

CHAPTER 13

The Economic Responsibility of Government

by Milton Friedman

The title of this session, “The Economic Responsibility of Government” reminds me of an ancient story that I think is relevant. It has to do with a couple of youngsters from the boondocks (maybe from College Station or Bryan) who came to New York for the first time. They had never been to a big city and they were awed with the great metropolis. After a week in New York, on their last day, they were trying to work up the courage to have dinner in a really fancy New York restaurant. (Maybe it was Sardi’s or the Club 21.) They walked back and forth outside the restaurant before they got up enough courage. They ordered dinner, including soup, an entree, dessert, and coffee and then the waiter brought them finger bowls. The first one looked at the other and said, “What do you suppose that thing is?” The second one said, “Gee, I don’t know. It can’t be soup, we already had soup.” The first one said, “Well, it can’t be a drink, we just had some coffee.” The second one said, “I’m going to ask the waiter.” The first one said, “Oh no, no. He’ll think we’re hicks.” But his friend insisted, “No, I’m going to ask the waiter.” So they called the waiter over and asked him what the fancy bowls with the clear liquid were for and the waiter said, “Well, of course, that’s to wash your fingers in.” As the waiter went away, the first one looked triumphantly at his friend and he said, “You see, you ask a foolish question and you get a foolish answer.”

That is the same problem with the title of this session. Government has no economic responsibility. Only people have responsibility and the government is not a person. The notion that government has a responsibility sends one looking for an answer in the wrong direction, because it suggests that government is a collective entity. It promotes the idea that there is something over and above the millions of individuals who constitute the society.

The right question, in my opinion, is a very different one. It is not, “What are the economic or other responsibilities of government?” It is rather, “What things do we want to do through government?” Government is an instrumentality, it is the means that we use to achieve our objectives.

Consequently, the important questions are: How do we use it effectively? For what do we use it? How do we keep it from becoming our master?

The notion of government as a collectivity has unfortunately been all too dominant throughout history. It is a notion that has destroyed freedom in many parts of the world. It has not done so here in the United States and we trust that it will not. But I believe that it will contribute to our keeping government in its proper role if we think of it in the right way. Sometimes it is difficult to do so. The people who are employed in government, civil servants, the people who sit behind those millions of desks, are supposed to be our servants. But when they call you in to question you about your income tax return, or to discuss whether you are obeying the OSHA regulations, I doubt very much that you feel that you are the master.

What do we want to do through government? What are the things that we believe we can accomplish better through political arrangement, through governmental structures, than we can through our separate voluntary cooperative effort? If we look at the traditional functions assigned to government in the United States, they are very straightforward. The central function we have always tended to assign to government is to preserve law and order; to keep one man from coercing his fellow man, to keep a person from hitting his neighbor over the head with a blunt instrument. Second, we expect the government to protect the nation against foreign enemies, to provide for the national defense. Third, through legislative and similar means, we want our government to establish a framework of rules under which we operate, and to enforce contracts that we voluntarily enter into with one another. Fourth, we ask the government to provide a judiciary that can settle any disputes or disagreements that may arise. Fifth, we commission the government to provide a common medium of exchange, to provide a monetary system. Finally a paternalistic element, we want our government to provide for people who cannot care of themselves—people who are in dire distress. These are the traditional functions of government.

What has been happening in the past fifty years is that we have been expanding very greatly the role of government. We have been having it undertake a wider and wider range of activities, particularly in the two final areas: in the area of monetary and economic controls, including governmental regulation, and in the area of paternalistic activities. One of the most interesting phenomena is that as government has

expanded its scope by undertaking a wider range of activities—activities that were never traditionally a part of the functions we assigned to government—it has performed its traditional functions of preserving law and order and keeping a framework for a decent society less and less well.

I want to discuss the expansion of governmental activities particularly in the monetary area and the paternalistic area; but I want to note first the extraordinary importance of the traditional functions, the functions of preserving law and order, of establishing a framework of rules, and so on. Those functions are crucial to the economic health and development of a nation. You may ask why I should be discussing those functions under the heading of the “economic” responsibility of government. Economic progress is not possible anywhere—anywhere in the world or at any time—unless there is a relatively stable structure of law and order and a reasonable degree of security of person and property. If there is a complete insecurity of person and property, economic growth and progress are impossible. That has been demonstrated over and over again. On the other hand, if there is a reasonable degree of security of person and property, if people can be assured that they will benefit from their own activities, that if they acquire something, it cannot be taken away from them by force or other means, they will work to acquire that property. So, a very essential precondition for any kind of satisfactory economic progress is security and stability of person and property which have been the traditional functions of government in the United States.

