

"The Future of Capitalism"\*

by Milton Friedman

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The problem of the future of capitalism is really not a problem of economics, nor is it a problem simply of an enterprise system; it is fundamentally the problem of the future of freedom.

There is no country at any time in the history of the world that has been able to maintain a free political system unless the greater part of the resources of that country were organized by a free, private enterprise, capitalist system.

There is no exception, and hence, if we do not succeed in maintaining in a considerable part of what we now call the West – a shrinking area unfortunately – the essentials of a free enterprise system we shall not be able to maintain our personal and our individual freedoms.

The word “capitalism”, when you talk about the future of capitalism, is, by itself, not a very good description. It is, in fact, a very misleading description because every important society and every major economic group is in a large part capitalist. After all, the Soviet Union has a great amount of amassed capital, as has the United States. However, the distinction that is important is not between private capitalism and government capitalism. In every society most of the capital, properly defined, is privately owned. The most important source of productive capacity in any society, including the Soviet Union, is the skills and the abilities of the human beings who compose it.

And there is a sense in which even in the Soviet Union that labour power, that human ability, belongs to the individuals, although I recognize that in a society as authoritarian as the Soviet Union that is a limited sense.

The important distinction is not even the extent to which the market system is used although in principle you can distinguish two very different ways of organizing economic activity.

On the one hand you have the command economy which is like an army, in which the General tells the Colonel, the Colonel tells the Major and the Major tells the Lieutenant, and so on down the line; on the other hand you have an economy operating on the basis of voluntary co-operation, of purchase and sale through the market. Although, in principle, these are two different ways in which you can organize economic activity, in practice no complex society can operate strictly on the command principle. It is impossible.

There is no way in which people at the centre can know enough about all of the details of society, about what's happening everywhere, to be able to send the orders up and down the chain of command so as to achieve the desired results.

Even in a country which is as centralized and as collectivist as the Soviet Union I venture to suggest that the great bulk of all organization of economic activity in that country is carried on through market activities.

Take some very simple examples. The Soviet Union explicitly permits farmers, people in the countryside, to have small private plots and to sell the produce of these private plots through what are essentially open and free markets in the cities. According to the Soviet statistics themselves, those private plots account for about 3 per cent of the arable land of the Soviet Union. But the fraction of the total agricultural output which is attributed to them is between a quarter and a third of the total agricultural output of the Soviet Union.

I say **advisedly** the fraction which is attributed to them, because I am not by any means sure that all of that proportion is produced on those private plots; it may well be that some is produced on the government farms that surround them, but then come through those private plots.

But it is an interesting example of the extent to which, in order to have some incentive and to have some success in feeding their people, they have to rely on private markets.

The use of private markets in Russia goes much beyond that. The most active and extensive market in the Soviet Union is the Black Market. If something goes wrong in your apartment with your electricity, you will naturally be unwilling to wait the six months that is required before a Russian civil servant comes around to fix it—and as a result an active private market in home repair has grown up. In fact, what determines which official jobs people want to get in the Soviet Union is in very large measure the Black Market opportunities that different jobs provide. If you can get a job driving a truck then it's worth your while taking that job even at a low rate of pay, because in the off-hours you can earn a good deal by using the truck.

I don't intend to deliver an extensive discourse about the Soviet Union. I am trying to get across the point that when we talk about the future of capitalism we are not talking about the future of market arrangements or of large aggregations of capital. There is no possibility whatsoever of the future proceeding without markets and without large aggregations of capital, without there being capitalist societies in that sense, regardless of their political and economic organization.

The question at issue is a very different one: to what extent is there a future for free, private enterprise capitalism? That is the key question and, when we talk about it, we have to be very clear as to exactly what we mean. Free enterprise capitalism is often interpreted as a system in which enterprises are free to do what they want. That is a fundamentally fallacious idea; it is not what free enterprise is about and it is not what is important for the preservation of freedom.

