

against which classical liberalism fought. In the very act of turning the clock back to seventeenth-century mercantilism, he is fond of castigating true liberals as reactionary!

The change in the meaning attached to the term liberalism is more striking in economic matters than in political. The twentieth-century liberal, like the nineteenth-century liberal, favors parliamentary institutions, representative government, civil rights, and so on. Yet even in political matters, there is a notable difference. Jealous of liberty, and hence fearful of centralized power, whether in governmental or private hands, the nineteenth-century liberal favored political decentralization. Committed to action and confident of the beneficence of power so long as it is in the hands of a government ostensibly controlled by the electorate, the twentieth-century liberal favors centralized government. He will resolve any doubt about where power should be located in favor of the state instead of the city, of the federal government instead of the state, and of a world organization instead of a national government.

Because of the corruption of the term liberalism, the views that formerly went under that name are now often labeled conservatism. But this is not a satisfactory alternative. The nineteenth-century liberal was a radical, both in the etymological sense of going to the root of the matter, and in the political sense of favoring major changes in social institutions. So too must be his modern heir. We do not wish to conserve the state interventions that have interfered so greatly with our freedom, though, of course, we do wish to conserve those that have promoted it. Moreover, in practice, the term conservatism has come to cover so wide a range of views, and views so incompatible with one another, that we shall no doubt see the growth of hyphenated designations, such as libertarian-conservative and aristocratic-conservative.

Partly because of my reluctance to surrender the term to proponents of measures that would destroy liberty, partly because I cannot find a better alternative, I shall resolve these difficulties by using the word liberalism in its original sense — as the doctrines pertaining to a free man.

Milton Friedman  
Capitalism and Freedom  
Univ of Chicago Press, 1962

## Chapter I



### The Relation between Economic Freedom and Political Freedom

IT IS WIDELY BELIEVED that politics and economics are separate and largely unconnected; that individual freedom is a political problem and material welfare an economic problem; and that any kind of political arrangements can be combined with any kind of economic arrangements. The chief contemporary manifestation of this idea is the advocacy of "democratic socialism" by many who condemn out of hand the restrictions on individual freedom imposed by "totalitarian socialism" in Russia, and who are persuaded that it is possible for a country to adopt the essential features of Russian economic arrangements and yet to ensure individual freedom through political arrangements. The

thesis of this chapter is that such a view is a delusion, that there is an intimate connection between economics and politics, that only certain combinations of political and economic arrangements are possible, and that in particular, a society which is socialist cannot also be democratic, in the sense of guaranteeing individual freedom.

Economic arrangements play a dual role in the promotion of a free society. On the one hand, freedom in economic arrangements is itself a component of freedom broadly understood, so economic freedom is an end in itself. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.

The first of these roles of economic freedom needs special emphasis because intellectuals in particular have a strong bias against regarding this aspect of freedom as important. They tend to express contempt for what they regard as material aspects of life, and to regard their own pursuit of allegedly higher values as on a different plane of significance and as deserving of special attention. For most citizens of the country, however, if not for the intellectual, the direct importance of economic freedom is at least comparable in significance to the indirect importance of economic freedom as a means to political freedom.

The citizen of Great Britain, who after World War II was not permitted to spend his vacation in the United States because of exchange control, was being deprived of an essential freedom no less than the citizen of the United States, who was denied the opportunity to spend his vacation in Russia because of his political views. The one was ostensibly an economic limitation on freedom and the other a political limitation, yet there is no essential difference between the two.

The citizen of the United States who is compelled by law to devote something like 10 per cent of his income to the purchase of a particular kind of retirement contract, administered by the government, is being deprived of a corresponding part of his personal freedom. How strongly this deprivation may be felt and its closeness to the deprivation of religious freedom, which all would regard as "civil" or "political" rather than "economic", were dramatized by an episode involving a group of farmers of the Amish sect. On grounds of principle, this group

regarded compulsory federal old age programs as an infringement of their personal individual freedom and refused to pay taxes or accept benefits. As a result, some of their livestock were sold by auction in order to satisfy claims for social security levies. True, the number of citizens who regard compulsory old age insurance as a deprivation of freedom may be few, but the believer in freedom has never counted noses.

A citizen of the United States who under the laws of various states is not free to follow the occupation of his own choosing unless he can get a license for it, is likewise being deprived of an essential part of his freedom. So is the man who would like to exchange some of his goods with, say, a Swiss for a watch but is prevented from doing so by a quota. So also is the Californian who was thrown into jail for selling Alka Seltzer at a price below that set by the manufacturer under so-called "fair trade" laws. So also is the farmer who cannot grow the amount of wheat he wants. And so on. Clearly, economic freedom, in and of itself, is an extremely important part of total freedom.