Having stated those preconditions, I want to spend most of my time on a discussion of the areas in which government has been expanding its role in recent decades in directions which seem to me to have been very unsatisfactory and unsuccessful. The provision of a money supply is a traditional function. You all recall from your history courses that the U.S. Constitution provides that Congress shall have the power and I quote, “to coin money, regulate the value thereof, and of foreign coin.” Now of course, that specification, “to coin money, regulate the value thereof, and of foreign coin,” when it was first introduced, meant a very different thing from what it has come to mean. It has expanded enormously. The first great expansion came during the Civil War, over a hundred years ago, when the federal government issued paper money, which came to be called “greenbacks,” to pay part of the cost of the Civil War.

One of the most amusing incidents of that whole venture involved a man named Salmon P. Chase who was the Secretary of the Treasury at the time of the Civil War. As the Secretary of the Treasury, he was responsible for the issuing of greenbacks. Some ten years or so later he was the Chief Justice of the Supreme Court of the United States when the first of the famous “greenback” cases, *Hepburn v. Griswold* was brought before it. At issue was the question of whether it was or was not constitutional for him in his capacity as Secretary of the Treasury to have issued the greenbacks. Not only did he not disqualify himself from the case, but he voted with the majority that it had been unconstitutional for him to do what he did. That gave rise to the first episode of court packing. The decision was one that those in power could not tolerate, so they expanded the size of the Supreme Court from seven to the present nine members and appointed two new members. Fourteen months later in the case of *Knox v. Lee*, Salmon Chase voted the same way as before, but he was in the minority this time. That was the constitutional authority for the printing of “greenbacks.”

Since 1871, that function has been expanded enormously not only to the provision of a medium of exchange, not only to the regulation and control of commercial banks, the establishment of the Federal Reserve System, and so on, but also to the idea that it would be possible for government to promote economic stability through fine-tuning monetary magnitudes and fiscal magnitudes. That development has not been peculiar to the United States; it has occurred throughout the world. It was a reaction to the Great Depression of 1929 to 1933—a catastrophe that was wrongly, in my opinion, attributed to a failure of the capitalist system. The Depression was not a failure of capitalism. It was a failure of government policy and management. The Great Depression was produced by the mistakes that the Federal Reserve Board made in permitting the quantity of money to decline by one-third. Nonetheless, it stimulated the belief that government had to be in there manipulating these dials so as to promote economic stability, full employment, stable prices, and the whole litany of fine objectives. The results have been very different from the hopes that were placed in these mechanisms. Instead of a period of economic stability, we have had a period of ups and downs, of gradually rising inflation, of instability, of what now has come to be known by the unlovely name of “stagflation.”

Increasingly in the post war period, the experience has been that inflation has risen and fallen. We have had a roller-coaster ride about a long-term upward trend of inflation. We have had a roller-coaster ride about an upward trend in the levels of unemployment. And in recent years, even more seriously, we have had a definite reduction in the rate of economic growth. I don't want to attribute all those results to the idea of fine-tuning the economy or to counter-cyclical monetary and fiscal policy in particular. I believe that the growth in the size of the government—in government spending and government regulation—and the disincentive effects on business investments have had much more to do with the slowdown in economic growth and declining productivity growth than has monetary and fiscal policy itself, or indeed than inflation. Nevertheless, we have tried hard to stabilize the economy, and the results have been very disappointing. I believe that economists as a group have done a great deal of harm to society by promising too much. We have believed that we knew the secret of how to manipulate government spending and monetary flows in such a way as to keep everything on an even keel. Again, that is not specific to the United States; the experience is the same in Great Britain and many of the countries of the world.

I turn from that to another governmental activity that has expanded enormously: the paternalistic function of taking care of the irresponsible. That function, at one time exercised primarily by local governments, by local communities, with a great deal of private charitable activity as well, has been expanded enormously. It has been the most rapidly expanding area of government spending—particularly in the past two decades. Total spending on various programs supposed to redistribute income, supposed to eliminate poverty, supposed to transfer income to the needy, has grown by leaps and bounds. Ten years ago, the national defense budget in this country was one-and-a-half times as large as the budget of the Department of Health, Education and Welfare. Currently, the two component parts of HEW, the new Department of Education and the Department of Health and Human Services, have a budget that is one-and-a-half times the total military budget. Those are the programs that have grown. Spending on national defense has gone down from something like eight percent of the national income to five percent of national income. At the same time, spending on the transfer programs and the HEW type programs has gone in the oppo-

site direction. The objectives of these programs have been noble. Helping the poor, providing a wider range of opportunity, making it possible for people to further their objectives more effectively, those objectives have all been noble, but the results, in my opinion, have been ignoble. The results, in my opinion, have been the opposite of those that have been intended by the well-meaning proponents of such programs.