The *Wealth of Nations* was not, as it is now so often regarded, a plea for a status quo; it was in fact a revolutionary document. It was a document calling for a drastic change in circumstances. The situation of Britain and of the rest of the world at the end of the 18th century was very close indeed to the situation that all of our countries are approaching today, that is, a situation of extensive governmental control. Adam Smith's book was an attack on mercantilism; it was an attack on the principle that government should decide who could trade with whom, what products could be imported, what products could be exported, and all the other paraphernalia of the command economy. It was followed in the course of the next 70 years in Britain, in the

United States and elsewhere as well by a dismantling of the governmental interventions and controls of the mercantilist period.

The repeal of the corn laws in Britain in 1846, which meant the repeal of tariffs on the import of food products, was a major step that started Britain along the road to a free enterprise society, towards a *laissez-faire* society in which government had very little role to play in guiding the economy. Similarly in the United States in the 19th century, government had very little role to play.

What you really must mean by free enterprise is a system in which anybody is free to set up an enterprise. The important thing is not freedom for existing enterprises to combine with one another to keep out competitors. The important thing is freedom to compete: freedom for somebody else to come in and offer an alternative to what you are producing or for somebody else to come in and offer you an alternative product or alternative employment. When we talk about that kind of free enterprise capitalism then we are talking about freedom in general and as I have already indicated, the two are indissolubly linked. I know of no case, at any time, anywhere, in which there has been any exception to that rule.

In discussing the future of free enterprise capitalism it is well for us first to look at its past and at its present. The high tide of free enterprise capitalism was undoubtedly the 19th and early 20th century, a period which was more or less instituted by the industrial revolution in Britain whose birthdate in a certain important sense we passed a couple of weeks ago on March 9, 1976. This was the 200th anniversary of the publication of *The Wealth of Nations*, by Adam Smith which is in many ways the bible of a true free enterprise system. That date – 1776 – is a double bicentenary. March 9 marks the birth of the free enterprise bible while July 4 marks the 200th anniversary of the political counterpart of a free enterprise society: the declaration of Independence of the United States. This was the beginning of a free political society in the United States, which was largely built in the following century or century and a half, along the lines set forth by Adam Smith in the “Wealth of Nations.”

If you want to look at a single number which will guide you along this line, you might ask what proportion of the total income of any community is spent on behalf of its citizens by government. At the time of Queen Victoria’s Jubilee in Britain, the time of Great Britain’s greatest power and influence over the world, total government spending in Britain, including central, provincial and municipal, amounted to roughly 10 per cent of the national income. In the United States during the 19th century, which was the period of the height of free enterprise and *laissez-faire* capitalism, total government spending – federal, state and local – amounted to less than 10 per cent of the national income. I shall return to that number later because it has changed somewhat since then.

That period is an era which the enemies of freedom have tried to denigrate as a time in which the masses were being exploited by the people of influence and economic power. In the standard writings of the modern proponents of Fabian Socialism, or in the United States of democratic liberalism, the malefactors of great wealth ground the poor, ordinary man under their heels. This is precisely the opposite of the truth. There is no century in history that can compare with the 19th and early 20th centuries in the extent to which the ordinary man reaped greater benefits, had

a greater expansion of opportunities open to him or was able more effectively to establish a situation under which his children and children's children could have a better opportunity in life.

In Great Britain, where the *Wealth of Nations* made its first impact, where the industrial revolution occurred, where *laissez-faire* has its home-land, the ordinary working man had an enormous increase in his well-being. The average level of living went up sharply in the United States. It was a period when millions of impoverished people from all over the world came in as immigrants with empty hands, bringing nothing in the way of possessions.

Decade after decade the conditions of the ordinary man improved. His opportunities broadened. He was able to establish a base for himself and for his children. I speak feelingly, because I, myself, am a product of that process. I, and millions of my fellow citizens in the United States, would not now be able to have the amenities we have, or the possibilities and opportunities we have, if it had not been possible for our parents and our parents' parents to leave countries in Europe in which their conditions were very disadvantaged and make their way to the United States. They progressed in that country, not despite, but solely as a result, of the absence of government controls and intervention and the existence, therefore, of an essentially free society.

