Milton Friedman: A Tribute

12 March 2007

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Chaired by Greg Lindsay

Speakers
Maurice Newman
Peter Swan
Mark Harrison
Alex Robson
Wolfgang Kasper

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Contents

Foreword

There is no question that Milton Friedman was one of the towering intellectual figures of the last century. 'As to a man's influence on the theory and practice of political economy in his own age,' Wolfgang Kasper says here, 'Friedman only compares to Adam Smith.' Friedman's contributions to scholarship led to his being awarded the Nobel Prize for Economics in 1976—as the citation states, 'for his achievements in the fields of consumption analysis, monetary history and theory, and for his demonstration of the complexity of stabilization policy.' Along with his great friend George Stigler and with Friedrich Hayek, Friedman was at the first meeting of the Mont Pelerin Society, founded in 1947 to defend the free society against ideological and political encroachments on universal moral standards, the rule of law, private property, and free markets. Like Hayek and Stigler, Friedman served as the Society's president, from 1970–72.

Friedman visited Australia a number of times, initially in 1975 at the tumultuous end of the Whitlam era. Then, the Centre for Independent Studies (CIS) was yet to be born, but on Friedman's second visit, in 1981, the CIS organized a sellout public forum. In his opening remarks there, Friedman joked that either the ideas about personal and economic freedom promoted by the CIS were becoming very popular, or that the CIS had set the ticket price too low. The CIS published the transcript in a little booklet soon afterwards.

Milton Friedman died on 16 November 2006, at the age of ninety-four. In little booklet, the CIS collects the addresses of five prominent speakers at the tribute it hosted on 12 March 2007 to commemorate Friedman and his contribution to Australia's political and economic life.

Opening this collection, Maurice Newman, who organised Milton and Rose Friedman's visits to Australia in 1975 and 1981, reflects on Friedman's Australian visits and on his influence on thinking about economic policy around the tumultuous final days of the Whitlam Government. In the following piece, Peter Swan examines how Friedman-like policies have contributed to Australian government control of inflation in the post-Whitlam era.

The next two contributions, from Mark Harrison and from Alex Robson, demonstrate the kind of contribution Friedman was able to make on microeconomic issues with profound social implications. Harrison focuses on Friedman's influence on Australian education policy, discussing the extent to which his proposals have been implemented in Australian programs such as the Higher Education Contribution Scheme (HECS). Robson recounts how Friedman's analysis of the relative costs of the US running an all-volunteer military, as opposed to a partially conscripted one, contributed to the ending of the draft in 1973.

Finally, Wolfgang Kasper's speech concludes this published version of the CIS tribute to Friedman, not only summarising his achievements in economics, but also giving him the acclaim he deserves for advancing the cause of personal freedom through economic freedom. 'He saw free markets as the best instrument known to man to empower the poor and enterprising,' says Kasper. Friedman's careful research and original insights have provided generations of political and economic leaders with some of the intellectual tools they have needed to enrich and free the people whose welfare they are entrusted with. The wealth and liberty of millions will be his greatest and most enduring legacy.

Greg Lindsay
Executive Director
The Centre for Independent Studies

How Friedman rallied Australian free thinkers

Maurice L. Newman
Chairman, ASX Ltd

In late 1974, I was beginning to despair for the future of Australia. The economy was in free fall, including employment and the currency, in a highly inflationary environment. The Whitlam Government regularly mocked markets and business, and engaged endlessly in mindless class warfare as if embarking on its own version of the mad and irrational Cultural Revolution. There were few credible voices of reason to be heard—many who tried to speak out were widely scorned.

I became aware of Milton Friedman through his regular columns in *Newsweek,* and thought that his messages were spot-on for Australia. I decided to call him at the University of Chicago and extended an urgent invitation, explaining my fears and concerns.

He had never been to Australia, and to my surprise and delight, said yes on the spot. He agreed on what, even then, was a nominal $5,000 fee, plus travel and accommodation for himself and his wife, Rose.

Maurice L. Newman AC

Maurice L. Newman, chairman of the CIS from 1985 to 1995, has been the chairman of the Australian Securities Exchange since 1994.

Mr Newman's forty-year career in the financial services industry culminated in his role as the executive chairman of the Deutsche Bank Group in Australia and New Zealand from 1985 to 1999.

He is currently the chairman of the Australian Broadcasting Corporation, the chancellor of Macquarie University, the chairman of The Taronga Foundation and the Australian Father's Day Council, the director of the Queensland Investment Corporation, an advisor to the Marsh Group of Companies, a member of the Business Council of Australia's Chairmen's Panel, a patron of the Committee for Economic Development of Australia, and a civil patron of the Royal Australian Naval Reserves' Professional Studies Program.

I then had the job of persuading my partners. It was not an easy sell. Milton Friedman was relatively unknown in 1975 Australia. When I went to the Mitchell Library to do some research, not one of his books could be found, even though they were catalogued. Was removing his books part of the Cultural Revolution, I wondered? I still find it strange. Remember, in 1975 there was no internet alternative.

While some businessmen had heard of him and were enthusiastic, still others were not. Likewise with many academics and journalists. They saw Milton as too radical, and tried to paint him as a sort of hard-hearted capitalist extremist. His views were misrepresented and ridiculed. It took leadership from Federal Treasury and the Reserve Bank to give the visit an official blessing before many business people would commit to supporting it. It was a lesson to me of how quickly and easily governments with the power of patronage can silence people.

Friedman met with Bill Hayden, who was then Federal Treasurer, together with selected members of the Labor Party, Coalition, Shadow Ministers, the Treasury, Reserve Bank, business people, and academics. He appeared on national radio and television. He participated in a seminar conducted by the Graduate Business School Club and a public dinner for five hundred people at the Wentworth Hotel. He had an impact on everyone he met, which in the main was overwhelmingly positive.

By every measure, Milton Friedman's visit exceeded my wildest expectations. This little man with a giant intellect captured the imagination of everyone. His capacity to distil the most complex ideas to their basic elements was powerful and disarming. His impish, almost childlike, openness often hid a hard intellectual edge that he generally reserved for people who disagreed with him without well-reasoned arguments. But this was more than offset by his genuine warmth, charm, and the clarity of his thoughts. I can tell you that one week with Milton Friedman was an exhausting exercise, with his constant challenging of your views.

I wanted Milton Friedman to heighten awareness of the dangers of inflation and to offer cures consistent with the maintenance of liberty and free enterprise. He did that. In fact, he did much more than that, by exposing the paucity of free market thinking in Australia at that time.

He pointed to the major costs of inflation and the false cures that governments try to take. He worried about the inability of governments or the community to learn from their mistakes. The movement towards the welfare state was a move by good people trying to do good in the wrong way. In this way, the welfare state hurt the poorest people in the community. He was opposed to middle-class welfare and welfare for business.

In December 1975, eight months after Friedman's visit, the Senate withheld supply, the Whitlam Government was dismissed, and an election was called.

On the day before the election, *The Age* ran an editorial that observed, 'We think the Whitlam Government underplayed the power of inflation to debauch the currency and destroy social values.'

It went on to talk about an issue 'little spoken of in the campaign. This issue is philosophical and hard to define: it has to do with the sort of Australia people want. An Australia in which a benevolent, but permissive, state gets bigger and the individual smaller. Or, an Australia in which the dignity of the individual and the concepts of self-help and personal initiative are paramount.' This was vintage Friedman, not vintage *Age,* and there is little doubt in my mind that the influence of Milton Friedman had rubbed off on *The Age*'s editorial writer.