I have been very much impressed by some of the reactions that we have gotten in this connection to our TV program "Free to Choose." The reaction of the public-at-large to that program has been fascinating in many ways. I may say on the whole it has been extremely favorable, and I suggest there is a much wider constituency within the broader body politic for the view that government has gone too far and should be cut back in size than one might suppose. But what I want to refer to now are not those favorable reactions, but a small minority of very vitriolic and negative reactions. And they all have one common component. They all sound the theme, "You are heartless, you have no sympathy for humankind, you want to grind the poor under your heels."

Let me quote from one such letter, just to show you the flavor. "Your viewpoints, reminiscent of Queen Antoinette, the Russian Czars, Nero, and worse, are the most animalistically inhumane I have ever heard." Well, that was a nice pat on the back.

Why do I cite it? Because it seems to me to bring out very clearly what is the key point of confusion: the confusion between objectives on the one hand and results on the other. Here we have a very wide range of governmental programs which supposedly are intended to help the poor. In fact, almost every single one of them has the opposite effect. They impose burdens on the poor in order to benefit middle and upper classes. Which is more inhumane? Which is more humane? Is it more humane to promote the fiction, to object to people who try to uncover that fiction, who try to show what is actually happening despite the good intentions? Or is it more humane to uncover the fiction and try to bring out the facts and to explain what is actually going on?

My objection to these governmental programs has nothing to do with the objectives of many of the well-meaning people who promote them. My objection has to do with the consequences they have actually had. I do not believe that those consequences arise because the people who administer the programs are evil, or because the people who designed them

are evil, or because anybody intends the programs to go astray. Those perverse results arise, I think, from a much more fundamental feature. And that fundamental feature is that you cannot achieve good objectives by bad means.

The means of trying to finance these large scale redistributive programs involve coercion; they involve people using some force to take money from other people for the benefit of still third parties. Nobody spends somebody else's money as carefully as he spends his own. The one thing you can count on everybody to do is to put his interest above yours. That you can really count on people to do. The fundamentally good objectives of these programs are flawed by what I regard as the fundamentally bad means that are used, the means of force and coercion. Now I do not want to continue on that abstract level; I want to use the little time I have left to get down to cases and say exactly what I mean. And here is where some of you may be a little disturbed, because I want to start right here at home, at Texas A&M with the problem of financing higher education.

No governmental program that I know is so clearly perverse in its redistributive aspects, so clearly imposes burdens on low income people for the benefit of middle and upper income people. Let me hasten to add that this is not a criticism of any individual. I, myself, am a beneficiary of such a perverse program. I went to college with a scholarship that was granted by the state of New Jersey. I happen to think it was a good thing that I went to college (though there are many people who do not think so). But the day after I got my bachelor's degree, I left New Jersey and I have hardly ever been back since. I don't know what the people of New Jersey got out of it, but, I do know what I got out of it. I got the opportunity to have a much higher income than most of the people who paid the taxes. I should have paid for that education, not they.

Consider any one of our institutions of higher education being financed by the state. The budget of Texas A&M University, I am told, is somewhere in the neighborhood of \$250 million of which, I understand, \$200 million or so comes from state or federal tax fund! You have an excellent student body here—fine, highly motivated people. Your performance is very high compared to most state universities. I have been inquiring about that; I make it a hobby to find out what the ratio of graduates is to entrants. At the University of California at Los Angeles it is fifty percent, and that is one of the good state universities. Here I am told it is up in the sixty-five to

seventy percent range, which is a very high ratio. So I am not criticizing the performance, but I want you to look at the equity of it. Ask yourself what average income of the students who graduate from this university will have and what average income the people who pay taxes to send them to this university will have. Is there any doubt what the answer is? The average income of the people who pay taxes is vastly lower than the average income of the families from which the students come and it will be lower than the income these students will have in their later years. Try to justify that on equity grounds. And I believe there are no other grounds on which it can be justified.

The major beneficiaries of higher education are those of us who get the education, the students including me and others who got a tax-subsidized education. We are the ones who benefit most. We hope society benefits also—that would be nice; but that is not a reason for imposing burdens on low income people. We in the middle and upper income classes have been able to con the poor suckers at the bottom (and ourselves as well) into believing that it is all right for us to be subsidized at their expense. I believe that every young person who has the ability and desire should be able to go to a university—*provided* he is willing to pay for it, either at the time he attends or subsequently out of the higher income which he will earn. Again, this phenomenon is not peculiar to Texas. It occurs in every state in this country. And the argument holds for the funds that are provided both at the federal and the state level. That is one example.