Even in an area which is generally ignored, that of eleemosynary activity, the 19th century is a period without parallel. Consider the great private institutions that arose during that period including, for example, the private universities. My own university, the University of Chicago, is a private university, Yale, Princeton and so on, were all founded as a result of private benefactions. It was a period in which we developed a system of non-profit, non-proprietary hospitals to serve the medical needs of people around the country. It was a period of the Carnegie Libraries, of foreign missions, of the establishment of the Society for the Prevention of Cruelty to Animals and other similar movements too numerous to mention.

There is almost no period that I know which there was an equal outburst of activities directed to help the fellow man, the reason is that free enterprise has a role to play in private eleemosynary activities no less than it does in the strictly industrial and economic activities.

You South Africans are yourselves the beneficiaries of the process whereby free enterprise *laissez-faire* in the 19th century made it possible for the underdeveloped countries of the world to emerge. It was not through any government foreign aid programmes, or their equivalent, that any part of Africa developed, including South Africa, or other regions of the world. If Japan is today a great nation it is because in the 19th century, when Japan had its major restoration in 1867, it both took for granted and was forced to adopt a *laissez-faire* policy. Its growth in the next 30 years came entirely in a free trade world, in which it had no tariffs, no restrictions on imports or on exports and in which it was forced to compete with the rest of the world. No matter where you look in that period, the evidence is clear that the private enterprise, capitalist system promoted well-being and released productive power of a kind that has never been seen before.

Indeed, the most eloquent paean of praise that I know of for the private enterprise system is contained in the *Communist Manifesto* by Marx and Engels published in 1848, in which they say that, in all of human history, nothing has released so much productive power as the capitalist system.

And what was true of the 19th century is no less true today. The same effectiveness of free enterprise capitalism in promoting the conditions of the ordinary people shows up today. You have, for example, the large country of Red China and next to it the tiny island of Hong Kong. Which one of these two countries has to police its borders to keep residents from other countries from trying to get in? It is not Red China. You have East Germany and West Germany – two people separated by the accidents of war and providing an almost perfectly controlled experiment for scientific purposes: people of the same heritage, the same technical skill and the same industrial background. Which one of those two countries had to build a wall to keep its citizens from trying to get out? On the one side of that wall you have misery and indigence. On the other side of that wall you have affluence and prosperity. What is true of those countries is true wherever you look. Compare Taiwan and Japan, on the one hand, with Red China on the other, or compare Singapore with Indonesia. Whatever comparisons you make, you will find that where free enterprise has been allowed to stretch its muscles, where it has been allowed to operate, you have both an improvement in the well-being of ordinary people and a large measure of political freedom.

But along about the end of the 19th century there began an intellectual drift away from this system. The belief in individualism declined and a belief in collectivism emerged. Just as the process towards freedom had started in Britain with Adam Smith's *Wealth of Nations* so the movement away from freedom started also in Britain at the end of the 19th century, fundamentally with the rise of the Fabian Socialist movement. The earlier *Communist Manifesto* had an enormous influence in socialist states around the world. But, from the point of view of the world that was free, the Western world, it was not Marx or *Das Kapital*, that was the source of change in public attitudes; it was rather the move towards collectivism which, in the British case, took the form of Fabian Socialism and which spread from Britain to the rest of the Western world. The great English constitutional lawyer, A. V. Dicey, gave a series of lectures in 1899 at Harvard University, under the title of "Law and Public Opinion in the 19th Century." He re-published those lectures in 1913 with a new preface, and in that preface he already foretold the direction in which Britain was to go because it was already clear by that time, Britain had started to shift away from an individualist, free enterprise society, towards a collectivist society. The term, "the welfare state," had not been coined and he did not use it; but in that preface he is essentially setting forth the future effects of this loss of reliance on individualism and the tendency towards collectivism.

