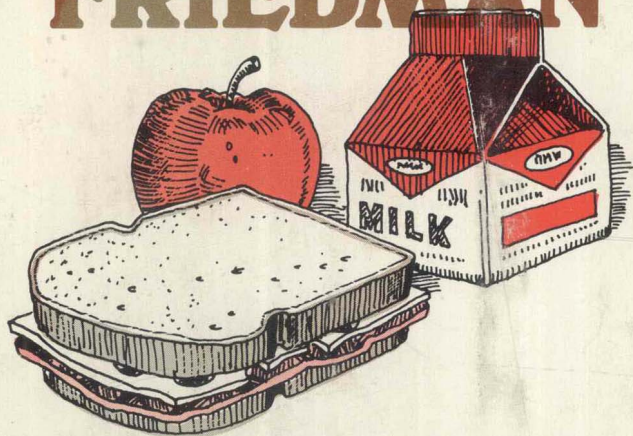


# THERE'S NO SUCH THING AS A FREE LUNCH

MILTON  
FRIEDMAN



# There's No Such Thing as a Free Lunch

Milton Friedman

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# Preface

In a book published in 1891, John Neville Keynes, the father of the more famous John Maynard Keynes, wrote: ". . . People think themselves competent to reason about economic problems, however complex, without any such preparatory scientific training as would be universally considered essential in other departments of enquiry. This temptation to discuss economic questions without adequate scientific preparation is all the greater because economic conditions exert so powerful an influence upon men's material interests. 'Few men,' says General Walker [a famous American economist of the nineteenth century], 'are presumptuous enough to dispute with the chemist or mechanician upon points connected with the studies and labours of his life; but almost any man who can read and write feels himself at liberty to form and maintain opinions of his own upon trade and money.' The economic literature of every succeeding year embraces works conceived in the true scientific spirit, and works exhibiting the most vulgar ignorance of economic history, and the most flagrant contempt for the conditions of economic investigation. It is much as if astrology were being pursued side by side with astronomy, or alchemy with chemistry."

I often send this quotation as part of a response to letters from earnest, sincere, well-intentioned, but economically illiterate, correspondents offering their own economic panaceas, or criticising my views, who display an utter lack of comprehension that economics is a serious subject with a hard core of sophisticated analysis that is widely accepted by professional economists of every political persuasion and that the chances against a rank amateur stumbling on a profound—and true—law are millions to one.

Let me hasten to add that the correspondents are not wholly to blame. Economists, like other scientists, do not write a great deal about the part of their subject that is taken for granted—that is taught in the schools and enshrined in advanced textbooks. They write mostly about the frontiers of the subject, the areas about which there is controversy. More important, economists, to a far greater extent than most other scientists, and precisely for the reasons John Neville Keynes stressed, are likely to be concerned with broad public issues in which technical economic analysis is only one element, and in which personal values and political beliefs—with respect to which the authors are not experts—play a vital role. The general public is far more likely to be exposed to the writings of economists on such subjects than to their more technical publications. Further, the writings that demand least in the way of hard thought and that appeal most to emotion and prejudice are likely to command the widest readership.

There is no satisfactory solution to the dilemma posed by the propositions: (1) there is a body of "positive" economics that can be applied to specific problems and that can yield reliable predictions of the consequences of change; (2) there are "experts" in positive economics; (3) differences about the desirability of governmental policies often reflect different beliefs about the consequences of the policies—conclusions of positive economics—rather than different values; (4) there is no simple litmus test by which a citizen can decide who is an "expert" and who is a "quack"; yet (5) even though the patient is incompetent to choose the physician, there is no alternative in a free society.

This book offers the reader no prescription for choosing among experts.

As was the case in my former book *An Economist's Protest*, the present volume consists primarily of columns which I have been contributing to *Newsweek* once every three weeks over the past eight years. Some of the columns of the previous book have been retained as still pertinent and new columns published in the past two years, along with a few other significant items, have been added. However, the basic themes remain the same and are dual: First, to offer persuasive evidence that there is a valuable body of positive economic analysis that can yield reliable results when applied to specific problems and that has important implications for both the consequences and the desirability of public policies. (We are today paying heavily for having neglected this simple

proposition.) Second, to present an evaluation of current policies in light of a fervent belief that the promotion of individual freedom should be the prime objective of social arrangements.