I believe that, like that editorial writer, voters were also influenced by Friedman's visit. I am sure they had formed their own opinions of the incompetent Whitlam Government and the series of catastrophes it had wrought upon them, but it was Friedman's simple articulation that gave them a clearer picture of the issues and a better understanding of the risks.

In the event, these people voted for change, and, despite the rage of Whitlam and his followers, Malcolm Fraser won in a landslide that delivered him an overwhelming mandate.

My relationship with Milton and Rose developed and, in 1976, I had the pleasure and honour of being their house guest at Capitaf, their small farm in Ely, Vermont. Milton had invited me to the regional meeting of the Mont Pelerin Society held at Hillsdale College in Michigan. There I was exposed to more free market literature and thinkers than I knew existed, and I returned to Australia loaded with books and pamphlets and an address book of contacts. These included Antony Fisher, who went on to establish the Atlas Foundation and financed the creation of the London-based Institute of Economic Affairs, run by two wonderful intellects, Ralph Harris (later Lord Harris of High Cross) and Arthur Seldon. The IEA was a spectacular success, and had much to do with setting the agenda for Margaret Thatcher and public policy reforms.

My visit to Hillsdale made me determined to build on the success of 1975, and I maintained contact with those free market supporters I had met during Milton's stay. Treasury and the Reserve Bank of Australia (RBA) were outstanding contributors to the debate, and the RBA invited monetarists like Mike Parkin and David Laidler to Australia to do work on monetary policy. A number of seminars were held, and the period following Friedman's visit saw the building of a momentum, both in relation to monetary economics and free market thinking generally.

During this period, Antony Fisher came to Australia, and it was then that I was introduced to Greg Lindsay, who ran his Centre for Independent Studies out of a garage. During this time, I became a member of the Mont Pelerin Society and kept in regular touch with the Friedmans. All of this developed my education and interest in free market economics.

Despite two clear mandates, Malcolm Fraser's government wasted opportunity after opportunity to modernise and free up the Australian economy. It was largely a 'do nothing' government, in stark contrast to its predecessor.

Under Bill Hayden, the Labor Opposition renewed itself and began to assemble a formidable front bench. Hayden and his chief of staff, Paddy McGuinness, refined their own economic thinking and began to reflect this in policies that were in the main more sound and rational than the government's.

Here, again, the 1975 visit of Friedman was important. Paradoxically, it was the Labor Party, not the Coalition, that offered a way through the institutional rigidities of the times.

Milton and Rose Friedman returned to Australia in 1981. Again, I began to despair at the lack of progress being made. The visit was intended to reinforce the good work done in 1975 and develop some political will in government.

Unfortunately, my abiding memory of the 1981 visit was meeting with Prime Minister Malcolm Fraser, during which Fraser regularly referred questions to Treasurer John Howard and rudely talked over him as he tried to answer. Rather than listen, he berated Friedman for America's agricultural policies and used them to defend Australia's then protectionist ways. I remember Billy Snedden raising his considerable eyebrows at me in frustration and embarrassment. It was another wasted Fraser opportunity. Friedman later confided in me that he had had meetings in recent times with many leaders, including Margaret Thatcher, Golda Meir, and Prime Minister Zenkô Suzuki of Japan, but he had never experienced anything as unpleasant or disappointing as the meeting with Malcolm Fraser. I was crushed, but saw hope in the Labor Party. This was rewarded through the Hawke Government and a supportive John-Howard-led opposition.

The Friedmans' last visit to Australia was in April of 2005, when they transited through Sydney. Even in their nineties they were active and alert. They flew non-stop back to San Francisco after a day in Sydney, but not before I drove them to Macquarie University and got them to set foot on the campus.

Milton Friedman's contribution to Australia's economic progress and public policy is, in my view, immeasurable. It is not too great a stretch to give him some credit for our sixteen years of uninterrupted growth.

That said, for me, Milton's greatest and most enduring legacy is not so much becoming a voice for reason in an hour of need, but that he became the rallying point for free thinkers all over Australia. It is not least because of him that we have a vigorous and dedicated band of people, as exemplified by Greg Lindsay and the CIS, who continue to uphold the principles of life, liberty, and property. Those of us who were around in the three years to 1975 may appreciate that something as precious as individual freedom should never be taken for granted, let alone left to politicians to protect.

Thank you

Friedman's impact on the conduct of Australian monetary policy[1]

Peter Swan
Scientia Professor
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With Milton Friedman's death at the age of ninety-four in November 2006, there passed away one of the greatest and perhaps the best known of economists of the twentieth century, and one of its finest intellects.[2]

It is debatable, but certainly arguable, that his ideas spurred the demolition of the Berlin Wall, the demise of the Soviet Union and of communism, the rise of Maggie Thatcher in the UK, and the magnificent success of the early Hawke-Keating Government. Hawke and Keating freed up the financial system, floated the dollar, and deregulated and privatised much of the economy. And Friedman's ideas surely laid the foundations for the great prosperity enjoyed by Australians under the Howard Government.

It is impossible to understand Milton's contributions to monetary policy without understanding the methodology that he promoted in his essay on 'positive economics' and applied throughout his lifetime.[3] He points out that it is not the realism of assumptions that matters, but rather their power to predict:

Peter Swan AM

Peter Swan is in the Australian School of Business at the University of New South Wales. In the Honours List 2003, he was appointed as a Member of the Order of Australia (AM). His citation was "For services to academia as a scholar and researcher and through contributions to public policy in the fields of economics and finance." UNSW appointed him a scientia professor in January 2003, in recognition of his international eminence in research. He is a long-term admirer of Milton Friedman and has been a CIS advisory board member. He wrote the CIS's first policy paper. His pro-competitive views have been influential in promoting privatisation, abolition of the two-airline policy, and reform of the financial sector and taxation, including security market taxation.

> Truly important and significant hypotheses will be found to have 'assumptions' that are wildly inaccurate descriptive representations of reality, and, in general, the more significant the theory, the more unrealistic the assumptions … A hypothesis is important if it 'explains' much by little, that is, if it abstracts the common and crucial elements from the mass of complex and detailed circumstances surrounding the phenomena to be explained and permits valid predictions on the basis of them alone.[4]

A classic example is the motorist who acts as if he can instantly solve the most sophisticated differential equations whenever he successfully overtakes another car. The 'unrealistic' assumption that motorists are trained in higher mathematics yields the correct prediction from the model of driving behaviour that it leads to.

Even today, Friedman's version of Occam's razor, the benefits of simplicity with the minimal structure required to give a result, continues to pay great dividends.[5]

Milton first arrived in Australia in 1975, just as Australia was transforming itself from close on a hundred years of being a slow-growing, inward-looking, protectionist economy to the vibrant, competitive, outward-looking, rapidly growing, and prosperous society, free of union domination, that we have become within an exceedingly short period of time.

My first thought when I attended Milton's lecture at ANU in 1975 was, 'what a magnificent breath of fresh air.' Maurice Newman had made an outstanding gift to the nation by bringing him out here.

