwartz took the other side. She argued that Stigler's alternative explanation of the repeal of the Corn Laws was not compelling. She went on to cite some examples of Friedman's influence: the volun-

teer army, education vouchers, and repeal of interest rate ceilings. But she also cited some examples where his proposals had not been adopted; minimum wage laws and import quotas are two examples. Schwartz also included a flat-rate income tax with no deductions. Since that time, the U.S. tax schedule has become flatter, and the Russians and some other former communist countries have adopted a flat-rate income tax.

Not only is influence now an established theme when we celebrate the contributions the Friedmans have made alone and together, but I believe there is more to be said about influence. The Friedmans' efforts to change major aspects of society represented by *Free to Choose*, *Capitalism and Freedom* and many other works contain numerous suggestions and proposals that were adopted, some that were adopted in part or in modified form, and some that remain dormant and rarely discussed. I will suggest some reasons for these successes and failures.

Further, though I disagree with the main thrust of George Stigler's comments about influence, he raises an important question. In his terms, if economists convinced the British to repeal the Corn Laws and move decisively toward free trade, why did the same logic not persuade other governments at the time or in the next century? Why did it take seventy years for Adam Smith's argument about the benefits of free trade to be accepted in Britain? Stigler suggested that external conditions, particularly demographics, were the dominant influence. More generally, how important are external conditions, and how do they interact with the ideas of economists, social scientists, or reformers?

One of the benefits of writing this paper was that, to prepare it, I reread both *Capitalism and Freedom* and *Free to Choose*. These books are, in different ways, rich in proposals for changes that increase liberty and opportunity and suggestions about why some proposals might not be adopted. The main reasons given for expecting proposals to fail are bureaucratic inertia and myopia. Although there are references to theories of public choice, the authors mostly do not emphasize rational, maximizing public officials. An exception is the discussion of drug licensing (Friedman and Friedman 1980, 209).

The Friedmans conclude *Free to Choose* with a chapter that has a hopeful and even optimistic title: "The Tide Is Turning," a declarative statement, not a question. I will do the same, concluding by offering some thoughts on that subject twenty-five years after the publication of their book.

THE CLIMATE OF OPINION

Anyone under sixty years old may find it difficult to appreciate what the climate of opinion was in the 1930s and how much it has changed both within the economics profession and without. The dominant view then was that capitalism had failed; the future was some form of socialism, and the only issue was

how extensive it should be. Keynes wanted free markets for consumer goods but state planning and direction of investment. Alvin Hansen claimed that market economies faced stagnation, unless the state managed investment to maintain full employment. There were opposing views. Schumpeter (1942) dismissed Hansen's argument about stagnation, but he, too, for very different reasons, saw socialism as the future.

Microeconomists discussed the "wastes of competition," for example, two or three milk companies delivering milk to the same streets. Planning could deliver the milk and avoid the waste. Oxford studies showed that businessmen never considered interest rates when making investments. Prices had little to do with resource allocation. George Stigler mocked these early econometric studies, offering Stigler's law: All demand curves are price inelastic.

Price theory was taught as mainly an exercise in applied geometry or, for the more advanced, algebra. Economic textbooks of that period, and even much later, offered few applications to problems. Agriculture was the exception. Price theory could show the effects of agricultural price supports. More adventurous authors used price theory to show the incidence of taxes. There was little discussion in economics of prices directing resource use or of crime, health care, education, and many other topics that are the daily concerns of modern economists. The marginal productivity theory of labor was taught but dismissed as lacking empirical content, an empty box.

In recalling that era, I don't think I have exaggerated. As always, there were exceptions, just as there are now Marxists, neo-Marxists and socialists of various types in economics departments teaching something other than price theory and its applications.

To me, personally, Hayek's *The Road to Serfdom* came as a shock. Later came *Capitalism and Freedom*, a book that presented as its major theme that the "organization of the bulk of economic activity through private enterprise operating in a free market promotes economic welfare and political freedom" (Friedman 1962, 4). By that time, I was a practicing economist and, partly under the influence of Armen Alchian and Karl Brunner, had given up my earlier leftist orientation. The numerous, creative applications in *Capitalism and Freedom* were then, as they are now, a treat to read and think about.