To further the first theme, I have tried, as in the earlier book, to attach footnotes to all predictions indicating whether they were confirmed or contradicted. On the whole, the batting average of positive economics is excellent.

To further the second theme, I have included as the first item in the book a lengthy interview initially published in *Playboy* magazine. I am grateful to *Playboy* for permitting republication and especially to Michael Lawrence and Geoffrey Norman, the *Playboy* editors who conducted the interview. They devoted much effort to planning the questions and editing and organizing the answers. Their friendly skepticism, intellectual acuteness, and fine command of style contributed greatly to the effectiveness of the interview.

With the same objective I have replaced in the present Chapter Eleven an article that I wrote for the *New York Times Magazine* on "Social Responsibility of Business" with an interview published in *Business and Society Review*, which covers the same subject but also ranges more widely. I am indebted to the *Review* and especially to John McClaughry, who conducted the interview and wrestled a very much longer initial transcript into a readable final form.

In addition to these interviews and the new columns, I have added two other items: in Chapter Six, in which I have drawn together items about indexing, a piece first published in *Fortune* magazine urging the widespread adoption of escalator clauses; and in Chapter Twelve, an updated analysis of the voucher scheme for schooling, written for the *New York Times Magazine*.

We are indebted to these publications as well as to *Newsweek* for permission to reprint. I am indebted also to Barry Keating of Virginia Polytechnic Institute; Gerald Gunderson of the University of Massachusetts, E. Barry Solomon of George Mason University, Lawrence B. Smith of Grossmont College, and James G. Witte of Indiana University, for comments on the first volume that were extremely helpful in preparing this revised volume. My secretary, Gloria Valentine, contributed to this revised volume with the efficiency and good-will that I have been so fortunate as to be able to take for granted. This indebtedness is an addition to, not a substitute for, the debts acknowl-

edged in the earlier book. As I face my mounting intellectual debt, I am reassured by the absence of any maturity date—else, I would be a hopeless bankrupt.

MILTON FRIEDMAN

Ely, Vermont

August 2, 1974

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# Introduction Playboy Interview

[February, 1973]

*Playboy:* In every public debate on an issue involving economics, there seem to be nearly as many conflicting opinions as there are economists. Why can't you people get together?

*Friedman:* We do. But that seldom makes news. It's our disagreements that receive attention. For example, how much attention is paid to agreement between Galbraith and myself in opposing a draft and favoring an all-volunteer armed force, or in opposing tariffs and favoring free trade, or on a host of other issues? What is newsworthy is that Galbraith endorses wage and price controls, while I oppose them.

*Playboy:* Yet in the past election, you supported Nixon despite his imposition of controls. Have you changed your mind?

*Friedman:* I haven't—and neither has Nixon. I'm still opposed to wage and price controls, and so is he. Incidentally, going back to Galbraith, in a note that I wrote to him shortly after Nixon imposed the controls, I said, "You must be as chagrined as I am to have Nixon for your disciple." So far, he hasn't replied.

I regret that he imposed them; yet in doing so, I think he behaved the only way a responsible leader of a democracy could. He resisted controls for nearly three years when there was strong pressure for their introduction. He tried to make the case against controls, to educate the people about the causes of inflation, and the best methods of fighting it—namely, reduced monetary growth and lower federal spending. But he failed, and finally gave in to the popular demand for some kind of immediate and extreme measure to halt rising prices, and controls were the measure most people seemed to agree on. As a leader, that was a proper thing for him to do, even though he felt it was the wrong solution. He behaved the same way with regard to the war.

*Playboy:* Aren't you saying that there's been a large element of political opportunism in Nixon's reversals?

*Friedman:* One man's opportunism is another's statesmanship. There is a very delicate balance between the two in our society. Good politics is what we should demand from our politicians—to a degree. We don't want our leaders to charge off in every direction trying to satisfy the latest public whim, but neither do we want them to completely ignore the will of the people. I think Nixon acted properly. The real problem is educating the public, and there he was unsuccessful.

*Playboy:* Isn't it possible that Nixon was wrong? Wasn't inflation at a level that demanded drastic action such as controls?

*Friedman:* No. Inflation was already tapering off as a result of earlier monetary and fiscal measures when the President imposed controls. In any event, controls are the wrong way to ease inflation.

*Playboy:* Why?

*Friedman:* Because they never work. We've seen that throughout history, ever since the time of the Emperor Diocletian. If controls are administered with any real zeal, people find ways to get around them. The current controls cover only about one-third of all prices. Suppose those prices were kept down by controls. That would simply mean people would have more money to spend on the products represented by the other two-thirds and would drive up the prices of those goods and services.