Viewed as a means to the end of political freedom, economic arrangements are important because of their effect on the concentration or dispersion of power. The kind of economic organization that provides economic freedom directly, namely, competitive capitalism, also promotes political freedom because it separates economic power from political power and in this way enables the one to offset the other.

Historical evidence speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organize the bulk of economic activity.

Because we live in a largely free society, we tend to forget how limited is the span of time and the part of the globe for which there has ever been anything like political freedom: the typical state of mankind is tyranny, servitude, and misery. The nineteenth century and early twentieth century in the Western world stand out as striking exceptions to the general trend of historical development. Political freedom in this instance clearly came along with the free market and the development of capitalist

institutions. So also did political freedom in the golden age of Greece and in the early days of the Roman era.

History suggests only that capitalism is a necessary condition for political freedom. Clearly it is not a sufficient condition. Fascist Italy and Fascist Spain, Germany at various times in the last seventy years, Japan before World Wars I and II, tsarist Russia in the decades before World War I—are all societies that cannot conceivably be described as politically free. Yet, in each, private enterprise was the dominant form of economic organization. It is therefore clearly possible to have economic arrangements that are fundamentally capitalist and political arrangements that are not free.

Even in those societies, the citizenry had a good deal more freedom than citizens of a modern totalitarian state like Russia or Nazi Germany, in which economic totalitarianism is combined with political totalitarianism. Even in Russia under the Tzars, it was possible for some citizens, under some circumstances, to change their jobs without getting permission from political authority because capitalism and the existence of private property provided some check to the centralized power of the state.

The relation between political and economic freedom is complex and by no means unilateral. In the early nineteenth century, Bentham and the Philosophical Radicals were inclined to regard political freedom as a means to economic freedom. They believed that the masses were being hampered by the restrictions that were being imposed upon them, and that if political reform gave the bulk of the people the vote, they would do what was good for them, which was to vote for *laissez faire*. In retrospect, one cannot say that they were wrong. There was a large measure of political reform that was accompanied by economic reform in the direction of a great deal of *laissez faire*. An enormous increase in the well-being of the masses followed this change in economic arrangements.

The triumph of Benthamite liberalism in nineteenth-century England was followed by a reaction toward increasing intervention by government in economic affairs. This tendency to collectivism was greatly accelerated, both in England and elsewhere, by the two World Wars. Welfare rather than freedom be-

came the dominant note in democratic countries. Recognizing the implicit threat to individualism, the intellectual descendants of the Philosophical Radicals—Dicey, Mises, Hayek, and Simmons, to mention only a few—feared that a continued movement toward centralized control of economic activity would prove *The Road to Serfdom*, as Hayek entitled his penetrating analysis of the process. Their emphasis was on economic freedom as a means toward political freedom.

Events since the end of World War II display still a different relation between economic and political freedom. Collectivist economic planning has indeed interfered with individual freedom. At least in some countries, however, the result has not been the suppression of freedom, but the reversal of economic policy. England again provides the most striking example. The turning point was perhaps the "control of engagements" order which, despite great misgivings, the Labour party found it necessary to impose in order to carry out its economic policy. Fully enforced and carried through, the law would have involved centralized allocation of individuals to occupations. This conflicted so sharply with personal liberty that it was enforced in a negligible number of cases, and then repealed after the law had been in effect for only a short period. Its repeal ushered in a decided shift in economic policy, marked by reduced reliance on centralized "plans" and "programs", by the dismantling of many controls, and by increased emphasis on the private market. A similar shift in policy occurred in most other democratic countries.

The proximate explanation of these shifts in policy is the limited success of central planning or its outright failure to achieve stated objectives. However, this failure is itself to be attributed, at least in some measure, to the political implications of central planning and to an unwillingness to follow out its logic when doing so requires trampling rough-shod on treasured private rights. It may well be that the shift is only a temporary interruption in the collectivist trend of this century. Even so, it illustrates the close relation between political freedom and economic arrangements.

Historical evidence by itself can never be convincing. Perhaps it was sheer coincidence that the expansion of freedom occurred

at the same time as the development of capitalist and market institutions. Why should there be a connection? What are the logical links between economic and political freedom? In discussing these questions we shall consider first the market as a direct component of freedom, and then the indirect relation between market arrangements and political freedom. A by-product will be an outline of the ideal economic arrangements for a free society.