SUCCESSES AND FAILURES

The Friedmans, Milton especially, have had an enormous influence not only on economists and the academic profession but on policies in the United States and large parts of the world. Their efforts to induce societies to foster liberty, individual initiative, and freedom to choose and their successes have few parallels. One thinks of Smith or Marx, both of whom are still read and whose works are invoked as a basis for changes, albeit very different changes. Of

course, there is Keynes the polemicist who wrote *The Economic Consequences of the Peace*, the economist whose *General Theory* changed economic theory and policy, and the social reformer whose *Essays in Persuasion* offered many proposals for social and economic change. Whether we favor or oppose the recommendations, this is distinguished company. Each of these economists continues to influence policies and interpretations of events.

My Oxford dictionary lists several definitions of influence. The relevant one refers to the power indirectly to affect the course of events. The only change I would make is to insert "directly and" before indirectly, so that the definition refers to direct and indirect influence on events. Friedman's influence on the military draft was direct. As I discuss below, he and others convinced the military and other officials to try a volunteer army.

By my count, there are more than twenty-five specific recommendations in *Capitalism and Freedom*, some additions, extensions, and repetitions in *Free to Choose*, and other proposals scattered through Milton Friedman's published works. I find it useful to divide the proposals, first, into those to which the Friedmans devoted considerable effort and those that received less of their attention, perhaps because implementation seemed unlikely. Two caveats apply. First, decisions about success and failure and about effort unavoidably have a subjective element. Second, some of the proposals may have been adopted in other countries. I offer some examples, but I do not have enough knowledge of practices throughout the world to claim accuracy.

Failures

Here are some proposals that have not been adopted and, I believe, are not currently under consideration. Each of these can be found in *Capitalism and Freedom*. Friedman proposed to abolish state universities; abolish licensing of doctors, lawyers, accountants, and other professions; eliminate agricultural subsidies, minimum wage laws, right to work and fair employment practice laws; and adopt a spending limitation amendment. In *Free to Choose* and elsewhere, the Friedmans amplified the last proposal and, with others, developed a proposed constitutional amendment to limit growth of government spending.

None of this has happened, and none of these proposals seems likely to be adopted soon, if ever. Of course, the future is not knowable, but none of these proposals is under active consideration currently. Some issues have moved farther from free choice.

About fifteen or twenty years ago, more than thirty states approved a call for a constitutional convention to adopt a spending limitation amendment to the Constitution. The Constitution requires thirty-four states to adopt the call. I followed the effort closely because one of our sons worked for the National Taxpayers Union, a group that sponsored the amendment. At the time, one of his

responsibilities was to work with legislators to get the call for a convention approved. The effort failed in the states with relatively more unionized workforces. The early successes may have benefited from some free riders—legislators who voted aye because the number of states remained below the constitutional requirement. I count that as a failure.

In *Free to Choose*, the Friedmans proposed to phase out Old Age and Survivors Insurance (OASI). They would honor existing obligations, repeal the payroll tax, and rely on voluntary decisions about pensions. They predicted that their proposal "has no chance whatsoever of being enacted at present" (1980, 124). Stigler's comment about demographics seems apposite. Recently, President Bush proposed private management of a part of OASI accounts, a small but important step in the direction the Friedmans proposed. The incentives for the currently younger generation to seek to increase their return on pension assets suggests that the "at present" in the quotation is more critical than at first appears. The Friedmans' proposal has not been adopted, and it seems unlikely that the government will withdraw completely from managing pensions and redistributing income intergenerationally. A partial success seems more likely now than when they wrote.

Complete Successes

I count four complete successes—proposals that became law or policy without major change from the Friedmans' proposals. Three of the four are of considerable importance. Each is a shift from command and control regulation to free markets and free choice. The fourth success, the right of U.S. citizens to own, buy, and sell gold, I regard as less important because there are many alternative assets and instruments. Fortunately, the time has never come when ownership of gold was needed here to protect wealth from a tyrant.

The three major successes are floating the dollar, ending the military draft, and removing interest rate ceilings on demand and time deposits. The three have in common that each change occurred in response to a crisis; the existing system failed. In each case, there was at least one alternative solution that prevented free choice in competition with the Friedmans' proposals. One lesson these experiences illustrate is that a market solution is not a government's first choice, or the obvious alternative in a crisis. Free market solutions have a greater chance of success if the proposals are known in advance, proponents have responded to criticisms and objections, and officials have become sufficiently familiar with the proposal that they believe it can work.