I was very disappointed at not being able to get acquainted with him two years earlier, when I spent the year at the Chicago Graduate School of Business. There, I had lunch frequently with George Stigler (Nobel laureate, 1982), Milton's great friend and mentor. It was not until later, when I was at the Hoover Institute at Stanford, that I got to know Milton at the more personal level and was directly faced with his powers of argument. After Milton's formal 'retirement' from Chicago in 1977, he was affiliated with Hoover until his death.

Here are his words given at an Australian venue:

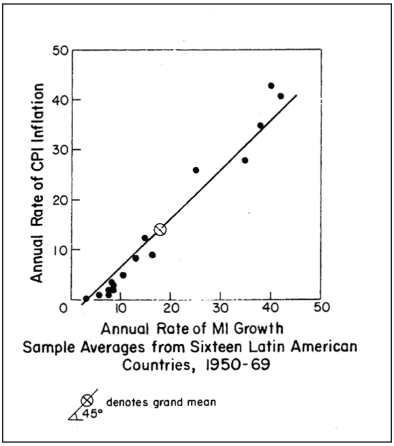
> But I think it is well to start by disabusing oneself of some ideas. As I said to begin with, there is always a tendency to look at local peculiarities. Yet, the fascinating thing is that this common experience transcends those peculiarities. Inflation in particular is not a capitalist phenomenon; it is not a socialist phenomenon.

> Yugoslavia has the highest rate of inflation of any nation in the European Continent. It is a communist society. Germany has the lowest rate of inflation; it is largely a capitalist market oriented society. Inflation is not a phenomenon of trade unions or of non-trade unions. Britain and Australia, which have a very high degree of trade unionism, have high rates of inflation, but Japan which has a very low degree of trade unionism and where I think no one can say that trade unions cause inflation, had an even higher rate of inflation a year ago than either Britain or Australia. On the superficial level, inflation is not a capitalist phenomenon, not a socialist phenomenon, not a trade union phenomenon. It is a printing press phenomenon. The immediate proximate source of inflation everywhere, under all circumstances, is a more rapid increase in the quantity of money than in output.[6]

Notice how clearly, simply, elegantly and beautifully he distils the classical idea of quantity of money as the determinant of the price level. He can convey to both the scholar and the man in the street the essence of the idea in just a few sentences. No room is left for doubt or equivocation. Few people could survive an intellectual onslaught from Milton Friedman. He is utterly convincing and, disturbingly, almost always right.[7] He is completely unlike the 'two handed' economist who says something with one hand and then qualifies or retracts it with the other.

Robert Lucas (Nobel laureate, 1995) establishes the empirical validity of the quantity theory as two long-term relationships: a given change in the rate of change of the quantity of money induces (i) an equal change in the rate of price inflation and (ii) an equal change in the nominal rate of interest.[8] Hence, as Irvine Fisher postulated, the real rate of interest adjusting for price changes is unaffected by the growth in the money supply and inflation.

Figure 1: M1 for sixteen Latin American countries, 1950–1969



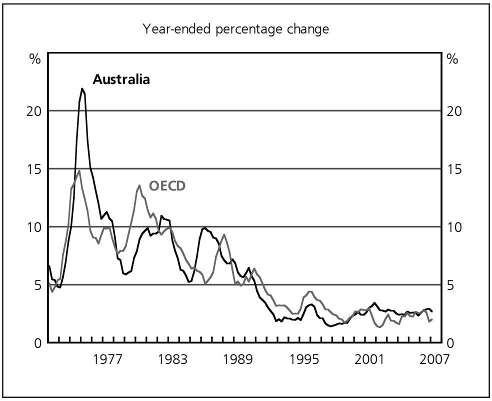
The relationship between the price level change and the average growth in the narrow definition of money, M1 (coins, currency, and cheque account balances), for sixteen Latin American countries, 1950–1969, is shown in Figure

1, which shows that the average growth rate in money narrowly defined almost perfectly explains the average rate of inflation across these countries.

Likewise, Lucas shows that with smoothed data, the two implications of the quantity theory hold very precisely for the US over the period 1955–75. Hence, Friedman was right to call inflation a monetary phenomenon and to recognise that the monetisation of government deficits rather than borrowing or raising taxes—that is, printing money to pay for goods and services—is the root cause of inflation.

I now turn to the dire situation that prevailed in Australia on Milton's arrival in 1975. It can be seen from Figure 2 that the inflationary situation in Australia was far worse than the OECD average and was well in excess of 20% per annum. This contrasts with the average rate of 4% that pertained for the 1960s. Unemployment was also extraordinarily high, at 4.6%, compared with the average figure of 1.6% for the decade prior to Whitlam's Labor government coming into power in 1973.

Figure 2: Australian and OECD Inflation, 1972–2007.



Sources: ABS, OECD.

In the 'Cairns Budget' of 1974–75, government expenditure was raised by 33%, and this 'irresponsible' behaviour was blamed for inflation that appeared out of control.[9]

According to Cairns, the massive deficit was justified on Keynesian pump priming grounds, even though it sent the inflation rate into the stratosphere and did nothing to reduce high unemployment by historical standards:

> The deficit was aimed directly at the economy to increase production, to get the economy going and to employ resources wherever there are resources available for employment.[10]

However, following the sacking of Jim Cairns over the Juni Morosi affair, and his replacement as Treasurer by Bill Hayden, one of the most responsible budgets was brought down in 1975–76.[11] It was the climate of opinion in favour of 'fighting inflation first' brought about by Friedman's visit, plus strong support from Sir Frederick Wheeler, Secretary to the Treasury 1971–1979, and John Stone, not to mention advice to Hayden from Trevor Swan, that reduced inflation to below the OECD average and close to 5% by about 1978. With a balanced budget, there is no need to print money to finance expenditure, and hence price stability can be achieved.

As can be seen from Figure 2, inflationary outcomes were exceedingly poor over the period 1978–1992, including the Fraser Government and Hawke-Keating governments. While there was essentially the pretence of monetary targeting based on M3 (broad money) up until 1984, as Stephen Grenville points out, it was no more than a 'conditional projection' established by the Treasurer.[12] It was recognised that unemployment was high due to the massive real wage spurt towards the end of the Whitlam regime.

The Hawke-Keating Government relied on the Incomes Accord with the trade unions to raise employment by depressing the growth in nominal wages while prices continued to spiral. Very little emphasis was put on inflation, and the Reserve Bank retained its inconsistent aims of targeting both full employment and inflation with the one instrument of monetary policy. There was practically no consistency in monetary policy, as advocated by Friedman, with a simple monetary growth rate rule. A policy of a rule rather than discretion was formalised in the 'time inconsistency' model of Finn Kydland and Edward Prescott, for which in 2004 they were awarded the Nobel Prize for Economics.[13]

In creating Paul Keating's 'recession we had to have' in the period 1990–91, the Reserve Bank raised interest rates by an almost unprecedented two hundred basis points in April/May 1988 and then subsequently over the next fifteen months by a staggering further five hundred basis points.[14] A number of banks, such as Westpac, were paying over 20% on certificates of deposit, so severe became the crisis. Whether the Reserve Bank simply wanted to slow the asset boom and wages growth and rein in balance of payments problems and overreacted, or was consistently and severely targeting inflation, is a matter of controversy. However, regardless of the motives, inflationary expectations were knocked out of the economy by the severe 1991–92 recession and price stability in the region of two to three percent per annum has been preserved until quite recently. We are now in the more dangerous 3.3% territory, and once again facing the prospect of a regime change.