As liberals, we take freedom of the individual, or perhaps the family, as our ultimate goal in judging social arrangements. Freedom as a value in this sense has to do with the interrelations among people; it has no meaning whatsoever to a Robinson Crusoe on an isolated island (without his Man Friday). Robinson Crusoe on his island is subject to "constraint," he has limited "power," and he has only a limited number of alternatives, but there is no problem of freedom in the sense that is relevant to our discussion. Similarly, in a society freedom has nothing to say about what an individual does with his freedom; it is not an all-embracing ethic. Indeed, a major aim of the liberal is to leave the ethical problem for the individual to wrestle with. The "really" important ethical problems are those that face an individual in a free society — what he should do with his freedom. There are thus two sets of values that a liberal will emphasize — the values that are relevant to relations among people, which is the context in which he assigns first priority to freedom; and the values that are relevant to the individual in the exercise of his freedom, which is the realm of individual ethics and philosophy.

The liberal conceives of men as imperfect beings. He regards the problem of social organization to be as much a negative problem of preventing "bad" people from doing harm as of enabling "good" people to do good; and, of course, "bad" and "good" people may be the same people, depending on who is judging them.

The basic problem of social organization is how to co-ordinate the economic activities of large numbers of people. Even in relatively backward societies, extensive division of labor and specialization of function is required to make effective use of available resources. In advanced societies, the scale on which co-

ordination is needed, to take full advantage of the opportunities offered by modern science and technology, is enormously greater. Literally millions of people are involved in providing one another with their daily bread, let alone with their yearly automobiles. The challenge to the believer in liberty is to reconcile this widespread interdependence with individual freedom.

Fundamentally, there are only two ways of co-ordinating the economic activities of millions. One is central direction involving the use of coercion — the technique of the army and of the modern totalitarian state. The other is voluntary co-operation of individuals — the technique of the market place.

The possibility of co-ordination through voluntary co-operation rests on the elementary — yet frequently denied — proposition that both parties to an economic transaction benefit from it, *provided the transaction is bi-laterally voluntary and informed.*

Exchange can therefore bring about co-ordination without coercion. A working model of a society organized through voluntary exchange is a *free private enterprise exchange economy* — what we have been calling competitive capitalism.

In its simplest form, such a society consists of a number of independent households — a collection of Robinson Crusoes, as it were. Each household uses the resources it controls to produce goods and services that it exchanges for goods and services produced by other households, on terms mutually acceptable to the two parties to the bargain. It is thereby enabled to satisfy its wants indirectly by producing goods and services for others, rather than directly by producing goods for its own immediate use. The incentive for adopting this indirect route is, of course, the increased product made possible by division of labor and specialization of function. Since the household always has the alternative of producing directly for itself, it need not enter into any exchange unless it benefits from it. Hence, no exchange will take place unless both parties do benefit from it. Co-operation is thereby achieved without coercion.

Specialization of function and division of labor would not go far if the ultimate productive unit were the household. In a modern society, we have gone much farther. We have introduced enterprises which are intermediaries between individuals

in their capacities as suppliers of service and as purchasers of goods. And similarly, specialization of function and division of labor could not go very far if we had to continue to rely on the barter of product for product. In consequence, money has been introduced as a means of facilitating exchange, and of enabling the acts of purchase and of sale to be separated into two parts.

Despite the important role of enterprises and of money in our actual economy, and despite the numerous and complex problems they raise, the central characteristic of the market technique of achieving co-ordination is fully displayed in the simple exchange economy that contains neither enterprises nor money. As in that simple model, so in the complex enterprise and money-exchange economy, co-operation is strictly individual and voluntary *provided*: (a) that enterprises are private, so that the ultimate contracting parties are individuals and (b) that individuals are effectively free to enter or not to enter into any particular exchange, so that every transaction is strictly voluntary.

It is far easier to state these provisos in general terms than to spell them out in detail, or to specify precisely the institutional arrangements most conducive to their maintenance. Indeed, much of technical economic literature is concerned with precisely these questions. The basic requisite is the maintenance of law and order to prevent physical coercion of one individual by another and to enforce contracts voluntarily entered into, thus giving substance to "private". Aside from this, perhaps the most difficult problems arise from monopoly — which inhibits effective freedom by denying individuals alternatives to the particular exchange — and from "neighborhood effects" — effects on third parties for which it is not feasible to charge or recompense them. These problems will be discussed in more detail in the following chapter.

So long as effective freedom of exchange is maintained, the central feature of the market organization of economic activity is that it prevents one person from interfering with another in respect of most of his activities. The consumer is protected from coercion by the seller because of the presence of other sellers with whom he can deal. The seller is protected from coercion by the consumer because of other consumers to whom he can sell. The employee is protected from coercion by the employer because of

other employers for whom he can work, and so on. And the market does this impersonally and without centralized authority.