In the United States the intellectual movement towards the welfare state was a little later in getting under way, and was longer in making itself felt. Fortunately the United States is a more diversified country than the United Kingdom. The United Kingdom is a much more structured society and has a more homogeneous group of leaders and it can therefore move more rapidly in a good or in a bad direction. The United States is a much more heterogeneous, diversified, widespread society and it therefore takes us longer to do good, but by the same token it takes us longer to do the wrong things. Thus we have been somewhat slower in moving in the same direction.

The key event in the United States was undoubtedly the Great Depression which crystallized the intellectual movement, and caused it to have its effects in action which in turn caused a widespread change in attitudes about the role of government away from the earlier view that government was to serve as an umpire towards the modern view that government is to serve as

the Big Brother. That Great Depression itself helped to crystallize this change, because of the misinterpretation of its origin and sources. It was said that the capitalist system was fundamentally unstable and that private enterprise produced the Great Depression and the government, of course, had to step in, in order to bail society out.

Once again the facts are the opposite of the myth: the Great Depression was a result of bad government policy, not of a failure of private enterprise. In the United States the Great Depression was produced by the mis-management of the monetary system by the Federal Reserve System. The Great Depression, in its worst manifestations throughout the world, had its origins in the United States, and spread from there to other countries. If you trace its origins in the United States, you will find that it developed from a failure of the Federal Reserve System to act in accordance with the objective that had been set for it when it was founded in 1914 to prevent monetary crises and panics.

In the event it permitted the total quantity of money in the United States to decline by a third from 1929 to 1933. It produced a banking panic in early 1933 that was vastly more severe, more extensive and more destructive than anything that had happened before World War One. Indeed, in a book that I and Anne Schwartz wrote some years back on the monetary history of the United States we argued, and I believe provided persuasive evidence, that if the Federal Reserve System had never been established in 1914 the United States and the world would never have experienced the Great Depression. But yet the fault was attributed to free enterprise. If anything goes wrong in the world, you can be sure that the government will say: "It's not our fault. Don't blame us."

In the United States and in the most of the rest of the world, the two greatest enemies of the free enterprise system have been my fellow intellectuals, on the one hand, and you and your fellow businessmen on the other – for opposite reasons. My fellow intellectuals are all in favour of freedom for themselves, they want freedom to speak, to write and to do research as they wish. The idea of establishing a central planning board which would decide what projects should be researched, and select the appropriate project in accordance with social priorities and grant it to the individual who is best qualified to do it would cause them to throw up their hands in horror – and quite rightly. But when my fellow intellectuals come to look at the economic world they look at it very differently. Then they say: "You can't afford those wastes of competition. You have to rationalize and organize things. You have to put us in charge to tell them what to do." So my fellow intellectuals are in favour of freedom for themselves – but not for anybody else.

The businessman is very different. He is always in favour of freedom for everybody else. If I ask a businessman whether we ought to have free competition, provided I talk about some industry other than that in which he is engaged, he is all in favour of it. But if I meet a businessman in, for example, the textile industry, he will tell me: "Of course, we need a tariff, of course we need to have the government give us special tax privileges," and so on. If I talk to somebody in the business of producing agricultural products in the United States he will want quotas. I understand that, even in such a free enterprise place as South Africa, people who produce grapes have to have quotas, at least if they are going to sell them for wine, instead of just for the grapes of wrath! The businessman is always in favour of freedom for everybody else but he always wants special treatment for himself.

As the intellectual tide has shifted away from a belief in individualism towards collectivism, practice has shifted in the same direction propelled by the co-operation of these two most unlikely bed-fellows, the intellectuals, do-good reformers, on the one hand and the supposedly hard-headed businessman on the other. Together they are driving society towards an end which, if achieved, neither will be able to live with. In the United States consider the oldest example of widespread government interference, the Interstate Commerce Commission, a governmental commission that was established in the 1880's to control the railroad industries. The movement towards it was started by reformers who thought the railroads **in** the United States were monopolies who were exploiting their customers, and that we should have a governmental commission in order to make sure that the railroad fares were held down and were fair and competitive.