Around this time, two propositions became accepted and a third went some way towards acceptance. These were all incorporated into the (2006) by the Treasurer and the Governor of the Reserve Bank: (i) the Reserve Bank would be able to pursue monetary policy independently of Government and the Treasury; (ii) the Bank was to ensure that inflation remained in the 2–3% band over the business cycle; and (iii) the Bank would only concentrate on inflation while downplaying the requirement to maintain full employment. 'These objectives,' the report states, 'allow the Board to focus on price (currency) stability while taking account of the implications of monetary policy for activity and, therefore, employment in the short term. Price stability is a crucial precondition for sustained growth in economic activity and employment.'[15]

These three major policy changes have been synonymous with the successful management of monetary policy over the last fifteen years or so. Moreover, it can be regarded as the necessary application of Friedman's policy agenda:

(i) The independence of the Reserve Bank from the direct dictates of the government is essential for a rules-based rather than discretionary monetary policy. Otherwise, the government would flood the economy with money by running a huge deficit come election time. Governments love to manipulate the political business cycle for electoral gain. Admittedly, the rule adopted was not strictly the Friedman money growth rule [see (ii) below]. Moreover, if a rules-based policy can be adopted, then, strictly speaking, who implements it is irrelevant. While it is true that Friedman was not an advocate of central bank independence, it is hard to imagine how any organisation acting purely at the whim of government could credibly implement a rules-based policy. A counter-argument is that since the 1980s the government has chosen not to monetise deficits, but rather has sold its debts at market interest rates. Unfortunately, the maintenance of such a policy, if it is at the whim of an elected government alone, is unlikely to be maintained under stress in the run-up to a critical election.

(ii) While the Bank targets inflation directly, largely using monetary policy to alter interest rates, rather than indirectly via a monetary growth rate target advocated by Friedman, this is still the embodiment of a Friedman-like policy objective, in which monetary policy is directed only at the inflation target.

(iii) The watering down of the full-employment objective means that the Bank can no longer use unemployment, or the exchange rate as an indirect means of manipulating unemployment, as an excuse for

> allowing inflation to get out of hand. Friedman's primacy of monetary policy targeting the one policy—moderate and stable inflation in the 2–3% band—has been achieved at last.[16]

Admittedly, the Bank's job has been made infinitely easier by two policy changes of fundamental importance:

(i) The adoption of the Campbell Committee reforms, together with the floating of the dollar in 1983, has taken the government out of the price-fixing role for both interest rates and the exchange rate, and made monetary policy possible for the first time. Prior to the adoption of these policies it was impossible for the Reserve Bank to control the money supply. Moreover, both policies were strongly urged by Friedman.

(ii) The abandonment of Keynesian pump-priming deficit budgets and the resort to the printing press indulged in by the 'Cairns budget' has been replaced by the surplus budgets of John Howard. Hence, the Reserve Bank has not had to cope with the monetisation of huge deficits (printing money) that it once did. Once again, Friedman's policies have triumphed.

Thanks to Friedman's urgings, central banks, including our own Reserve Bank of Australia, now focus on price stability. They no longer inflate the money supply by 'printing money' to fund profligate governments not willing to rein in spending or raise taxes. They no longer underwrite unions and courts that grant excessive wages by printing money in a futile attempt to 'correct' excessive wage increases and rising unemployment, shades of the Whitlam Government, Jim Cairns, and Clyde Cameron.

Paul Keating's 'recession we had to have' made possible the decades of low inflation and prosperity that we have experienced since then. It has enabled the Reserve Bank of Australia to focus on its single task of keeping inflation low.

When the Asian crisis hit, did we massively expand the money supply to counter rising unemployment as we would have done before Friedman? No! We allowed the Australian dollar to float downwards. All was well.

Australia and the world have lost a beacon. Milton Friedman played a major role in transforming us for the better. His departure is a sad loss.

Endnotes

1 Note that I have borrowed extensively from my own tribute to Milton on his death: Peter Swan, 'Friedman's ideas changed our world for the better,' (20 November 2006).

2 A useful description of some of Milton's contributions up until the award of the Nobel Prize in 1975 can be found in Niels Thygesen, 'The Scientific Contributions of Milton Friedman,' , 79 (1977), 56–98.

3 Milton Friedman, 'Philosophy of Positive Economics,' in (Chicago: Chicago University Press, 1953), 3–43.

4 As above, 14.

5 See William J. Frazer and Lawrence A. Boland, 'An Essay on the Foundations of Friedman's Methodology,' 73 (1983), 129–144, for a more philosophical discussion of Milton's contribution.

6 Friedman, 'Inflation, and the Management of Western Economies,' in (Sydney: Constable and Bain, 1975).

8 In their magnum opus, Milton Friedman and Anna J. Schwartz, (Princeton: Princeton University Press, 1963) describe in great detail the failings of the Federal Reserve System in the US, especially as they see it as something that greatly exacerbated the Great Depression of the early 1930s.

8 Robert E. Lucas, 'Two Illustrations of the Quantity Theory of Money,' 70 (1980), 1005–1014.

9 See, for example, Jerry Courvisanos and Alex Millmow, 'How Milton Friedman Came to Australia: A Case Study of Class-based Political Business Cycles,' School of Business, University of Ballarat, Working Paper 2005/03 (2005).

10 Quoted in Courvisanos and Millmow, as above.

11 According to Paddy McGuinness in the editorial for January–February 2003), 'Morosi was ignorant and paranoid, hated Treasury and any other critic of the current madness, and at one stage prevented Treasury officials having any direct access to the Treasurer, such that it seemed that no Budget could be formulated. (One story, emanating from that office, was that on hearing that a certain Milton Friedman was in Australia and was to visit the Treasurer she loudly demanded, "Who is this Friedman guy? What have we got on him?").'

12 Stephen Grenville, 'The Evolution of Monetary Policy: From Monetary Targets to Inflation Targets,' Reserve Bank of Australia Conference Paper (Sydney: RBA, 1997), 125, www.rba.gov.au/PublicationsAndResearch/Conferences/1997/Grenville.pdf.

13 Finn Kydland and Edward Prescott, 'Rules Rather than Discretion: The Inconsistency of Optimal Plans,' 85 (1977), 473–491.

14 Grenville, 'The Evolution of Monetary Policy.'

15 The Treasurer and Governor of the Reserve Bank, (2006), www.rba.gov.au/MonetaryPolicy/third_statement_on_the_conduct_of_monetary_policy_2006.html

16 There is an extensive literature on this agenda. It includes Ben Bernanke and Frederic S. Miskin, 'Central Bank Behavior and the Strategy of Monetary Policy: Observations from Six Industrialized Countries,' 7 (1992), 183–228; Bernanke and Miskin, 'Inflation

Targeting: A New Framework for Monetary Policy?,' 11 (1997), 97–116; Charles Goodhart, 'The Conduct of Monetary Policy,' 99 (1989), 293–346; Bradford De Long, 'The Triumph of Monetarism?' 14 (2000), 83–94; and with respect to Australia, David Orden and Lance A. Fisher, 'Financial Deregulation and the Dynamics of Money, Prices, and Output in New Zealand and Australia,' 25 (1993), 273–292; Guy Debelle, 'The Ends of Three Small Inflations: Australia, New Zealand and Canada,' 22 (1996), 56–78; and William Coleman, 'Is it Possible that an Independent Central Bank is Impossible?: The Case of the Australian Notes Issue Board, 1920–1924,' 33 (2001), 729–748.