Indeed, a major source of objection to a free economy is precisely that it does this task so well. It gives people what they want instead of what a particular group thinks they ought to want. Underlying most arguments against the free market is a lack of belief in freedom itself.

The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the "rules of the game" and as an umpire to interpret and enforce the rules decided on. What the market does is to reduce greatly the range of issues that must be decided through political means, and thereby to minimize the extent to which government need participate directly in the game. The characteristic feature of action through political channels is that it tends to require or enforce substantial conformity. The great advantage of the market, on the other hand, is that it permits wide diversity. It is, in political terms, a system of proportional representation. Each man can vote, as it were, for the color of tie he wants and get it; he does not have to see what color the majority wants and then, if he is in the minority, submit.

It is this feature of the market that we refer to when we say that the market provides economic freedom. But this characteristic also has implications that go far beyond the narrowly economic. Political freedom means the absence of coercion of a man by his fellow men. The fundamental threat to freedom is power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power cannot be eliminated — a system of checks and balances. By removing the organization of economic activity from the control of political authority, the market eliminates this source of coercive power. It enables economic strength to be a check to political power rather than a reinforcement.

Economic power can be widely dispersed. There is no law of conservation which forces the growth of new centers of eco-

nomic strength to be at the expense of existing centers. Political power, on the other hand, is more difficult to decentralize. There can be numerous small independent governments. But it is far more difficult to maintain numerous equipotent small centers of political power in a single large government than it is to have numerous centers of economic strength in a single large economy. There can be many millionaires in one large economy. But can there be more than one really outstanding leader, one person on whom the energies and enthusiasms of his countrymen are centered? If the central government gains power, it is likely to be at the expense of local governments. There seems to be something like a fixed total of political power to be distributed. Consequently, if economic power is joined to political power, concentration seems almost inevitable. On the other hand, if economic power is kept in separate hands from political power, it can serve as a check and a counter to political power.

The force of this abstract argument can perhaps best be demonstrated by example. Let us consider first, a hypothetical example that may help to bring out the principles involved, and then some actual examples from recent experience that illustrate the way in which the market works to preserve political freedom.

One feature of a free society is surely the freedom of individuals to advocate and propagandize openly for a radical change in the structure of the society — so long as the advocacy is restricted to persuasion and does not include force or other forms of coercion. It is a mark of the political freedom of a capitalist society that men can openly advocate and work for socialism. Equally, political freedom in a socialist society would require that men be free to advocate the introduction of capitalism. How could the freedom to advocate capitalism be preserved and protected in a socialist society?

In order for men to advocate anything, they must in the first place be able to earn a living. This already raises a problem in a socialist society, since all jobs are under the direct control of political authorities. It would take an act of self-denial whose difficulty is underlined by experience in the United States after World War II with the problem of "security" among Federal

employees, for a socialist government to permit its employees to advocate policies directly contrary to official doctrine.

But let us suppose this act of self-denial to be achieved. For advocacy of capitalism to mean anything, the proponents must be able to finance their cause — to hold public meetings, publish pamphlets, buy radio time, issue newspapers and magazines, and so on. How could they raise the funds? There might and probably would be men in the socialist society with large incomes, perhaps even large capital sums in the form of government bonds and the like, but these would of necessity be high public officials. It is possible to conceive of a minor socialist official retaining his job although openly advocating capitalism. It strains credulity to imagine the socialist top brass financing such "subversive" activities.

The only recourse for funds would be to raise small amounts from a large number of minor officials. But this is no real answer. To tap these sources, many people would already have to be persuaded, and our whole problem is how to initiate and finance a campaign to do so. Radical movements in capitalist societies have never been financed this way. They have typically been supported by a few wealthy individuals who have become persuaded — by a Frederick Vanderbilt Field, or an Anita McCormick Blaine, or a Corliss Lamont, to mention a few names recently prominent, or by a Friedrich Engels, to go farther back. This is a role of inequality of wealth in preserving political freedom that is seldom noted — the role of the patron.

In a capitalist society, it is only necessary to convince a few wealthy people to get funds to launch any idea, however strange, and there are many such persons, many independent foci of support. And, indeed, it is not even necessary to persuade people or financial institutions with available funds of the soundness of the ideas to be propagated. It is only necessary to persuade them that the propagation can be financially successful; that the newspaper or magazine or book or other venture will be profitable. The competitive publisher, for example, cannot afford to publish only writing with which he personally agrees; his touchstone must be the likelihood that the market will be large enough to yield a satisfactory return on his investment.