In the case of wages, there are any number of ways of getting around the controls. If an employer wants, for some reason, to pay a higher wage, he can promote the wage earner, offer him fringe benefits, give him a car—all sorts of things. This takes place especially at the higher income levels, with corporate executives, and so forth. So the people who are hurt most by wage controls are those the program is said to protect: the hourly wage earner, the employee on a low salary—production-line workers and secretaries.

If the controls are tightened or expanded, people will find new and more ingenious ways of getting around them. And as the power of enforcement increases, you move farther and farther from a free society; this is the most damaging effect of controls. The apparatus required to make them effective in even a limited way will be unpopular in a free society. We saw that in World War Two; even then, when there was fairly broad agreement on the need for controls, there was resentment and there were black markets.

*Playboy:* Why does inflation seem to be such a perennially insoluble problem?

*Friedman:* Technically, inflation isn't terribly difficult to stop. The real problem is that the favorable effects of inflation come early, the bad effects late. In a way, it's like drink. The first few months or years of inflation, like the first few drinks, seem just fine. Everyone has more money to spend and prices aren't rising quite as fast as the money that's available. The hangover comes when prices start to catch up. And, of course, some people are hurt worse than others by inflation. Usually people without much political voice—the poor and retired people on fixed incomes. Some people aren't hurt at all. And others profit enormously.

When you start to take some action *against* inflation, on the other hand, the bad effects are felt right away. People are out of work. Interest rates go up. Money gets tight. It's unpleasant. Only later do the good effects of an end to rising prices show up. The problem is getting through the painful cure without wanting another drink. The greatest difficulty in curtailng inflation is that, after a while, people begin to think they'd rather have the sickness than the cure. What they don't realize is that once the cure has taken effect, it's possible to have both economic growth and price stability. But as we saw with Nixon, there is terrible public pressure to junk the cure and go back to being sick—or drunk, to continue the metaphor.

*Playboy:* Why is it so difficult to make the public understand this?

*Friedman:* That has to do with the rather complex causes of inflation. When a shopper goes to the grocery store and sees that the price of meat has gone up 10 percent or so, she screams bloody murder and demands that something be done about it. She writes her congressman. Well, perhaps she's been admonishing that same congressman to vote for Medicare and increased Social Security and federal housing assistance—and, naturally, for no increase in the income tax. The congressman has voted for all these things and the Federal Reserve Board has made it possible for her congressman to pay for these measures, without increasing taxes, by expanding the money supply. Those are the basic sources of inflation and they are hidden. The shopper thinks the butcher is stealing and she wants it stopped. The butcher thinks his landlord is stealing when he increases the rent by 15 percent. The landlord, in turn, is upset about the increased costs of maintaining his building, and so on.

*Playboy:* But why have costs and prices risen?

*Friedman:* Not because of greedy wage earners or avaricious businessmen. Prices have risen by 25 percent in the past five years because of what nineteen identifiable men, sitting around a table in Washington, did with respect to such arcane subjects as reserve requirements, discount rates, and purchases on the open market.

*Playboy:* You're talking about the Federal Reserve Board?

*Friedman:* Of course. Now, I'm not talking about any kind of conspiracy, or even dereliction of duty. These men did what they thought best for the country. They would have acted differently had government expenditures gone up less rapidly, had the deficits been lower.

*Playboy:* But how does the Federal Reserve System cause inflation? Isn't it simply the government's bank?

*Friedman:* That "simply" covers a lot of ground. The Fed, because it's the government's bank, has the power to create—to print—money, and it's too much money that causes inflation. For a rudimentary understanding of how the Federal Reserve System causes inflation, it's necessary to know what it has the power to do. It can print paper money; almost all the bills you have in your pocket are federal reserve notes. It can create deposits that can be held by commercial banks, which is equivalent to printing notes. It can extend credit to banks. It can set the reserve requirements of its member banks—that is, how much a bank must hold in cash or on deposit with the Federal Reserve Bank for every dollar of deposits. The higher the reserve requirement, the less the bank can lend, and conversely.