Floating the Dollar. Floating the dollar in 1971 and 1973 illustrates these principles. Milton Friedman first proposed floating exchange rates in the early 1950s. At the time and for many years, there was no interest among politicians. Friedman (1953) predicted that the Bretton Woods system of fixed but adjustable

exchange rates would break down. By the 1960s others began to recognize that the system was in trouble. The stock phrase at the time was that there were three problems: liquidity, adjustment mechanisms, and confidence. Though repeated endlessly, the main effort went to create additional liquidity, the SDR. Governments and their officials solved a problem that did not exist and ignored the overvaluation of the dollar. There were ample reserves of dollars available, and the supply continued to grow. Except for France, foreign governments did not wish to abandon the dollar or the fixed exchange rate system. They wanted the United States to do the impossible—reduce the supply of dollars without deflating or reducing U.S. imports. With the modest exceptions of Germany, the Netherlands, Switzerland, and Austria, countries did not revalue their currencies, and only France demanded devaluation of the dollar against gold.

A personal anecdote illustrates the state of informed discussion. Many meetings and symposia on the dollar and the international monetary system considered proposals for monetary reform. At one in the summer of 1968, organized by Edward Bernstein and hosted by David Rockefeller, several academics met with prominent bankers and government officials. The agenda included proposals for the SDR and return to a gold standard. Floating exchange rates was not on the program.

Gottfried Haberler and I proposed to Bernstein that this should be added. After some discussion with the hosts, he told us that floating exchange rates were impractical but, as a concession, he would announce that those interested in discussing floating rates could hold a separate session on the afternoon reserved for tennis, golf, swimming, and other recreation. (Meetings of this kind avoided shabby locations.) We declined.

This occurred after the Bretton Woods system had taken a major step toward its demise. In March 1968, President Johnson had embargoed gold exports except for central banks and discouraged central banks from asking for gold. Three years later, the dollar floated, temporarily officials believed. Nevertheless, it floated—and experience with floating showed that it was not impractical or destabilizing. The attempt to fix exchange at new parities lasted less than 15 months. In March 1973, the dollar floated and, with the exception of a few brief periods, the United States allowed it to float freely. The European Central Bank also allows the euro to float. Of course, many other countries peg or intervene. Since 1972, international reserves, mainly dollars, increased at an 8.5 percent compound annual rate. At the end of 2002, two-thirds of the $1.8 trillion in international reserves belonged to China, Japan, Taiwan, Korea, and Hong Kong.

Floating the dollar in 1971 was the most contentious issue when President Nixon met with his advisers at Camp David in August 1971. Arthur Burns opposed even after the president decided tentatively on including a floating rate in the package. The alternative was direct controls on imports, perhaps making

the 15 percent surtax on imports, approved at that meeting, a permanent instead of temporary part of the president's program or imposing more so-called voluntary quotas on automobile, steel, and other imports.

Floating exchange rates increased freedom. Once the dollar floated permanently, the government removed capital controls that had been imposed in the 1960s. Other countries followed. Early in the 1980s, Britain held its first election without capital controls since 1936.

Ending the Military Draft. Milton Friedman was a proponent of an all-volunteer army and served as a member of the Gates Commission, which voted unanimously to recommend that President Nixon ask Congress to end the military draft. The idea was not new. The United States had relied on a volunteer army through much of its history. But relying on a volunteer army to fight a large-scale war was new, and there were many skeptics.

Walter Oi (1998) explained that President Nixon discussed a volunteer army during the 1968 election campaign. After the election Alan Wallis urged Arthur Burns to discuss the issue with President-elect Nixon. Wallis got Bill Mechling, Martin Bailey, Walter Oi and Harry Gilman to work out estimates of the demand and supply schedules and to compute equilibrium wages. Friedman's principal role was to explain and defend the proposal and respond to questions. As a member of the Gates Commission, appointed by President Nixon to consider alternatives to the military draft, he succeeded in getting the military and members of Congress to see the benefits to them and the nation of a volunteer army.

