

"The Milton Friedman View"

by Milton Friedman

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*Professor Friedman's skill as a debater is legendary and he was given ample opportunity to demonstrate it to South African audiences. He held a series of seminars for staff and members of the MBA Programme at the GSB. He took questions after each of his formal dinner addresses and gave several press interviews. On the following pages, we publish a selection of his answers to very wide-ranging questions.*

### **Government Development of the Infrastructure**

*From an MBA seminar at the Graduate School of Business, Cape Town, March 26, 1976.*

You say private enterprise would not have undertaken certain "infrastructural developments." Is it clear that all of them should be undertaken? If it is not clear then what criterion are you to use to decide whether they should be undertaken? Electricity generating projects for example are perfectly capable of generating an economic return because they produce electricity that can be sold. But what are the externalities which justify other projects – to get back to the favourite way of evading hard issues? I'm not going to say that there are no projects which are ever justified by externalities. After all one of the duties my great and revered teacher, Adam Smith, assigned government was erecting and mounting certain public works and certain public institutions which it can never be for the interest of any individual or small number of individuals, to erect and maintain because the profit could never repay the expense to any individual or small number of individuals though it may frequently do much more than repay it to a great society.

He made exactly the same kind of exception that modern people do. But which projects are in that category? Why should a steel factory be governmental rather than private? Why should an oil project be governmental rather than private? Governments get capital from the people one way or another. A government's credit abroad might be better than the credit of some private people, but that aside, the capital available to government is also available to private enterprise.

Take our Western irrigation schemes in the United States. We spent at times \$500 an acre to irrigate land that after it's irrigated is worth \$100 an acre. I don't mean those exact numbers but that's the ratio over and over again. The worst case right now is the environmental legislation which required people who strip-mine to replace the contours of the land, even in areas where there are no people. Sometimes it costs a couple of thousand dollars an acre to redeem land which, after it is recovered, is worth perhaps \$5 an acre. That's absolute insanity. If the value of recovered land rises to the point where it is worth the economic cost of recovering it, you can recover it at that time.

Most irrigation schemes such as those in underdeveloped countries are very hard to justify by cost benefit analysis. I know a good deal about India for instance where there was a tremendous

waste of money on big irrigation dams when every indication was that you would get a lot more for the money if you drilled individual tube wells, for individual families. Now a high governmental official gets no great glory from cutting a ribbon on a tube well. And so the tendency in all of this “infrastructure problem” is to build monuments. All underdeveloped countries are the same. They all build the same monuments regardless of the circumstances. There is not one of them without its own steel mill. Every one has to have its own international airline. They all have their own domestically assembled cars which break apart on the road and so on.

### Bribes, Watergate and Morals

*From an MBA seminar at the Graduate School of Business, Cape Town, March 26, 1976.*

We have just reconciled ourselves to the fact that we are not going to be the policemen of the world. Now the same people who have objected most strenuously to our being the policemen want us to be the moralists of the world. It's absolutely absurd and I agree, masochistic. Whatever our own laws about bribes, it's not in our national interest nor is it our right to set moral standards for other countries. So I have no sympathy whatsoever for this drive about bribes. I think we are doing ourselves enormous harm.

The Watergate business was a very complicated affair. The actions which Mr. Nixon and his associates took in covering up Watergate cannot be condoned, but at the same time they are not completely out of the range of historical precedent. The reason why Mr. Nixon was deposed had very little to do with the moral indignation at the acts which were undertaken. They had much more to do with the coming together of a number of forces which were strongly opposed to Mr. Nixon.

In the first place the news media reflected the animosity of the general intellectual community towards Mr. Nixon which dates back a long way, to things like the Alger Hiss case. Mr. Nixon also had the great unwisdom to threaten another group which then made common cause with the media – namely the civil service bureaucrats. Every country in the world is really run by its bureaucracy and Mr. Nixon became very aware of this. He inherited a bureaucracy that had been built up primarily under preceding Democratic administrations and that was out of sympathy with his general philosophy, so when he came into office for his second term he made up his mind that he was going to get some control of it. He asked a large number of top bureaucrats to submit undated resignations, that he could accept or not to his wish. Well I believe that this was a very fatal step. It's not an accident that there was a sudden spurt of leaks from official sources that made their way into the news media. I believe that it was really the combination of these two groups plus, of course, Mr. Nixon's own mistakes in handling the matter – the kind of arrogance that develops in anybody who is in a position of power for a long time – those three things combined ended up in the Watergate fiasco.