When this idea was broached, some of the people in the railroad industry thought that it had some merit as the industry had been trying for years to have price fixing agreements. The problem was that no sooner would they get a price fixing agreement established, then some chiseler would deviate from the agreement and it would come crashing down.

So, quietly, not letting anybody know they were involved, some of the central figures in the railroad industry got behind the Interstate Commerce Commission which was soon dominated by the railroads and worked very well as a device for keeping fares up and preventing competition from lowering them. And that has been the experience of every single commission from that day to this.

Of course, the same course of events is not unknown in South Africa. A former professor at the University of Cape Town, W. H. Hutt, wrote a book a few years ago called *The Economics of the Colour Bar* in which he pointed out that the policy of apartheid in South Africa had its origin in trade union insistence on equal pay for equal work. If there is going to be equal pay for equal work, then there are going to be segregated jobs. We have the same problem in the United States. We have our poor, misguided women labourers saying: "We have to have governmental laws to make sure that there is equal pay for men and women in the same job." They do not realize it is anti-feminist legislation because if they insist that by law you have equal pay for equal work they are going to end up having reduced employment opportunities for women in jobs in which, for one reason or another, the males have an advantage, whether that reason be irrational prejudice or valid differentiation.

No man who looks coldly at the facts can deny that there has been a vast reduction in the extent of free enterprise capitalism both geographically and within individual countries. The United States is today the major bastion of free enterprise that remains, certainly on any large scale, and even we have retreated very far down the line.

In the purely economic area, our freedoms have been restricted to set up enterprises such as banks, television stations or taxi cab companies. But of course, the retreat from a free society has gone on in all areas. I mentioned earlier that, in the 19th century, government spending in the United States was about 10 percent of the national income. In the 40 years since the 1930's that fraction has risen until it is now 40 per cent of the national income. That means that every man, woman and child in the United States works, on the average, 40 per cent of the year in order to provide income for government to spend on his behalf. We have, of course, voted for this

through a democratic process. And yet, what we have voted for is a restriction on our individual freedom to use our resources as we see fit for our purposes.

The 40 per cent figure grossly understates the extent to which government controls our activities. Many restrictions do not involve any expenditure: the fact that I have to get permits to engage in certain activities for example, does not involve much government expenditure. There are many other restrictions that do not show up in government expenditures.

Freedom in the economic sphere has had an impact on our political freedom and our freedom in a most fundamental sense: our freedom of speech. Few businessmen in the United States today feel free to express their views openly in the public forum, and I do not blame them. There are exceptions, but the businessman will surely think twice about coming out openly in opposition to government policies when he knows that one result may be a tax man on his doorstep the next day. Another possibility may be the threat of an anti-trust suit, or the loss of a lucrative government contract. I have been impressed in the United States by the extent to which the level of public discussion of public issue by the business community has been at a very much more decorous, polite and non-controversial level than it was 50 years ago. There are some exceptions but they are few and far between. This trend affects not only the businessman.

I find it very hard to believe, for example, a medical professor, whose research is being supported by our national institutes of health, will not think twice or three times before he comes out with a public polemic against socialized medicine. In fact, I have sometimes said that perhaps the only people in the United States who have effective freedom of speech are that small number of people who are in my fortunate position: tenured professors at major private universities on the verge of retirement.

And yet I do not want to give a false impression: America today remains a predominantly free society.

We are certainly a more prosperous society than others not because of government intervention, but despite it. We are more prosperous because we have been able to build on the foundations laid in the 19th century. If in the 19th century there had been as much government intervention and control in the United States as there is now, the United States would be an underdeveloped country, but today we have the great benefit of our inheritance, and we are a rich and wealthy country which can afford a lot of ruin. After the United States won the battle of Yorktown, the final victory over Britain in the Revolution, a young man came to Adam Smith and bemoaned the loss, saying that it was going to be the ruin of the British nation. Said Adam Smith: "Young man there's a deal of ruin in a nation" and that is a very wise thought.

