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Right from the Start?

What Milton Friedman can teach progressives.

MILTON FRIEDMAN: A BIOGRAPHY BY LANNY EBENSTEIN • PALGRAVE MACMILLAN • 2007 • 272 PAGES • $27.95

Lanny Ebenstein's *Milton Friedman: A Biography* comes out at what is both a bad and a good time for us. We mourn the loss of the biography's subject, who died last November. And we will never now know what the late libertarian economist thought about the book—which is too bad, because his thoughts would have been lively, instructive, and optimistic about us and our future. Nevertheless, Ebenstein's unintentional timing is fortuitous because it provides a well-thought-out, if largely biased, roadmap for any discussion of Friedman's legacy. And while that legacy will inevitably be more appreciated by those on the right, and in particular those with a strong libertarian leaning, it would be wrong for his purported intellectual adversaries to give him the short shrift. As a first-class intellect, Friedman provides us

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with a worthy adversary, one that challenges our assumptions and prescriptions, and in so doing prods us to improve ourselves and our ideas. But, while he is rightly credited with providing intellectual impetus to the rise of the right in the latter half of the twentieth century, he also leaves behind a surprisingly liberal legacy. Indeed, many of his ideas, most notably the "negative tax" (later adopted as the Earned Income Tax Credit), have become central parts of the liberal policy agenda. Which means that, while Friedman will always occupy a place in the conservative intellectual history, he should receive credit from liberals as well.

Ebenstein covers a lot of material with an engaging, lively style, and he does so in a relatively short space. And there is a lot to cover. His subject was one of the top handful of professional, technical research economists in the second half of the twentieth century; one of the very best and most open-minded teachers, someone who truly understood the value of a diversified intellectual portfolio, and that education was about the growth of the student rather than the cloning of the teacher; among the top echelon of public intellectuals; and, as many fellow economists and policymakers knew well, one of the most lively and curious dinner partners.

Milton Friedman was born in 1912 in New York City to immigrant parents. Somewhat surprisingly for a libertarian, he always called himself one of the world's supremely "lucky"—rather than "skillful" or "meritorious"—people, having managed, despite his family's relative poverty, to graduate from Rutgers University at the start of the Great Depression, before going on to get a master's in economics from the University of Chicago in 1933. Like many young professors at the time, he couldn't make an academic career during the Depression; he was let go by the University of Wisconsin, probably primarily for being Jewish. But he did not despair of making a go at being an economist. In the late 1930s he hooked up with the National Bureau of Economic Research's Simon Kuznets and Arthur Burns, worked for the U.S. Treasury during World War II (where he was one of the designers of our current system of income-tax withholding), earned his Ph. D. from Columbia University in 1946, and finally landed on his feet at the University of Chicago.

Back then, Friedman was relatively liberal in the American sense. He had trust and confidence in the market, yet he also thought that Franklin Roosevelt's New Deal, while destructive in a considerable part of its detailed policies, was worth doing. He believed that it was, on balance, a positive contribution to economic recovery. Nevertheless, there are more than hints of the later libertarian in his doctoral dissertation, entitled "Income from Independent Professional Practice."

Friedman—correctly—viewed the high incomes of independent professionals as being, to a considerable degree, the moral equivalent of a racketeering enterprise: Using the government to seize control over licensing under color of guaranteeing high quality standards, the true aim of professional licensing was to restrict entry (especially of religious, ethnic, and racial minorities) and so guarantee high incomes to a favored few. Generalizing from this study would underpin all of Friedman's arguments when cornered: "Yes," he would say when debating opponents who thought they had him trapped, "this market may be failing—but any attempt to use government to fix it will only make matters worse."

Friedman rapidly became the intellectual leader of the macroeconomic wing of the Chicago faculty, otherwise known as the monetarist wing—those economists who focused on the banking system and the money supply as the keys to understanding the dynamics of inflation and unemployment. By 1951 he was already a superstar, having won the John Bates Clark Medal, awarded every second year to the outstanding American economist under 40. The next 15 years recorded his meteoric rise to the top of his profession: 1953 saw him publish his *Essays in Positive Economics*; in 1956, he edited *Studies in the Quantity Theory of Money*, the book that restored Chicago School monetarism to respectability in technical economics; in 1957, he published *Theory of the Consumption Function*; 1962 saw the birth of Friedman the public intellectual with *Capitalism and Freedom*; in 1963, together with Anna J. Schwartz, he wrote *Monetary History of the United States*; and in 1967 he gave his landmark American Economic Association presidential address, "The Role of Monetary Policy."

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Relatively early in his Chicago days, Friedman swung to the libertarian edge of the political and economic spectrum, having, in his later words, woken up to reality. I don't want to say to the right: drug liberalization, an end to the military draft, civil rights, government out of the bedroom, and free immigration were not right-wing causes even then. But in any case, by the early 1950s, his respect for even the possibility of government action was gone. His grudging approval of the New Deal was gone, too: Those elements that weren't positively destructive were ineffective, diverting attention from what Friedman now believed would have cured the Great Depression, a substantial expansion of the money supply. The New Deal, Friedman concluded, had been "the wrong cure for the wrong disease."