The war had become unpopular, and the draft had provoked riots, burning draft cards, and a spreading belief that the draft was unfair. An eligible draftee could escape by going to college, fleeing to Canada, or having braces put on his teeth. Ending the draft would be popular. The principal alternative to the voluntary army, however, was a lottery. An eligible citizen would get the privilege of serving his country if he lost—that is won—the lottery.

More than thirty years later, the volunteer army remains. A voice now and again calls for a return of the military draft—usually based on an effort to share the cost of war "equally," whatever that might mean. These voices do not, as far as I know, include senior military officers or presidents of either party.

Repealing Interest Rate Ceilings. Unlike the draft and floating exchange rates, there was little controversy among economists about repeal of interest rate ceilings. Those who wrote or spoke on that issue generally favored repeal of ceilings on time deposit rates. Within the Federal Reserve, there was considerable sentiment, possibly a majority in the 1950s, in favor of making the ceiling rate nonbinding (Meltzer 2003, Chapter 3). The members were reluctant to ask Congress to repeal the legislation. Although several recognized that the ceilings distorted allocation of financial assets, it was never exactly the right time to put ceiling rates on standby. Fear of congressional response appears to have been

a major reason, and there was no sign of crisis. By the mid-1960s, members of the Federal Reserve acquiesced in or favored extension of ceiling rates to savings accounts at nonbank thrift institutions (Meltzer 2003, Chapter 4). The first response was to extend controls, not ease them. A first constructive step in 1970 removed interest rate ceilings from negotiable certificates of deposit (CDs) of $100,000 or more following the Penn Central failure.

It did not take long for entrepreneurs to recognize that fortunes could be made by organizing mutual funds to buy large CDs and, for a fee, offering participation to small depositors. The crisis came when the drain into these mutual funds became relatively large. Banks and thrifts had to buy back their deposits at interest rates well above the ceilings. This was particularly hard for mortgage lenders when short-term rates remained above the long-term rates on their mortgage portfolios. Elimination of ceilings had been widely discussed. Additional controls seemed unlikely to solve the problem. At best, they would postpone a permanent solution.

The three successes have in common that policymakers perceived that there was a crisis. There was also a well-presented, market alternative that dominated other available alternatives that offered less freedom to choose in markets.

There is some symmetry. There were no important crises affecting right to work laws, state universities, licensing of doctors and lawyers, and many other issues where the Friedmans proposed changes. A recent perceived crisis about accounting processes and accountants led to increased regulation, but there was no well-developed proposal to use markets and incentives in place of regulation. Political response is most often the work of lawyers. Their training typically leads them to propose regulations—command and control schemes—instead of aligning private and social interests by changing incentives when the two diverge.

NON-CRISIS CHANGES

Many of the Friedmans' proposals have been adopted in part without the push from a major crisis. Crises provide an opportunity for governments to make reforms, but reforms and changes occur at other times. Crises can create the sufficient condition for ideas and persuasion to influence policy, but the influence of ideas on policy occurs at other times.

Tariffs have been reduced throughout the world. Reductions are rarely unilateral, as the Friedmans urged, and trade agreements contain many protectionist clauses. Deregulation of transport, banking, and telecommunications is widely accepted as beneficial to consumers, but radio and television licensing remains regulated by the Federal Communications Commission. The Treasury offers inflation-indexed bonds, and it auctions long-term securities, as Friedman proposed in the 1960s. One result of the bond auction is that the Federal

Reserve ended its so-called even keel policy of supplying reserves to hold money market conditions constant when the Treasury marketed its debt. The even keel policy often required the Federal Reserve to supply enough bank reserves to ensure that the Treasury's issues were sold. During the 1960s and 1970s, reserves provided under even keel were a main source of excess money growth.

Education Vouchers. The Friedmans' proposal to issue education vouchers would increase parents' freedom to choose the school they believe benefits their children. Although many reports with titles such as "A Nation at Risk" use the language of crisis, the public, and its elected representatives, have given only modest support to Friedman-type vouchers. One reason is that until recently the constitutionality of parents using vouchers in parochial schools had not been decided. But vouchers and other methods that provide greater choice and increase pressure for reform of ineffective schools have not produced dramatic improvements in learning, as measured by conventional testing procedures. Further, proponents of vouchers would cite the intense opposition of teachers unions as part of the explanation for the failure of vouchers to be adopted widely.