The United States is rich, we can stand a lot of ruin. We have strong traditions and, above all, to preserve our freedom, fortunately, we have a most inefficient government! You must not suppose that that is simply a humorous comment. The greatest defence of human freedom is, without question, the inefficiency of government. If there are elements of freedom left in the Soviet Union it is because of the inefficiency of the government.

In the United States, fortunately, most of that 40 per cent which is being spent by government is being wasted and therefore not doing the amount of harm it could. A great teacher of mine,



Harold Hotelling, a great mathematical statistician, once wrote an article on the teaching of statistics in which he said: "Pedagogical ability is a vice rather than a virtue if it is devoted to teaching error." Now efficiency is a vice if it is devoted to doing the wrong thing. If the government is engaging in wage and price control – the more efficient it is the worse it is for the country, whereas the less efficient it is, the less harm it does.

In general, we have as much freedom as we do because so much of our governmental expenditure is wasteful, and because our citizens are so adept and so ingenious at finding ways to get around governmental regulations.

There is no doubt, however, that, not only in the United States, but throughout the world, the area of freedom is contracting. In the United Kingdom today, 60 per cent of the national income is being spent by the government and the United Kingdom is very near to the tipping point where it may lose its freedom within the next decade unless there is a drastic change. But we have come to something of a turning point, I think, in the state of the world. If you were to extrapolate past trends you would have to conclude that the days of freedom are over and that the world is heading towards totalitarianism. Happily, you cannot extrapolate past trends. They cannot continue. For example, the fraction of the national income spent by government in the United States went from ten to 40 per cent in the past 40 years. I assure you it will not go from 40 to 60 per cent in the next 40 years! And we are coming, I think, in many countries, and particularly I feel strongly in the United States, to a turning point where there is a possibility that the trends will be reversed. As government spending is expanded and as government controls are expanded we have shifted from the situation in which small taxes are being imposed on many people to give concentrated benefits to a few, to a situation in which all of us are reaching into our right hand pocket to put something into our left hand pocket and in which the public at large has been getting wiser about the possibilities of governmental action.

There is no doubt that the citizens in the United States, even many of its intellectuals, have been largely disillusioned about the extent to which you can solve social or economic problems simply by turning them over to the government. We have had a wonderful lesson, in my opinion, which bodes very well for the future, in the experience of New York City, the most welfare-state and socialist-oriented city in the United States. Fortunately unlike the United Kingdom, unlike Washington, unlike South Africa, New York City does not have the printing press on which it can turn out those pieces of paper we call money. As a result, it was unable to bail itself out by going in for a high rate of inflation and it therefore had no choice but to face up to its difficulties. The fact that in New York City, it became patently obvious that the result of government spending had been to make matters worse for the ordinary people brought home sharply to the American people that the end process of this development is financial chaos and loss of freedom. The citizens of New York City no longer have a vote in their destiny. Because of their financial crisis there is now a caretaker group appointed by the State of New York to run New York City.

The example of New York City had a great impact on the people of the United States. There is a widening recognition on their part, and the part of people throughout the world, that government is not a very efficient mechanism for achieving good results. In addition, everywhere the public at large is getting fed up with the high rates of inflation that have been one of the consequences of the attempts by government to spend more, yet appear to tax less. Consequently, there are

important forces at work which offer the possibility of bringing an end to the trend that we have been experiencing.

It is very far from being a sure thing. On the contrary, unless we turn in the very near future it is doubtful that we will have the opportunity to turn at all.

But I believe that there is still time, still hope and still possibility. All of us all over the world should ponder that possibility and do what we can to encourage a movement away from greater reliance on governmental authorities and a movement toward greater reliance on individual enterprise and initiative.

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### Notes

\* An address to 200 Durban Businessmen, 29 March 1976.

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