Ebenstein covers this as a triumphal march, as the victory of rationality and truth, first in Friedman's mind and then in his influence over the broader world, as Chicago became the dominant school within American economics, supplanting the high post–World War II tide of American social democracy. But to do so, Ebenstein papers over the inconsistencies, conflicts, and errors of Friedman's thought. Regardless of how intelligent and influential he was, Friedman was the first to acknowledge his critics, and an even-handed biography would have done the same. Including criticisms against him also would have helped explain to those on Friedman's left why he matters to us. Namely, we are interested in Friedman as intellectual adversary—where his arguments are strong enough to make the reality-based among us rethink our positions and change our minds, and where his arguments lead us to strengthen and better understand our own. As John Stuart Mill wrote in his "Essay on Coleridge," every liberal should pray for an intelligent conservative intellectual adversary: "Lord, enlighten thou our enemies. Sharpen their wits, give acuteness to their perceptions, and consecutiveness and clearness to their reasoning powers: we are in danger from their folly, not from their wisdom; their weakness is what fills us with apprehension, not their strength." Milton Friedman was the answer to our prayers.

Part of what made Friedman a worthy adversary for American liberals was that he had a fully formed worldview, one that started with a bedrock commitment to people, to their ability to make judgments for themselves and to decide what they like best. Out of this commitment grew an imperative to maximize individual freedom. On top of that came the judgment that free markets are almost always the silver bullet to solve all of society's problems, as well as a powerful conviction that the facts, if honestly examined, will always be on his side. And on top of that was layered a fear and suspicion of government as an easily captured tool for the enrichment of the cynical and powerful, who grab what they can.

Friedman hated government and society sticking their nose into people's private business. He scorned government regulation of all kinds—regulators were, he thought, inevitably captured by those they were supposed to regulate. As a result, they regulated not in the public interest but in the interest of the companies where they hoped to get jobs when they left the government. He hated big government spending. He hated budget deficits—cynical politicians could use them to pretend that the costs of government were less than they were and push into the future the raising of taxes to pay for spending into the future. He sought to inoculate citizens against such political games of three-card-monte: "Remember," he would say, "to spend is to tax."

What's more, Friedman sharply parted from his own teacher, Henry Simons, and from an earlier Chicago tradition that had seen big business as a force as dangerous as big government. Simons had thought that the anti-trust wing of the Federal Trade Commission (FTC) ought to be the most important arm of government, dedicated to breaking up monopolies so that no American was ever in the position of having to accept the terms they dictated. Friedman and his generation at Chicago disagreed. FTC lawyers, they thought, would make sure that anti-trust policies as actually implemented would do more harm than good. It was better, they thought, to let the market deal with things itself: Where there was a monopoly making big profits, there was an incentive for clever people to find a way to compete with it. And if the profits weren't big enough to attract entry by competitors, then potential competition had already pulled the monopoly's fangs and rendered it harmless.

But this antipathy toward the state masks a Friedman more amenable to contemporary liberal values. For Friedman hated government—except when he didn't. To be sure, the generation of libertarians to follow Friedman wanted to eliminate government completely. Have a dispute with your neighbor? Agree with him to pick 12 of your other neighbors to adjudicate. If the neighbor doesn't accept the judgment? Round up a posse to deal with the situation using your unalienable rights to bear arms. Friedman never went there. He had no problem with governments that declared and enforced property rights, that adjudicated contracts, that even, in certain specified situations, imposed extra taxes to counterbalance externalities or provided social insurance where transactions costs seemed to keep the requisite markets from existing. London Mayor Ken Livingstone's congestion tax on cars in central London is Friedman's idea. Friedman's negative income tax is one of the parents of what is now America's largest anti-poverty program, the Earned Income Tax Credit. Perhaps, you could get Friedman to say, in a first-best world you wouldn't need a negative income tax, because people would sign up when relatively young for their own wage-insurance pools. But he would call that a sterile argument, given where we are now. Moreover, a negative income tax would be administratively cheap and effective, and it would remove the intrusive and offensive nanny-state over-regulation of the lives of the poor that the existing welfare system imposes. Few liberals today would disagree.

Most importantly, in Friedman's mind, the government has a very powerful and necessary role to play in keeping the monetary and banking system working smoothly through proper control of the money supply. If there was always sufficient liquidity in the economy—enough, but not too much—then you could trust the market system to do its job. If not, you got the Great Depression, or hyperinflation. Thus, it was Friedman's belief that the government was required to undertake relatively narrow but crucially important strategic interventions in order to stabilize the macroeconomy—to keep production, employment, and prices on an even keel.