I find the last argument incomplete. Interest groups did not prevent deregulation and increased choice in many areas. I do not question that teachers unions oppose vouchers. Why are they successful when others are not? Why did President Bush abandon a modest voucher proposal in his education bill?

I suggest that attitudes toward public goods and redistribution have an important role. Evidence suggests that some families purchase better schools by buying housing in districts known to have higher standards of educational achievement. They pay indirectly for school choice, so they have strong incentives to maintain their schools and much weaker incentives to improve schooling and learning for others. Also, proposals to give vouchers to the lowest income groups do not appeal to those just above the margin, especially if they pay full tuition to the parochial schools where many of the vouchers would be used.

Emphasis on increased choice fostered change. Both the charter school movement and home schooling have grown rapidly. In different ways, these two programs have enhanced opportunities for individual initiative and innovation in educational methods. The voucher proposal has encouraged choice and change in ways the Friedmans did not propose.

Negative Income Tax. One of the Friedmans' best-known proposals called for replacing all welfare programs with a negative income tax. Below a certain level of income, the tax authority would pay the citizen.

No government has replaced the welfare system with a negative income tax. The proposal continues to stimulate research, and it has been adopted as a supplement to existing welfare programs in various ways. The earned income tax credit (EITC) is one familiar program that supplements earned income for workers below median income.

There are three points to notice about EITC. First, it supplements programs like food stamps, health care, and educational grants but does not replace them. Second, it goes to people who have earned income and excludes those who do not. Third, the transfer payment increases with the number of dependent children, so it does not depend only on earnings. In 2000, 55 million people received payments under the EITC (Moffitt 2003). The maximum income at which a family received the transfer reached $32,000 in 2001, very close to median income of black families.

As Moffitt (2003, 32) notes in his recent survey, the negative income tax has ambiguous effects on labor supply and lacks a work requirement. Unlike transfers to farmers and business firms, most welfare programs either offer transfers in-kind or require work. Meltzer and Richard (1985) showed that a utility-maximizing voter prefers to offer in-kind transfers rather than cash transfers because the former induce more work by the recipients than do the latter. Public discussion of welfare-to-work programs during welfare reform in the 1990s, both in the United States and abroad, suggests that voters favor work requirements for all but the aged, infirm, and the most handicapped.

Again, on an issue involving substantial redistribution, the Friedmans' proposal influenced subsequent discussion but was not adopted in its entirety. The Meltzer and Richard paper developed a condition under which a negative income tax would replace in-kind transfers. The condition is that the pivotal or median voter does not work. Fortunately, we are not there yet.

I agree with Moffitt (2003, 33), who concluded his survey by noting that "the negative income tax has played a substantial role in reorienting the thinking of policymakers to the basic message that incentives matter. While this insight does not surprise academic economists, it is a new development in policy circles."

MONETARY POLICY

Possibly the most famous Friedman proposal called for a rule for constant monetary growth. Once again, Friedman's proposal had a major influence on subsequent developments but was not itself adopted. Several countries have an inflation target for monetary policy but not an explicit monetary rule. Absence of a consensus among economists is a major reason.

The history of money has a strong cyclical component. Periods in which money is considered a principal determinant of inflation are followed by the opposite—money is regarded as irrelevant for inflation or fluctuations in output. Currently, the most widely used model has only one interest rate: a short-term rate set by the central bank. Given that interest rate, aggregate demand and a Phillips curve determine output and inflation. With the interest rate fixed, the demand for money determines how much money the central bank supplies.

This model puts some strong restrictions on the relation of the interest rate

fixed by the central bank to other asset prices and exchange rates in the short run, before full adjustment of asset and output markets. Friedman's (1956) analysis of the demand for money included these asset prices as separate arguments in the demand function. In his model, money can affect a wide spectrum of asset prices and components of output in the short run, and, in turn, spending and the demand for money can be affected by those relative prices and demands. Friedman's money growth rule avoided the as-yet intractable problem of predicting how the many relative prices or interest rates interact.

Discussion of monetary rules revived after the major inflation of the 1970s and the publication of Kydland and Prescott's (1977) paper on rules and discretion. That paper and subsequent work on credibility heightened and focused central bankers' concern for the public's anticipations and beliefs. A monetary rule or guide provided that information by increasing information about intended future policy.