The influence of Friedman's ideas on Australia's education policy

Mark Harrison
Independent Economic Consultant

I'm sure we can all remember the first time we read Milton Friedman. For Antony Jay, who produced the TV series *Free To Choose* and later co-wrote *Yes Minister*, it was Friedman's interview in *Playboy* magazine. For me, my Economics 1 lecturer John Logan, who spent many years at the Centre for Independent Studies, had *Capitalism and Freedom* on the reading list as suggested further reading. I'm not sure which is nerdier: to spend time in first-year university doing the further reading or to be reading *Playboy* for the articles.

The education chapter in *Capitalism and Freedom*

Friedman's chapter on education, which is a slightly revised version of a 1955 paper, examines the role of government in education from first principles. He comes up with two policy proposals that have dominated the policy debate ever since: a voucher system for schooling and an income-contingent loans scheme for higher education.Reading *Capitalism and Freedom* changed my life, not only starting a process that would convert me from socialism, but inspiring me to do a PhD in economics at the University of Chicago, where I wrote my thesis on income-contingent loans.

Dr Mark Harrison

Mark Harrison has a PhD in economics from the University of Chicago, and taught for ten years at the Australian National University and the University of Chicago. He is currently a visiting researcher at the Productivity Commission. As an independent economic consultant, over the past seven years he has written a number of reports on education reform for government inquiries, ministries of education, and private bodies in Australia, New Zealand, and Oman, as well as academic papers, popular articles, and a book.

Re-reading the *Capitalism and Freedom* education chapter in preparation for this talk was an exhilarating experience. I was astonished to find how much insightful analysis it contains. Ideas and arguments that I had thought were developed over the fifty years since Friedman wrote it are there, such as a concern about churning—taxing people throughout their lives to give subsidies mostly to the same people. He also examines what he calls *denationalisation,* probably a better term than the later *privatisation.* Although it was the first article to set out the case for more competition and a reduced role for government in education, it is still one of the best.

I'll quickly run through what Friedman proposed and then contrast it with what we have done in Australia.

Voucher proposal

Friedman argues that there may be a case for the government to make some amount of schooling compulsory and to subsidise it, but there is no case for the government to administer schools. That is, nothing can justify the nationalisation of the bulk of the education sector.

The voucher scheme separates the finance of education from its provision. Parents are given vouchers redeemable for a specified maximum sum per child per year if spent on approved educational services. The educational services could be provided by private enterprises operating for profit, or by non-profit organisations. The government would be limited to ensuring minimum standards. Market competition would determine the relative size of different school sectors, depending on how they satisfy parental preferences.

Key points of Friedman's scheme include:

- Vouchers would go to parents, not to schools.
- Parents could add their own spending to the voucher.
- Vouchers could be spent at for-profit schools.
- Vouchers should be given out at the local and state government level, not the national level.
- The voucher should be sufficient to cover full costs (capital and operating) at a for-profit private school providing a quality education.
- Parents should be allowed to use their vouchers not only at private schools, but also at government schools. Government schools would then have to compete with one another and with private schools.

Vouchers would go to all parents. A universal voucher would create an increased demand for private schools and a real incentive for entrepreneurs to enter the industry. Further, a universal voucher would build a bigger constituency for reform, is more likely to overcome political obstacles, and encourages residential desegregation.

The idea is to create a competitive market in education. A market system would shift decision-making from government agencies to the family and to the school level—where the incentives and information are superior. Allowing a private, for-profit industry to develop provides a wide variety of earning opportunities and offers effective competition to government and non-profit schools, giving them an incentive to improve. Competition is a powerful tool that can be used to benefit consumers, raise productivity, and help the poor.

Income-contingent loan proposal

Turning to higher education, Friedman judges that there is no externality or equity case for subsidising vocational higher education, and so students should bear the full cost.

Subsidies to higher education go mainly to those from middle and upper-class families. Some people from poor families benefit from the subsidies, but they are the ones among the poor who are better off. They have the human qualities and skills that will enable them to profit from higher education. Friedman concludes that no other government program is so inequitable.

But the financing of higher education is subject to capital market imperfections, which could result in underinvestment. These imperfections would be important if subsidies to higher education were abolished. There is wide diversity in the earnings of college graduates, and higher education is a risky investment. Traditional loans, where students borrow money and agree to pay interest and principal (like a firm selling bonds) would be a heavy burden on the less-successful. The possibility of low earnings resulting in default deters students taking on traditional debt, and it is a poor way to finance higher education.Friedman points out that:

> The device adopted to meet the corresponding problem for other risky investments is equity investment plus limited liability on the part of the shareholders.[1]

Expanding an idea he first put forward in 1945, Friedman proposes an income-contingent loan program as a way to finance education on an equity, rather than a bond, basis. In return for the funds needed to finance his education, the student promises to pay the lender a fraction of his future earnings. In effect, the lender buys a share in the borrower's earning prospects, and can pool risks across many borrowers.

His objective is for everybody, no matter what their race, parents' income, or social position, to have the opportunity to get higher education, provided that they are willing to pay for it either currently or out of the higher income the schooling will enable them to earn.

Friedman argues the private sector has not offered these contracts because of the difficulty and costs of enforcing them over a long period of time, and justifies a role for government on the basis of administrative advantage. The government could combine repayments with payment of income tax, and so involve a minimum of additional expense.

Friedman emphasises that the loan should be available for the student to spend at any recognised institution, that the whole scheme should be self-financing, and that the program parameters, such as the fraction of earnings to be repaid, should vary from individual to individual in accordance with any differences in earning capacity that can be predicted in advance.

He states it would be preferable for private financial institutions and non-profit organisations, such as universities and foundations, to develop the plan. He points to the great danger of the program parameters turning into a political football and being used as a means of subsidising vocational education.

James Tobin, a Nobel-Prize-winning Keynesian economist, was Friedman's main antagonist in macroeconomic debates. Yet he was an enthusiastic supporter of the income-contingent loan idea and was instrumental in establishing the Yale Tuition Postponement Plan at Yale University in 1971–72—the first ever income-contingent loan scheme. It helped many students from low-income families afford a Yale education, including one particular Yale law student named Bill Clinton. I'll leave you to decide whether the resulting externalities were positive or negative.

Australian education policy

At first glance, it may seem that Australia has adopted Friedman's education policies. Certainly, they have made more headway here than in the US. As with the other policies spoken about today, it was the Labor Party that adopted Friedman's policy suggestions. We have per head funding for students in private schools (and a relatively large private sector—one-third of students) and the Commonwealth was the first government to adopt an income-contingent loan program for financing higher education.

Although we have a voucher scheme, it falls far short of Friedman's proposal. The voucher goes to schools, not to parents. Direct payments to schools provide a greater threat to their independence than payments to consumers. One result has been increased regulation of private schools, reducing their autonomy and incentive to cater to parents.

Although the private schools provide some competition for state schools, we do not have a competitive market. The voucher is quite low, making it expensive to buy private schooling and difficult for the poor to attend. House prices in the zones of popular schools limit the choices of the poor between state schools. There is little competitive pressure on government schools in poor areas, protecting poorly performing schools and reducing the pressure to change them. It is no accident that Australia does well on international testing except for those from low-income backgrounds.