These powers enable the Fed to determine how much money—currency plus deposits—there is in the country and to increase or decrease that amount. The men with this power are appointed by the President and approved by the Senate and are leading financial experts. But this is tremendous authority for any small group of men to have. These men have attempted for the past sixty years to predict where the economy is headed and to keep it on an even path of growth. I have studied the monetary history of the United States and written a book on the subject, and it's my opinion that there have been more severe crises in the years since we've had a Federal Reserve System than in the years from the Civil War until 1914. Even if you leave out the years covered by the two world wars, the Fed seems to have failed in its mission of keeping the economy on a steady plane.

*Playboy:* Why?

*Friedman:* Basically, I think because it's a system of men and not of

rules, and men are fallible. The decisions of the people who run the Fed, as I said, are made in good faith. They want to do the right thing. But the state of our knowledge is incomplete. Often they don't have all the facts or they see one particular phenomenon out of proportion. In the Great Depression, they managed to shrink the total money stock by a third. They did this for the most honorable of reasons, but it was exactly the wrong thing to do. Just as banks all around the country were closing, the Fed raised the discount rate; that's the rate they charge for loans to banks. Bank failures consequently increased spectacularly. We might have had an economic downturn in the thirties anyway, but in the absence of the Federal Reserve System—with its enormous power to make a bad situation worse—it wouldn't have been on anything like the scale we experienced.

*Playboy:* Has the Fed's recent record been this bad, or have we learned from past mistakes?

*Friedman:* We've learned a great deal from past mistakes. Two decades ago, I argued that the U.S. was depression-proof because the monetary authorities would never again permit a collapse of the monetary system like the one that occurred from 1929 to 1933. But I went on to say that the danger now was a swing in the other direction, that in attempting to avoid recession and unemployment, the system would overreact and produce inflation. Unfortunately, that is exactly what's occurred. Even so, the record for the post-World War Two period as a whole is enormously better than for the prewar period. We've had a quarter of a century without a really serious recession or depression, and our inflation, while we regard it as serious, has so far been mild by world standards. We've done better, but not as well as we easily could have done.

*Playboy:* What's the answer? Should we junk the Federal Reserve System and go back to private banking?

*Friedman:* No. But we can take some of the discretionary power away from the Fed and make it into a system that operates according to rules. If we're going to have economic growth without inflation, the stock of money should increase at a steady rate of about 4 percent per year—roughly matching the growth in goods and services. The Fed should be required to take the kind of limited action that would ensure this sort of monetary expansion.

*Playboy:* Wouldn't the Fed lose its emergency powers—powers that would be useful in a crisis?

*Friedman:* Most so-called crises will correct themselves if left alone. His-



tory suggests that the real problem is to keep the Fed, operating on the wrong premises, from doing precisely the *wrong* thing, from pouring gas on a fire. One reason we've so many government programs is that people are afraid to leave things alone when that is the best course of action. There is a notion—what I've called the Devil Theory—that's often behind a lot of this. The Fed was supposed to take power out the hands of the conniving bankers, who were supposed to profit when the economy fluctuated wildly. The idea is to pass a law and do something about it. Put good men in charge; that's one line. The competing line is that there are problems in the world not only because of bad men but also because it's an imperfect world. People are imperfect. There are scarcities. Shortages. You can let things work themselves out or try to do something about them by passing a law. Of course, you know which idea is easier to sell.

*Playboy*: But you prefer the *laissez-faire*—free-enterprise—approach.

*Friedman*: Generally. Because I think the government solution to a problem is usually as bad as the problem and very often makes the problem worse. Take, for example, the minimum wage, which has the effect of making the poor people at the bottom of the wage scale—those it was designed to help—worse off than before.

*Playboy*: How so?

*Friedman*: If you really want to get a feeling about the minimum wage, there's nothing more instructive than going to the congressional documents to read the proposals to raise the minimum wage and see who testifies. You very seldom find poor people testifying in favor of the minimum wage. The people who do are those who receive or pay wages much higher than the minimum. Frequently Northern textile manufacturers. John F. Kennedy, when he was in Congress, said explicitly that he was testifying in favor of a rise in the minimum wage because he wanted protection for the New England textile industry against competition from the so-called cheap labor of the South. But now look at it from the point of that cheap labor. If a high minimum wage makes unfeasible an otherwise feasible venture in the South, are people in the South benefited or harmed? Clearly harmed, because jobs otherwise available for them are no longer available. A minimum-wage law is, in reality, a law that makes it illegal for an employer to hire a person with limited skills.

*Playboy*: Isn't it, rather, a law that requires employers to pay a fair and livable wage?