Several central banks have now adopted a rule called inflation targeting. Many central banks calculate the interest rate consistent with their inflation and output targets using a formula or rule proposed by Taylor (1993), although they may not follow the rule. These limits on discretion are steps in the direction Friedman proposed.

Friedman's rule was a type of inflation control or inflation targeting. It differed from current inflation targeting rules not only by making money growth the key variable for central bank control but also by defining inflation as the *maintained* rate of price change. Friedman's much-quoted dictum that inflation is always and everywhere a monetary phenomenon excludes one-time price level changes. One should not doubt that Friedman understood that measured changes in a published price index could result from changes in tariffs, excise tax rates, exchange rates, oil shocks, productivity changes, and many other factors. His inflation rule permitted these price changes, positive and negative, to remain. The reported price level would be a random walk, but the expected rate of inflation would always be zero (or some constant value) if the maintained growth rates of output and monetary velocity remained unchanged. Rational individuals would make their consumption-saving decisions on this assumption. The Friedman rule would avoid persistent inflation and deflation and the wealth transfers they caused.

Current rules for inflation targeting treat all price level changes as inflation. There is no distinction between permanent, or persistent, changes and transitory, or one-time, price level changes. Following the constant inflation target requires rolling up or back all one-time price changes. In practice, many central banks will deviate from their target in the short run, if the target requires loss of output. The reason is that the difference between potential and actual output—the output gap—is an argument in economists' statement of the central banker's (or the community's) objective function.

HAS THE TIDE TURNED?

Writing in 1979–80 after the election of Margaret Thatcher, the Friedmans were optimistic about a retreat from the increased role for government that had characterized the previous fifty years in the United States and Great Britain. On the back cover of the 1990 edition, they were almost exultant. They ended *Free to Choose* this way (1980, 309–10):

> Fortunately, we are waking up. We are again recognizing the dangers of an over-governed society, coming to understand that good objectives can be perverted by bad means, that 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.

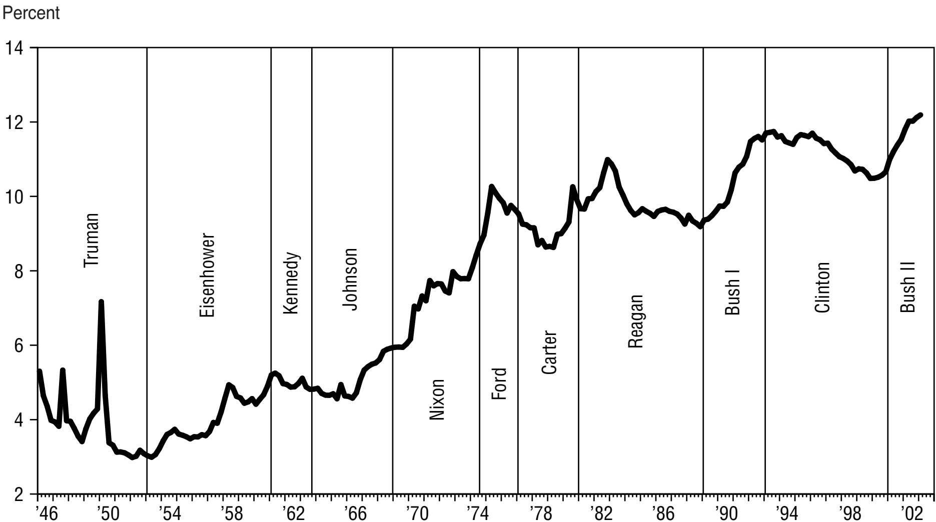
Would that it were so! The picture is much more mixed in the quarter century since they first wrote. Tax rates have been reduced in the United States and many other countries. Tariffs are lower, permitting trade to expand and living standards to rise in many developing countries. Democratic choice of government has spread to places where it had never been known. The former Soviet Union collapsed, freeing many of its citizens and the citizens of its satellites to choose capitalism and democracy. Countries everywhere have adopted some of the Friedmans' proposals in whole or part. For example, Russia has privatized land and property, adopted a flat tax, and developed a pension system with less redistribution than ours.