Our voucher scheme does not encourage entrepreneurs to open new schools. For-profit schools cannot receive funding. Indeed, explicit entry restrictions protect incumbents, both private and public. Often, a new school requires permission from its competitors to set up.

Income-contingent loans for higher education were recommended in the Wran report. Despite considering a voucher scheme and recommending an income-contingent loan, the authors did not acknowledge Friedman anywhere in the report, which was probably politically astute, if bad manners.

But it is probably just as well, as the Higher Education Contribution Scheme (HECS) is a shadow of what Friedman recommended. In the Australian scheme, student debt is indexed to the consumer price index, so the real interest rate on the loan is zero. Once the borrower's income reaches a threshold, he or she must pay a portion of it as repayment. Once the loan is repaid, a borrower has no further liability. The scheme is highly subsidised—the government gets a zero real rate of return from those who fully repay their loans, and a negative return from others.

Friedman intended equity financing to perfect the student loan market so that government subsidies could be reduced in the competitive US higher education system.

In Australia, HECS was used to cut the subsidy to higher education students, improving equity—although students remain generously subsidised. Further, the gains were partly offset by the scheme's interest subsidies. It did not introduce equity financing. Essentially, the scheme allows deferment of repayments when income is low. Nor did it create a competitive market. Australian universities remain under heavy central control.

In Australia, the focus of education policy has been on equity, rather than on Friedman's objective of expanding competition and consumer choice to promote freedom. Australia's education reforms have been well short of what Friedman proposed and the results have been disappointing. The reforms have been small steps in the right direction of improving equity, combined with steps in the wrong direction. They have failed to give power to consumers; instead, producer groups still rule. We could achieve more. Friedman's message is that competition works better than central direction, and that promoting freedom is the best way to promote equality of opportunity and improve equity and efficiency.

Endnotes

1 Milton Friedman, *Capitalism and Freedom* (Chicago: The University of Chicago Press, 1962), 103.

Milton Friedman and the all-volunteer force

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Milton Friedman was a longtime opponent of conscription and the military draft. To the best of my knowledge, he first publicly advocated abolishing the draft in June 1956, in his Wabash College Lectures. Those lectures later became Friedman's classic book, *Capitalism and Freedom*, which was published in 1962 by the University of Chicago Press.

In chapter 2 of *Capitalism and Freedom,* Friedman lists features of US government regulation at the time that he argues cannot validly be justified by classical liberal principles:

1. Price support for agriculture
2. Tariffs and export restrictions
3. Government control of output
4. Rent control
5. Minimum wages
6. Regulation of industries such as transportation
7. Government control of radio and television
8. Provision of retirement incomes
9. Occupational licensing provisions
10. Public housing

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11. Military conscription
12. National parks
13. Legal prohibition on carrying mail for profit
14. Publicly-owned toll roads

On conscription, he writes:

> The appropriate free market arrangement is volunteer military forces; which is to say, hiring men to serve. There is no justification for not paying whatever price is necessary to attract the required number of men. Present arrangements are inequitable and arbitrary, seriously interfere with the freedom of young men to shape their lives, and *probably are even more costly than the market alternative.* Universal military training to provide a reserve for war time is a different problem and may be justified on liberal grounds. [emphasis added]

Many philosophers throughout history have argued that each citizen owes a duty to the state to defend their country, and should therefore be compelled to serve as a soldier. But Friedman flatly rejected this line of argument. Like many of his policy prescriptions, Friedman's case against conscription consisted of two parts. On the one hand, he appeals to the principles of individual freedom; on the other hand, he explicitly makes a claim about the economic costs of the voluntary or market-based alternative. Both turned out to be equally important in persuading policymakers to finally abolish the draft. As usual, Friedman was right about both.

First, a bit of background. The draft using the Selective Service model had been used in the US in World War I by the Wilson administration, but was only reintroduced in 1940. It remained after that, through the Korean War and into the Vietnam War.

But when President John F. Kennedy signed the extension of the draft authority into law on 28 March 1963, the political mood was beginning to change, as draft calls began to involve greater numbers. In April 1964, prospective Republican presidential candidate Barry Goldwater announced his intention to end the draft if elected. Perhaps this is not so surprising—Goldwater's economic adviser was Milton Friedman.

In a matter of weeks after Goldwater's announcement, then-president Lyndon Johnson moved to defuse the issue and announced a comprehensive study into the issue to be undertaken by the Pentagon.

The Economic Analysis Division of this 1964 Pentagon Draft Study was headed by Walter Oi, who was a professor at the University of Washington and had earlier been a student of labour economist Gregg Lewis at the University of Chicago.

The decision to have economists study military personnel issues seems pretty obvious today, but at the time it was revolutionary. Oi and others would test Friedman's claim about the relative cost of the market alternative to the draft. Friedman's basic argument, which was developed more fully in a 1966 article, was that conscription imposed an implicit tax on draftees, as well as creating avoidance costs for those who applied for deferments. The pure budgetary cost of moving to an all-volunteer force with higher payroll costs must be balanced against the economic cost of the draft, which must include this implicit tax. He wrote:

> The argument that a voluntary army would cost more simply involves a confusion of apparent with real cost. When he is forced to serve, we are in effect imposing on him a tax in kind equal in value to the difference between what it would take to attract him and the military pay he actually receives. The implicit tax in kind should be added to the explicit taxes imposed on the rest of us to get the real cost of our armed forces. If this is done, it will be seen at once that abandoning the draft would almost surely reduce the real cost—because the armed forces would then be manned by men for whom soldiering was the best available career, and hence who would require the lowest sums of money to induce them to serve. Abandoning the draft might raise the apparent money cost to the government but only because it would substitute taxes in money for taxes in kind.

Oi's work on the 1964 Pentagon Draft Study was later published in the *American Economic Review* in 1967.[1] In it, he estimated these full economic costs and added considerable weight against the argument put by many Pentagon officials that the all-volunteer military would be unaffordable compared to the status quo.

Unfortunately, the report was withheld from the public for a year by the Johnson administration before finally being released in June 1966. Just two days later, Johnson issued an executive order that created a Presidential Advisory Commission on Selective Service (known as the Marshall Commission). In the spring of 1967, this Commission would end up rejecting the idea of a volunteer force as being too expensive.

But opponents of the draft were moving forward quickly with their own contributions. In December 1966, Professor Sol Tax, an anthropologist at the University of Chicago, held a four-day conference on the draft. Two of the speakers were Friedman and Oi. The papers were later published by the University of Chicago Press as *The Draft: A Handbook of Facts and Alternatives*.[2]

Attending that conference was a young Illinois congressman by the name of Donald Rumsfeld, who unsuccessfully pressed the Senate Armed Services Committee to establish an all-volunteer force. He also pushed the Johnson Administration to release the staff papers of the Marshall Commission, and, together with Missouri congressman Thomas Curtis, introduced a bill calling for a study of the feasibility of terminating the draft. Rumsfeld would later appear in the first episode of the original version of Friedman's *Free to Choose* video.

In the spring of 1967, *The New Individualist Review* (a student publication at the University of Chicago), published a symposium on conscription. This journal had begun in 1961, and the very first paper of the very first issue of the was entitled 'Capitalism and Freedom,' by Milton Friedman. The Spring 1967 articles included 'Why Not a Volunteer Army?' by Friedman, 'Conscription in a Democratic Society' by Robert Flacks (a sociology professor at Chicago), and 'The Real Costs of a Voluntary Military' by Oi.