Personally I hold against Mr. Nixon the imposition of price and wage control far more than I hold anything that came under Watergate. He did far more harm to the country and to the things he really should have been standing for by that act than he did later on. But the consequences of the Watergate episode have been very adverse for the United States and for the world. Our constitutional structure did not have any place for a president being deposed except through

either the termination of his period of office or the very rare impeachment. In fact Mr. Nixon was deposed by a branch of the government which is not recognized in the constitution – namely the news media. Once the news media has discovered its power that power will be used again. We have really had a fundamental change in our constitutional structure that is not for good.

So far as the world is concerned there is no doubt in my mind that if the Watergate incident had not arisen the political state of the world would be far healthier today. You would not have had Vietnam collapse as rapidly as it did. You would probably not have had the Yom Kippur war in the Middle East. You would certainly not have had Angola.

Two of these things happened during a year when the President was essentially immobilized and unable to conduct any effective foreign policy. And then you had his replacement by a new man whom the Soviet Union would have been stupid not to test, it's not clear that he passed the test with flying colours.

The extent to which the constitutional process was able to work, the extent to which we were able to get a change of President without any serious internal disturbance and so on, all speak very well for the toughness and reliability of our system. But taken as a whole we have paid a very very high price for it.

### **Exchange Control and the Rand**

*From an interview with Stephen Mulholland, Editor of the Business Times, published in the Sunday Times, March 28, 1976.*

South Africa is threatened from abroad and you may say, you should have exchange control to prevent people from taking capital out. There are two answers to that. The first is that it won't work. People will find ways around it. The second and more important answer is that it is not sensible to make it work.

When you talk about people taking capital out of South Africa, what you mean is that somebody in South Africa sells his property to somebody else in South Africa, induces somebody else to buy the South African rands for dollars or pounds and then takes dollars or pounds out.

Now, let's see who is on each side of that transaction. The man who sells his property in South Africa is somebody who does not have great confidence in the future of South Africa. He is a weak man from your point of view. The man who buys the property in South Africa is somebody who has confidence in South Africa. Moreover, the man who sells will have to sell on terms that are unfavourable to him. The man who buys will buy on favourable terms.

Thus the net result of an attempt to move capital out of South Africa is:

(a) To transfer capital from weak hands to strong hands.

(b) To require those people who get their capital out to pay a price, both in the form of a lower selling price for their property and a lower price in foreign currency for their rand.

If you are successful in maintaining exchange control, the effect is simply to improve the conditions of those people who succeed in getting their capital out of South Africa. That is equivalent, if you want, to a subsidy to the exporters of capital because if they succeed in getting permission, they get their capital out at a favourable rate.

It has always passed my understanding why any government should regard that as a sensible policy to follow.

On currency the wise policy for a country like South Africa is to allow a free float, allow it to vary from day to day or month to month as the market demands. In that way you avoid having a period of apparent calm and then having a major disturbance such as occurs when you have a large devaluation.

The problem with a pegged rate is that it is subject to change from time to time. In every case in which it has ever been adopted, it has led to trouble. Under such a system, small disturbances, small disequilibria are permitted to accumulate into large ones. And then the Government or the Authorities are always very reluctant to make changes when needed.

They are always hoping that if they postpone them long enough the need will go away. Thus, they allow the discrepancies and the disequilibria to accumulate until a major change becomes necessary, which causes a substantial difficulty.

### **The Oil Embargo**

*From an MBA seminar at the Graduate School of Business, Cape Town, March 26, 1976.*

The oil cartel will break pretty soon. Not in the next six months, but in the next year, two years, three years – that's the scale. It's showing signs of cracking at the seams now. If it weren't for the foolish domestic policies of the United States it probably would be closer to breaking. If the people who run our energy policy had been paid hirelings of the Saudi Arabians they could not have served their masters better. We have followed a very foolish policy by holding down the price of domestically produced oil and in effect giving a subsidy to foreign oil. Since the embargo in October, 1973 the fraction of American oil imported has gone up rather than down.

Even so, the quadrupling of the price of oil has stimulated efforts to reduce consumption and to find alternative means of supply, with the result that Saudi-Arabia and Kuwait are producing at something like fifty to sixty per cent of their capacity. They are holding the umbrella over most of the other countries in OPEC which are producing at something like eighty five per cent of capacity. It gets more and more difficult for Saudi-Arabia and Kuwait to do this as their production gets smaller as a percentage of the total, and one of these days the whole thing will break.

Some of the countries are held together by strong political considerations but not all. Iran is not an Arab country. Nigeria is not an Arab country. Venezuela is not an Arab country. One of these will break and oil prices will come tumbling down to a much lower level than they are at now. In a sense they already have. The price of oil today, if you allow for the world inflation in real terms, has come down about thirty per cent since October, 1973 when it was first quadrupled.