Against these promising reasons for hope, there are ample reasons for concern. Most of the deregulation in the United States came before the Reagan administration. Government programs in education, health care, and retirement continue to expand. Even the current conservative administration promotes a massive expansion of government involvement in health care. Measuring government size by the ratio of government transfer payments to gross domestic product shows a rise from 4 percent during the Truman administration to approximately 13 percent early in 2003. Figure 1 shows that periods of largest growth occurred during the administrations of Presidents Eisenhower, Johnson, Nixon, and the two Bushes. The Nixon years are especially notable. The transfer ratio rose from about 6 percent to 9 percent. The administration did little to stop or slow growth of the Great Society programs and even added its own large program called revenue sharing. The few periods of relative decline in transfers came during the Truman, Kennedy, Reagan, and Clinton administrations. Relative decline can occur, of course, if GDP grows rapidly, as during the Clinton administration, but that administration also reduced welfare payments by reforming the welfare system.

Figure 1 does not include the proposed prescription drug program. Since it includes only the budgetary cost of transfers, it also excludes costs of in-

Figure 1

Transfer Payments as a Percent of Gross Domestic Product, 1946:1 to 2003:1



creased regulation. Government intrusiveness is harder to measure than transfers; I know of no quantification of the welfare cost of environmental, health, product safety, and financial regulation. Some examples are instructive. Environmental regulation of wetlands curtails property rights without paying compensation. Price-setting for medical services distorts resource use, taxes specific types of income, and transfers wealth arbitrarily. The list is long. Recently states' attorneys general have added to the list using the courts instead of the legislature to regulate and penalize.

Governments at all levels have reversed their position on racial discrimination. Instead of enforcing segregation, as in the past, the law now enforces desegregation. Freedom to choose surely increased as a result, but pressures for mandating equal outcomes, not just equal opportunity, increased also.

Many of the changes away from freedom to choose toward increased regulation and more transfers are prompted by appeal to fairness or equity. *Free to Choose* and *Capitalism and Freedom* have very little to say about fairness. Their usual explanation of continued and enhanced regulation and redistribution is either a version of "rational ignorance" or a powerful bureaucracy foisting its will, or its clients' will, on the public. The literature of political economy or public choice is mentioned but not exploited.

I accept that rational ignorance applies to many details of tax or regulatory legislation and interpretation. Hardly anyone, including the legislators,

reads the often hundreds of pages in many of these bills. Few would understand the implications of many of the provisions for special interests, and much legislation allows the bureaucracy to fill in the details and decide on the application.

I submit that rational ignorance fails as an explanation of the trends in transfer payments or regulatory programs. Major spending programs for retirement, health, and education do not require knowledge of details to know whether one pays or receives. It does not take either much knowledge or much experience to know that governments cannot produce health care, pensions, or education. Production requires technical skills. Government provides inter- and intragenerational redistribution of the cost. When the government announces a major new program, such as the prescription drug program, those who benefit and those who pay generally know which group they are in. Entrepreneurial politicians understand that also. They recognize, for example, that the number of those who bear the cost of old age pensions is growing relative to those who benefit. It becomes feasible to discuss privatization for a small part of the program.

The first concern politicians typically have about a proposal is not whether it moves society toward a Pareto optimal allocation or increases efficiency. Their first concern is who gains and who loses, who pays and especially who receives. And that is what is most emphasized when they run for office. A Congressman who points to the new health benefit or new highway he got for the district doesn't point out that there are 434 other districts that received the same or possibly larger benefits.

By concentrating on the economic benefits and neglecting the political system and its interaction with the economic system, *Free to Choose* concludes on a more optimistic note than ex post judgment warrants. As de Tocqueville recognized long ago, the political incentive to redistribute income remains strong in democratic-capitalist systems. Votes are more equally distributed than income; each adult has one vote. Even if we allow for those who do not vote, the mass of the distribution of votes lies below the median earned income (Meltzer and Richard 1981). Voters with incomes at the median or below gain by transferring income to themselves. The efficiency loss to society from redistribution is part of the cost of democratic government and political freedom.

The Friedmans swam against this strong current. They could not stop or reverse it, but they influenced far more than most the ways in which people and politicians think and act. They influenced the economics profession and other scholars to analyze government programs and show their net costs. And they taught a generation or more about the value to them of remaining free to choose.

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