At about the same time as this conscription edition of the *New Individualist Review* appeared, Ayn Rand gave a lecture in Boston, entitled 'The Wreckage of the Consensus,' which appears in later editions of her book *Capitalism: The Unknown Ideal*.[3] Rand noted that 'It is the "conservatives," the alleged defenders of freedom and capitalism, who should be opposing the draft.' She also wrote that

> One of the notions used by all sides to justify the draft is that 'rights impose obligations.' Obligations to whom? And imposed by whom? Ideologically that notion is worse than the evil it attempts to justify: it implies that rights are a gift from the state, and that a man has to buy them by offering something (his life) in return.[4]

This is very much the argument made by Friedman in his introduction to *Capitalism and Freedom*.

The intellectual pressure to abolish the draft was quickly gathering pace. In the same month as the University of Chicago conference, Professor Martin Anderson of Columbia University became a 'brains truster' for Richard Nixon, and was soon appointed Nixon's research director. In July 1967, Anderson wrote a memo for Nixon that echoed many of the arguments Friedman and others had been making—some nineteen months before the Presidential election.

Nixon had previously been a supporter of the draft. But in November 1967, after many months of work by Anderson, and after being shown recently published articles by Friedman and others, Nixon announced in the *New York*

Times that 'what is needed is not a broad based draft, but a professional military corps. The nation must move toward a volunteer army by compensating those who go into the military on a basis comparable to those in civilian careers.'

The all-volunteer military was to become an integral part of Nixon's campaign platform. On 17 October 1968, as official presidential candidate for the Republican Party, Nixon stated:

> Today all across our country we face a crisis of confidence. Nowhere is it more acute than among our young people. They recognise the draft as an infringement on their liberty, which it is. To them, it represents a government insensitive to their rights, a government callous to their status as free men. They ask for justice, and they deserve it.

I don't think Milton Friedman could have said it any better.

Democratic senator George McGovern also supported a strict reliance on volunteers, whereas Republican moderate Nelson Rockefeller and anti-war Democratic senator Eugene McCarthy were advocating a fair draft. Other volunteer supporters included conservative senator Robert Dole, whereas draft-reform-minded senators included Edward Kennedy.

Nixon won the election, and, on 27 March 1969, in one of his first acts as President of the United States, he announced the formation of a commission to achieve the goal of an all-volunteer force. Known as the Gates Commission, after its chairman, former Defense Secretary Thomas Gates Jr—Nixon directed this group to 'develop a comprehensive plan for eliminating military conscription.'

The economists on this commission included Milton Friedman and Alan Greenspan. The commission's staff included economists William Meckling and Walter Oi. The commission did indeed develop such a plan, but they also addressed the question of why eliminating the draft was a desirable policy, even though Nixon had not directed them to do so.

The fifteen-member committee was initially evenly split on this question. According to later accounts by Martin Anderson, Gates was chosen as chairman precisely because he was opposed to the whole idea of a volunteer force. Nixon jokingly told Gates that if he changed his mind and decided we should end the draft, then Nixon would know it was a good idea.

In any case, the commission ended up producing a unanimous report in February 1970. They were initially sceptical of the Friedman/Oi 'implicit tax' argument, but ended up wholeheartedly endorsing it. This unanimity was undoubtedly due in no small part to Friedman's powers of persuasion, as well as to the sheer weight of empirical evidence that the economists on the panel had gathered.

By April 1970, Nixon had responded to the Gates report and decided to move towards the all-volunteer force. The draft finally ended in January 1973. In the interim, Nixon signed legislation passed by Congress that introduced a random selection lottery into the Selective Service system. Ironically, this provided yet another reason why a move to an all-volunteer military was desirable: the drawing of balls from fishbowls t urned out not to be statistically random.

Friedman, his colleagues and students at the University of Chicago, economists, and classical liberal scholars played an integral part in the decision to abolish the draft. Of course, abolishing the draft had wide public support. But the crucial issue of the day was: what alternative should be adopted?

The all-volunteer force that ultimately came to be adopted was opposed by many, including military leaders, Democrats, and Republicans. But it eventually became reality and remains to this day. Friedman's role on the Gates Commission was very important in showing that a market-based alternative was feasible, but he also played a larger role in the intellectual debate leading up to that and afterwards. In his joint autobiography with wife Rose, Milton Friedman wrote that 'no public-policy activity that I have ever engaged in has given me as much satisfaction as the All-Volunteer Commission.'[5] Looking back, it is easy to see why.

Endnotes

1 Walter Oi, 'The Economic Cost of the Draft,' *The American Economic Review* 57:2 (May 1967), 39–62.

2 Oi, 'The Costs and Implications of an All-Volunteer Force,' chapter 22 in *The Draft: A Handbook of Facts and Alternatives*, ed. Sol Tax (Chicago: University of Chicago Press, 1967).

3 Ayn Rand, 'The Wreckage of the Consensus,' chapter 21 in Rand, *Capitalism: The Unknown Ideal* (New York: The New American Library, 1967).

4 As above.

5 Milton Friedman and Rose D. Friedman, *Two Lucky People* (Chicago: The University of Chicago Press, 1999), 381.

When thinking of Milton Friedman

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Milton Friedman! When I think of Milton, I see before my mind's eye his sardonic, impish half-smile half-grin from behind owlish glasses. He, five foot two inches in his socks, was not among the tallest of men, but certainly one of the greatest economists of the twentieth century. Indeed, as to a man's influence on the theory and practice of political economy in his own age, Friedman only compares to Adam Smith.

Like Smith, who changed the mindset of Britons, Europeans, and Americans from interest-group-ridden mercantilism to liberalism—and the prosperity and social optimism that bred—Milton Friedman was instrumental in the intellectual pioneering of the new ascendancy of the freedom idea in his lifetime.

When I think of Milton Friedman, I remember above all his humanist instincts. He saw free markets as the best instrument known to man to empower the poor and enterprising. He was a passionate defender of secure private property rights and the freedom to use them, because free markets had allowed his and his wife's Rose's parents—poor Jewish immigrants to New York from what is now Ukraine—to rise, and learn, and prosper. The leitmotiv of his work is that the 'dollar democracy' has the potential of liberating almost everyone, and

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Professor Wolfgang Kasper

Wolfgang Kasper served as the foundation professor of economics on the University of New South Wales Defence Academy campus, and was a senior fellow with the Centre for Independent Studies. As a young researcher, he worked on exchange-rate flexibility and met Milton Friedman. Kasper was invited to join the 'Bürgenstock Group,' a small international expert group initiated by Friedman, which proposed ways to overcome the rigidities of the IMF system. Later, he served as an advisor to the Malaysian Finance Minister, and at the Australian National University, the Reserve Bank of Australia, the OECD in Paris, and the Federal Reserve of San Francisco. Kasper was an early advocate of opening and deregulating the Australian economy.

does so more effectively than any sort of collective action ever could. Moreover, the free market is the best corrective to the abuse of illegitimate political and economic monopolies.