There have been all sorts of side deals whereby the price has been shaved a little here and a little there – many signs of cracking. I don't want to predict how soon the break will come because I think economists are worst at predicting the exact timing of things. In 1973 when it first started I did not expect the cartel to last as long as it has. It may last another year or two but I think its days are very narrowly numbered.

### **How Much Should Government Spend?**

*At the dinner in Johannesburg, April 2, 1976.*

What percentage of national income do I think government should spend? There is no way to answer that question on the basis of theoretical considerations so I offer to you the empirical fact that at the height of the British empire, when it had more power both economically, politically and militarily than it has seen before or since, British government expenditure was 10 per cent of the national income. In the United States during its period of the greatest growth and prosperity, government spending for about a century was about 10 per cent of the national income. I've come to the conclusion that 10 per cent must be a pretty good number.

### **The Functions of Government**

*From an MBA seminar at the Graduate School of Business, Cape Town, March 24, 1976.*

First to protect people and their property against coercion by fellow citizens – a straightforward police function. Second, to provide for the defence of the country against enemies from abroad. Third, to provide a means for deciding on the rules under which the market is going to operate. Property rights for instance are not natural – they have to be defined. And fourth, to provide a mechanism for adjudicating disputes among people over the interpretation of those rules. Those are the four primary functions which government should have. In addition, because any society contains some groups of people who are not responsible for themselves, in particular children and insane people, government has to play a paternalistic role in protecting their interests. I realize that potentially that opens the door to further government involvement, but I don't see any way to avoid it in this case.

### **The International Monetary Fund and Special Drawing Rights**

*From an interview with Stephen Mulholland, Editor of the Business Times, published in the Sunday Times, April 4, 1976.*

I have long believed that the International Monetary Fund is a mistake. The world would have been better off if it had never been created and the world would be better off if it were abolished.

National central banks do harm within their countries; international central banks would do even more harm in the world at large if they were allowed to operate. Fortunately they are not.

The special drawing rights were also a mistake. They never should have been introduced and they are gradually sinking into a state of limbo. The whole justification for introducing them was linked to a world of fixed exchange rates. In a world of floating exchange rates SDR's have no use, certainly not as a component of international money. The SDR might continue as a unit of

account but it is not going to be an effective and important part of the total volume of world purchasing power.

### **Blacks, Whites and Egalitarianism**

*At the dinner in Johannesburg, April 2, 1976.*

The great discrepancy between the average income of the Whites and the Blacks in South Africa is at the root of your fundamental political difficulties with the rest of the world. Whether this discrepancy is just is not the issue. The issue is the perception of the rest of the world. And I believe South Africa will find it difficult to remain a stable society if it continues to have a discrepancy of ten-to-one between one sector of the society and another.

The pressures of the outside world, if nothing else, do not leave South Africa much alternative but to do something about it. How rapidly you can do it, whether you can succeed are questions which I am certainly not competent to judge, but I am enormously impressed that everybody I have talked to in South Africa has this problem at the top of his head.

I don't think you should finance a programme as you suggest. That is the approach of the controlled society, not of the free society. The first thing you ought to do is to eliminate the barriers which you now impose on equal movements, on equal opportunity, for the various groups. A state cannot raise the income of anybody, but it can provide people with opportunities for developing themselves and using their own resources. No money is needed to eliminate many of the discriminations between your different groups.

Take the case of elementary schooling. Elementary schooling for Whites is free and elementary schooling for Blacks involves school fees and payments for books. Now, the natural tendency is to say, well let's make it free for the Blacks as well. But surely the right way to go about it in the present circumstances is to impose identically the same fees on the Whites as you impose on the Blacks.

The problem is one of eliminating obstacles. I am not in favour of egalitarianism, in the sense of equal results. I see no merit in cutting down a tree in a forest that grows higher than the others in order to make them all equal. That is the egalitarian view. What you want to favour is the absence of the barriers, the absence of artificial impediments to the advancement of the individual in accordance with his capacity and ability. And for that you don't need any finance. On the contrary, the elimination of many of the barriers which you now impose would release finance for other purposes.

### **Democracy**

*At the Johannesburg dinner, April 2, 1976.*

The political mechanism is a very defective mechanism for expressing the will of the public. It is defective because the ordinary person has no incentive to inform himself about the consequences of measures that are taken. Small groups of people benefit very greatly from say, a tariff, a subsidy on farm products and other similar programmes. The special interest groups have an enormous incentive to get these programmes through commerce, through the legislature.

But here am I, an ordinary citizen. Any one of these programmes is going to cost me an extra 50 cents a year, and my vote is not going to make any difference anyway. When was the last time that anything like that was decided by one vote? As a result, although the form is majority rule, the reality is one of special interest rule.