In this, Friedman was in the same chapter, if not on the same page, as John Maynard Keynes, the economic giant of the previous generation whose doctrines and influence Friedman worked tirelessly to supplant. The Great Depression had convinced Keynes that central bankers alone could not rescue and stabilize the market economy. To Keynes, stronger and more drastic strategic interventions were needed to boost or curb demand directly. Friedman and his coauthor Anna J. Schwartz argued in their *Monetary History of the United States* that this was a misreading of the lessons of the Great Depression, which in Friedman's view was caused by monetary mismanagement (or perhaps could have been rapidly alleviated by skillful monetary management). Over the course of 40 years, his position carried the day: Federal Reserve Chair Ben Bernanke holds Friedman's view, not Keynes's.

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Nevertheless, Friedman was not an advocate of a fully automatic system, such as a gold standard. Under a gold standard it is possible for the money supply to collapse. If people start to fear that the banks to which they have entrusted their savings are shaky, they will go to the banks and—under a gold standard—demand that the banks give them their money back and give it back in gold. But with each dollar in gold that depositors withdraw, any banking system has to call in perhaps five or more dollars' worth of loans in order to raise cash to keep from being overwhelmed by demands for liquidity. Fear on the part of depositors leads to a drying-up of capital and liquidity for businesses, and ultimately to economic depression.

It is here that Friedman and Schwartz felt the Fed had made its key mistake during the Great Depression. The stock market crash of late 1929, the recession that had already begun that June, the existing agricultural depression, and other news that shook confidence in the banking system led depositors to withdraw money from their bank accounts. The calling-in on loans that followed led to a steep fall in the money supply, in the liquidity of the economy. And the Federal Reserve stood by. It did not—as Friedman thought it should have—take every active step it could to keep the economy liquid. It did not furiously print currency. It did not frantically buy Treasury bonds for cash from all comers. Instead, it followed what it thought was a "neutral" monetary policy. And it was this neutrality that, in Friedman's view—and in Bernanke's, as well as my own—made the Great Depression so great. This is not exactly the same view as Keynes, but the differences are smaller than most people realize.

To be sure, Friedman always said that he favored a minimalist government, a "night watchman" state only—but a government nonetheless. Establish property rights. Enforce contracts. Prevent violence and theft. Defend the country. Keep the economy liquid by keeping the monetary aggregate M2 on a stable growth path. That, to him, was a minimalist government. But the last of these sticks out like a sore thumb: What is so special about the banking industry that the government must respond to a fall in demand for its services (for that is what going to the bank to pull out your deposit in gold constitutes) by providing it with a huge, immediate subsidy (for that is what buying up banks' Treasury bonds for cash at their normal valuation constitutes)? And, if Friedman's detailed study of the banking sector led him to make an exception from laissez-faire for this industry, who is he to say that a similarly detailed study of other industries would lead to similar conclusions about useful deviations from laissez-faire? And we have not mentioned that the "night watchman" state is itself a very powerful enterprise, able to make and enforce its own judgments about who owns what against not just against roving bandits, but local notables and even its own functionaries. Friedman's minimal state is not so minimal, after all.

Friedman felt that his ideal state was the right one, but someone who reaches a different formulation can still agree with him on many of the same first principles. Indeed, it is by following through on these tensions in Friedman's thought that I, at least, am able to feel the power of his arguments and yet retain my own uneasy combination of neoliberalism and social democracy.

This is not to say that Friedman's legacy is all positive. Indeed, One of his closest ideological fellow travelers, Judge Richard Posner of the Seventh Circuit, worried about Friedman's "dogmatic streak," which took his "belief in the superior efficiency of free markets to government as a means of resource allocation" as "an article of faith, and not…a hypothesis." Posner claims that Friedman found the ability of Scandinavian nations, particularly Sweden, to achieve and maintain very high levels of economic output despite very high rates of taxation almost to be a personal affront. And, in the long run, this faith crippled the intellectual movement of which he was the head. Sometimes government failures are greater than the market failures for which they purport to compensate. Sometimes they are not. We badly need a sophisticated, flexible, and reality-based intellectual toolkit to analyze different cases. We do not have one, in part because Friedman's anti-government faith blocked his spear-carriers from helping to develop it.

But, perhaps more seriously, Friedman ducked the big questions regarding the relationship between economic freedom and political liberty, and he was completely incapable of seeing that political liberty is both a negative and a positive liberty: freedom from tyranny and oppression but also the freedom and power to decide on and accomplish our common purposes. These are the master questions of history and moral philosophy, and for all his brilliance and hard work, Friedman is of absolutely no help in answering them. As Posner says, Friedrich Hayek's *Road to Serfdom* "flunks the test of accuracy of prediction . . . [The] view that socialism of the sort that Britain embraced under the old Labour Party was incompatible with democracy [is] extreme and inaccurate." Yet Friedman bought into that Hayekian view. And in so doing, he ultimately led his followers, and tried to lead the rest of us, down a false path. D