Having struck at one sacred cow, let me strike at another—social security. Here is another example where we in the middle classes have conned the lower income classes into supporting us. How could I make such an outrageous statement? Simply because it is true. Let me suggest why it is true. Let me ask the question: at what age do young people from lower income classes go to work? They will tend to go to work at the age of sixteen or seventeen—eighteen at the latest. And they will start paying taxes immediately. At what age do the children of middle income parents go to work? Well, we are lucky if they are self-supporting by age twenty-five. When they do go to work, they start to pay social security taxes at that time. So the people from the lower income classes pay taxes for more years than the people from the upper income classes. That alone, if you do your arithmetic at any reasonable rate of interest, suggests that they are bearing a heavier burden. But it is

even worse if you look at the other end. All of the statistics show that people in lower income classes live shorter lives than those from upper income groups. So if we qualify for social security benefits, we shall receive benefits for a greater number of years on the average than those in the lower income classes. The net effect of that difference in the number of years in paying taxes and the difference in the number of years receiving benefits more than counterbalances the special provisions that are supposedly designed to benefit low income persons.

Let me hasten to add that again I am not criticizing any individual, I would not hesitate to take the social security benefits if I qualified for them. (I am over sixty-five; but, because my earned income is above the specified minimum, I do not get any social security benefits though I continue to pay the social security taxes.) We must distinguish two very different things: What is proper social policy (what we as citizens recommend and try to get enacted into law) and what is proper for us as individuals to do, given the set of rules under which we live. If our legislators are so foolish as to enact such measures, there is nothing wrong in any individual's obeying the law and benefiting from it. Again, I am not proposing an overnight stop to this. Take social security: I am not in favor of going back on any agreements we have made, any obligations we have assumed to people. But I am in favor of modifying the program from this day on so we don't assume any more obligations.

There is almost no program that I know of, enacted under the name of helping the poor, redistributing income, that is not perverse in this way. The only one that comes even close is direct welfare (aid to dependent children and the rest). And even that is by no means clear. In the first place under those programs there are many people receiving assistance who by no stretch of the imagination can be regarded as being in need. Moreover, you have to look at the funds that are siphoned off by the very large welfare bureaucracy. That bureaucracy has provided a large number of good jobs with high salaries for well-meaning people.

I have often challenged audiences to name a significant program of governmental reform intended to distribute income from high to low income, which succeeds in so doing. Almost every one that I know of has the opposite effect. I hasten to add that this is a complex matter. Frequently, the very highest income groups and the very poorest groups lose while the mid-

dle and upper-middle income groups gain. The groups at the bottom lose because they are politically ineffective, in general. The wealthiest groups lose because they offer such a nice, tempting prize to be exploited.

Let me close by saying that in the late 1930s after the noble experiment of prohibition had demonstrated that it was an utter failure, this nation had sense enough to discontinue the experiment and repeal the Eighteenth Amendment. We now have had a series of noble experiments: the New Deal, the Fair Deal, the Great Society. These experiments have failed, in my opinion, to achieve the hopes and the aims and the objectives of the people who promoted them so enthusiastically. The question is this: Will our society have the will and the sense to disband those aspects of those programs that have become a failure? I am, myself, optimistic—not from a short run point of view but from a long run point of view. There is a widespread disillusionment with the proposition that the way to solve every problem is to throw somebody else's money at it. There is a widening recognition on the part of the public that we need measures that will cut government down to size. The so-called tax revolt is very real in my opinion. I am encouraged by the number of states which have adopted constitutional amendments to limit spending by state government. I am encouraged by the strength of the popular will behind the corresponding constitutional amendment at the federal level to limit federal spending. It is even encouraging to hear all the lipservice that is being paid in Washington to the idea of cutting down the size of government and of balancing the budget—even though it is only lipservice. Even though the programs that are proposed are, in my opinion, ill-suited to achieve the stated objective, it is clear that the problem has been recognized. There is an old saying that hypocrisy is the tribute which vice pays to virtue. The hypocritical statements emanating from Washington about the desire to reduce government spending are the tribute which is being paid to the widening and broadening sentiment on the public at large. This is a democracy; and sooner or later the will of the voters will prevail, so I am optimistic that we shall learn from our experience and correct our errors.

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