The only way in which you can have a true democracy is through ordinances which limit the scope of the political mechanism to the area where it is not possible for each individual separately to go his own way – to matters which really have to be settled jointly. Then we should rely upon the market mechanism to co-ordinate the rest of the public's activities. It is paradoxical yet true that the market mechanism of voting enables people to achieve their own objectives more effectively than the mechanism of voting through a political process. And this is of course enormously important for countries like South Africa and my own. One of the beauties of the market mechanism is that it is colour blind. It enables people to co-operate together in their daily affairs regardless of whether they agree on political ideology, on religion or on other aspects of their life.

The basic problem with the political mechanism is that it requires too high a degree of conformism, which is very difficult to achieve without a very homogeneous population. Fundamentally, groups of people who differ very widely in custom and background can only live peacefully together in a *laissez-faire* world.

### **South Africa's Money Supply**

*From an interview with Stephen Mulholland, Editor of the Business Times, published in the Sunday Times, April 4, 1976.*

The actual rate of growth of the money supply which would allow stable real growth depends on the characteristics of particular countries. For example, I have done some work for Japan and for Japan the right number is not three to five per cent as it is in the United States. It is something like ten to fifteen per cent a year, because of the different technological and economic characteristics of Japan compared to the United States.

I do not know what it is for South Africa, but I gather that real output in South Africa has been rising at the annual rate of about five per cent per year for a long time. What I would like to know about South Africa is what has been happening to money propensities in general. Talking from the experience of other countries, if you have a country, that is in a relatively early state of development which applies not to the White part of South Africa but to the rest of the country – you find that, as in Japan, the desire to hold money rises sharply with economic development, as the money economy spreads.

In general, in a country in a stage of rapid development, for every one per cent increase in real output, it takes about a two per cent increase in the quantity of money to keep prices stable.

Now that's the rule that happens to apply in Japan. If South Africa is still in that state of development it could mean for example, that something like eight to ten per cent might be the right numbers for South Africa.

But a steady rate of monetary growth is not a guarantee of completely steady economic growth; you have many other factors that affect the society. No human activity goes on in a perfectly steady way.

I have never argued that you will have perfect stability. What I have argued is that instead of offsetting other forces making for instability, as the monetary authorities always claim they do, deviations from the steady rate of monetary growth in fact operate to exacerbate other forces; they tend to make things worse. So stable monetary growth is not a prescription for Utopia. It is only a prescription for keeping the monetary authorities from introducing additional instability into a society.

The fundamental source of the prosperity of a country must rest in the initiative, the capacities for work and the capacities for thrift of the people. At most money is a lubricator that can make it easier for those fundamental forces to manifest themselves. At worst, money is a disturbance that can frustrate those fundamental forces.

### **Am I a Purist?**

*At a seminar for MBA students, Graduate School of Business, Cape Town, March 26, 1976.*

My old teacher, Frank Knight, has a favourite story about a breed of ducks that flew in a V with the leader in front. Every now and then the ducks would veer off and go their own way. The leader would keep on flying until he looked behind him and saw they weren't there. Then he'd rush around and get in front of them again. Well, that's one way to have influence. It happens not to be my way, but I'm not a purist either. There's a great difference between simply accommodating existing circumstances and being willing to divide up reforms into pieces, one at a time. I don't regard that as being a purist.

How do people like myself have an influence? We don't have an influence by persuading people, because nobody changes unless he has to. When government has to change policy then the policy it adopts depends on what policies are lying around that have been worked out and are intellectually respectable. I believe that the role people like myself have is in contributing to the range of policies and options that are available, that have been thought through and kept alive until circumstances are right for their adoption.

Twenty years ago, you would have asked me why I was so utterly unrealistic as to talk about the possibility of floating exchange rates. "Don't you think you would have a little bit more influence if you weren't quite so pure," you might have said, "if you talked instead about a sliding peg or a managed float or something of that kind?" Well, nobody adopted a floating exchange rate because they were persuaded it was the right policy. The time simply came when you could no longer hold the pegged exchange rate. And if you ever want a marvelous example of my duck analogy it's the way the IMF has rushed to get in front of floating exchange rates because they don't want to lose their jobs.

Again, we have been preaching about quantity of money for a long time with little effect. In recent years there has been a widespread adoption of monetary aggregates as a guide to monetary policy – by the United States, by Germany, by Japan and by other countries. Why? Not because we persuaded people in the first place but because the earlier policy was an utter failure. Facts

have made it impossible for the former orthodoxy to be continued. You've had a shift – but the shift depended on what alternatives were available. That's the way in which people like me can play a role.

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