Milton Friedman's contributions to the sea changes in macroeconomic thinking that we have witnessed over the past quarter-century, have been highlighted in many obituaries. Let me just enumerate four to show how essential his applied analytical work was for the shift from fearful, dirigiste Keynesianism of the 1950s to the now prevailing—but alas, poorly practiced—confident liberalism in economic policy:

- In 1957, he showed in his *Theory of the Consumption Function* the consequences of the plausible idea that people's consumer spending is determined mainly by their *permanent* income expectations. This confronted the then dominant fear of the Keynesians that households would spend less and less of their rising incomes, so that government would have to step up investment spending to avert 'secular stagnation,' and that fluctuating household incomes needed to be 'stabilised' by countervailing, discretionary fiscal activism. The low household savings rates in the United States, Europe, and Australia that we now observe through boom and recession, show that Keynes was wrong and Friedman right.
- In 1963, based on earlier work on the quantity theory of money, he published, with Anna Schwartz, his monumental monetary history of the US, which disproved the then prevailing belief that the Great Depression had been caused by a failure of capitalism. He showed that massive policy failures of monetary management had in reality destabilised the economy. A large chunk of the US banking system had been driven into bankruptcy by undue Federal Reserve stringency. Friedman's emphasis on monetary policy went against the postwar credo that money doesn't matter and that Treasury tsars and parliaments will mitigate a cyclical boom in aggregate demand through timely public spending cuts and tax increases, and through an oncoming recession by spending boosts and tax reductions. The failure of discretionary fiscal policy during the first oil crisis of the early 1970s, at the very latest, proved Friedman right yet again and the Keynesians wrong. Nowadays, hardly anyone outside a few hidebound academic departments would deny that fiscal manipulation is destabilising and that we need a stable, independent central bank policy.
- In 1968, in his presidential address to the American Economic Association, Friedman showed that the Keynesian concept of the 'Phillips curve' was mistaken. Over the longer run, workers and unions could not be fooled—as Keynes had said they could in *The General Theory of Employment, Interest and Money*—by surreptitious inflation into accepting lower real wages, so that new

jobs are created. This notion had been popularised by New Zealand engineer and economist William Phillips, a one-time denizen of the Australian National University. We learned in the early 1970s—in Australia during the disastrous economic mismanagement of the Whitlam government—that Friedman was right yet again: structural rigidities, workplace regulations, and union power determine a *natural rate of unemployment*, which only microeconomic reforms can reduce. Some even learned from Friedman that inflation is a dangerous poison and should never be contemplated as a solution to any policy ailment.

- Since the 1950s and during the 1960s, Friedman argued for decontrolling the *exchange rate*, which was pegged by almost all governments under the Bretton Woods system that John Maynard Keynes had helped to set up in 1944. When regular currency crises endangered that very fabric of free capital flows and trade in the late 1960s, Friedman was instrumental in setting up a small international working party of academics and bankers to explore the details of free exchange markets. It took place on a mountain top in Switzerland in the summer of 1968. It was a week-long, tough but instructive intellectual wrestling match. I know, because I was there. Our surprising conclusion that this could indeed be done wiped out fixed exchange rates virtually overnight—and currency crises became history.[1]

Milton's microeconomic contributions included advocacy of school vouchers and of the merits of a professional military and a negative income tax for the very poor. These contributions were motivated by his humanitarian concerns about coercion and with the helpless and destitute. These writings do not fit in at all with the image, which his opponents have tried to depict, of a rabid defender of big capitalism. And you only have to go to Chile today to appreciate the wonderful social results of the reforms that the 'Chicago boys' initiated with a little bit of help from Milton. Monetary stability and liberal retirement-savings schemes are most popular in the poor barrios, not among the neo-socialist cappuccino intellectuals.

All these major contributions to changing the perceptions of public policy had two common threads:

- Friedman normally began as a derided iconoclast. He did the hard intellectual and empirical research and stood ready with crystal-clear policy ideas when crises and traumas made policymakers receptive to new ideas.
- His explications were based on the rational behaviour of individuals and the superiority of decentralised problem-solving over abstract, macro-mechanical concepts and the supposed wisdom and selfless action of political operators.

Friedman was to my mind so influential because he was such a committed, resourceful debater. He always argued over the issues and never played the man, though he could be ferocious and fearless in tackling errors, misleading self-seeking argument, and intellectual dishonesty. Milton had great charm, persistence, and high-wattage intellect on his side, as well as the brilliant help of his wife, economist Rose Director Friedman. I have met no one who could think so fast and incisively on his feet and who was so undaunted by the powerful. And he offered simple, plausible ideas for a complex world.

When thinking of Milton Friedman, I also remember the philosopher for whom economic freedom came first. In his wonderfully convincing masterpiece *Capitalism and Freedom,* he argued the case that people who enjoy secure property rights and the freedom to use them under the rule of law will sooner or later demand and obtain civil and political freedom. He disagreed with the Benthamites, who had argued for political empowerment and mass democracy as a way of giving people more freedom. By contrast, his was the pragmatic view that economic freedom will eventually give rise to a middle class that does not put up with political oppression. I know that this conviction motivated him when he went twice to China and met with the Communist Party leadership, and I believe that Friedman's optimism will eventually be proven right even with regard to the PRC.

Permit me to mention here that Greg Lindsay and I have just met with numerous young intellectuals in Africa. To their disappointment, their generation found out that political independence and the formality of the ballot had only replaced the moderate colonial oppressors with thuggish national governing elites. The new-generation Africans we met are all Friedmanite in that they see the need to fight for everybody's economic freedom as the vital first step to a freer, more prosperous Africa.

In the same spirit, Friedman instigated data collections to measure economic freedom over time and across nations, in order to stimulate informed analysis of this most fundamental of big ideas. The now well-respected Fraser Institute annual *Index of Economic Freedom* is the result. It has become a departure point for policy analysis around the world—another example of Friedman's commitment to quantitative analysis and his eye for what really matters in our discipline.[2]

Friedman's commitment to liberty made him a founding father and *spiritus mentor* of the Mont Pelerin Society, an international academy committed to the cultivation of freedom, whose originator, Friedrich Hayek, invited him to join in 1947. Much has been written about the differences between the classical liberal Chicago economists and the Austrian liberals. I can assure you that this was an amicable and productive relationship, although Milton had too much common-sense to ever subscribe to the wilder ideas of the Austrian-libertarian fringe (and so did Hayek).

I cannot conclude without mentioning Milton's acute wit and humour, which he used to great effect. When I last met him a few years ago around a small dinner table in San Francisco, I was invited to make my case for selecting immigrants by annual worldwide auctions for settlement rights, say, in the US, Australia and New Zealand. I argued that bureaucrats simply had not the knowledge to select the best immigrants, or were too corrupt, that the public would more readily accept new immigrants when they make a monetary contribution in exchange for benefiting from the physical and institutional capital that the incumbents had created, and that auction bids would give policymakers most instructive feedback. Friedman egged me on with twinkles of the eye, but a rather eminent US bureaucrat attacked me for wanting to 'sell passports.' When I about despaired at this tenacious hostility, Milton intervened: 'I am sure that everyone else here has understood Dr Kasper's argument. Why don't you think overnight about what he said, ring me in the morning, and I'll buy the two of you breakfast at the best place in town so that you can nut out your objections.'

Vintage Milton Friedman!

Alas, I never got that breakfast.

Endnotes

1 George N. Halm (ed.), *Approaches to Greater Flexibility of Exchange Rates: The Bürgenstock Papers* (Princeton, NJ: Princeton University Press, 1970).

2 The Fraser Institute, *Economic Freedom of the World,* http://www.freetheworld.com.

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