

“Where Are We Headed?”*

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I am an innate optimist. But today I find it very hard to be optimistic. I’m not referring to the current recession; that’s a short-term phenomenon which has all the earmarks of being practically over. What I want to talk about today is long-term prospects. Where are we as a nation, as a people, and as a society headed? And if we don’t like where we’re headed, what, if anything, can we do to alter that direction?

More than 50 years ago Oswald Spengler published a very famous book entitled *The Decline of the West*, whose thesis was that all civilizations go through a cycle of rise and decline. Spengler illustrated his theory with the experiences of the Chinese, Egyptian, Greek, and Roman civilizations, and argued that the West was suffering a similar fate. Now, 50 years later, I don’t believe such a cycle is inevitable; we can control our destiny—there’s nothing inevitable or preordained about the course of events. But we need to study such civilizations to avoid repeating their experience.

Is the U.S. on a Spenglerian path? I believe we are. A decade ago, I was far more optimistic; I thought Spengler would be proved wrong. The great danger, both then and now, is the expansion of government power and control over citizens. This expansion of power has always been the fundamental cause of the decline of civilizations. Ten years ago we seemed to be on the verge of reversing that trend. In California we passed Proposition 13 to stop property taxes from rising. Some years later, California passed what at the time was called Proposition 4, the Gann bill, to enact limits on state government spending.

On the federal level, Ronald Reagan was elected president on a platform of reducing the size of government to a level we could manage. He made real progress in that direction during his eight years in office—not as much as we needed, but some. In 1988, George Bush made his famous “read my lips” presidential campaign pledge. Since then, my optimism has been shattered by the course of events.

In California last year, the educational establishment’s Proposition 98—one of the most misleading and deceptive propositions ever on the California ballot—passed by a narrow margin. Proposition 98 essentially breached the Gann limit. While the public thought that voting for Proposition 98 would improve education, they were really voting to give the educational establishment more power and higher salaries.

There’s a lot of discussion in Sacramento about a so-called \$14 billion state budget deficit. That \$14 billion deficit is mostly a matter of bookkeeping—smoke and mirrors. If spending in California next year were held to the same level as this year, the deficit would be a mere \$1 billion. A little more than half of the so-called deficit comes from planned increases in spending. A little less than half comes from a belief that we need to build up a rainy day relief fund.

The Bush administration, with the aid of Congress, has essentially reversed every plank of Reagan's platform. In 1980 President Reagan had four major planks in his economic platform: 1) lower tax rates; 2) restrain government spending; 3) deregulate; and 4) create a stable monetary policy directed toward lowering inflation. The fourth plank is in the hands of the nominally independent Federal Reserve, which has been doing a good job. But the other three planks have all been reversed.

Tax rates have gone up, not down. Government spending has increased at a faster rate in Bush's two years than it has in any two-year period of any president since World War II. In fact government spending is at an all-time high—wartime excepted—as a ratio of national income. We've had an enormous increase in regulation, as evinced by the misnamed Clean Air Act and Disability Act. Reagan's policies produced the growth of the 1980s—the longest peacetime expansion—and an increase in international income. If you reverse those policies, you can expect exactly the opposite effect. Unless those policies are reversed again in the 1990s, we are destined to have a decade of slow economic growth.

But let's look beyond the economic range: Our schools are continuing to deteriorate. Crime is continuing to rise. Our inner cities are becoming uninhabitable. The trend to nationalized medicine is accelerating. You can imagine the rest of the dismal tale. As we look at the social arena, at the level of morality, of personal responsibility, what we begin to see is exactly what Spengler outlined as events in the decline of great civilizations. Make no mistake about it—we are a great civilization—that's what makes the situation so tragic. The challenge we face is to improve, not to move in the direction of decline and ruin.

Why has this happened? If you listen to the liberal pundits, they will tell you that the government has grown because the people wanted it to grow. They will say that our problems have arisen because people want the goodies government provides, but aren't willing to pay for them. If only those selfish people would be willing to turn over more of their income to Washington, all would be well.

On the contrary, whenever the public has a chance to express its view, whether through legislation, like Propositions 13 and 4, or last year's term limitation proposition, Proposition 140, through presidential elections, or in public opinion polls, the public demonstrates clear and unambiguous opposition to the growth of government. We are headed the wrong way because we have developed a governmental apparatus under which the public has no voice. We deceive ourselves if we believe "We the people" rule—we don't.

Let me give you another example. You have a teen-age daughter and are trying to instruct her in the ways of life. Would you dream of telling her that if she has an illegitimate child, you will give her an allowance sufficient to enable her to have a separate apartment and support herself? Would you tell her conversely that if she doesn't have a child, then she will have to live at home with nothing but pocket money? We as a nation tell our daughters exactly that. Our welfare program in many cases makes having an illegitimate child an attractive alternative to having a normal family.

On an issue closer to home, and on a broader level, consider California's so-called water shortage. Suppose you were so fortunate as to own a source of water, maybe a well or something.

Would you sell the water to some customers well below your cost to deliver it, and to others at 50 times that price? If any proprietor of a water company did that, the rest of us would think this person was insane. But we as a people do that. There's no shortage of water in California—that's absurd; there's plenty of water. But as many an economist will tell you, if the government were to fix the price of sand, you could have a shortage of sand in the desert.

If you give something away, there's going to be a shortage. Eighty percent of the water in California is given away to farmers at prices of nothing or close to nothing. What's it given for? To grow, among other things, alfalfa and cotton, for which the government then pays the farmers prices well in excess of the market price. I say the government pays them, but you pay them—out of your pockets as taxpayers. Now would we as individuals ever do this? Even if we did give farmers water for free, would we then overpay them for products they grew with it?

Government has become a self-generating monster. We all recognize the role of special interests. We have farmers who pressure Congress. We have the welfare bureaucracy that pressures Congress. A recent article brought home a view of special interests that I had not had before. The article examined testimony offered by witnesses in 14 different government hearings which all dealt with spending proposals. It found that of the 1014 witnesses who appeared in favor of the spending, only seven could be classified as opponents. In other words, pro-spending witnesses outnumbered anti-spending witnesses 145 to one. Of the 1060 total witnesses in the 14 sets of hearings, 47 percent were federal administrators, another 10 percent were state and local officials, and 6 percent were congressmen themselves.

The fact is, government has become a self-perpetuating bureaucracy. We all know there is very little turnover, except when officials voluntarily retire. The overwhelming bulk of people in Congress are reelected. We now have a tenure system in politics. And what is true of spending proposals is equally true of other government spending. Instead of Lincoln's "government of the people, by the people, and for the people," what we have in the U.S. today is a government *over* the people, by the bureaucrats, for the bureaucrats. What a decline from the ringing sentiments in the Declaration of Independence and the Constitution! It's no more "we the people," but "we the subjects." And our masters are the very people we ourselves have elected. How do we do anything about this? How do we make our vote effective and enable the public to rule again?

It's no use counting on electing the right people; we've tried that. The right people before they're elected become the wrong people after they're elected. The one thing you can count on everyone to do is to put their own interests above yours.

If any one of us were elected to Congress, and were subject year after year to testimony about the urgency of doing this, that, or other with somebody else's money, we would all fall into the same pattern. The problem is not one of people. Many of us thought we could solve the problem by electing the right president. We've tried, and that doesn't work either. To change the situation, we must change the fundamental structure of government.

Proposition 140 last year in California is at the moment the most hopeful prospect. If we can really get term limitation legislation, and keep those bureaucrats in Sacramento from overturning it, it offers the possibility of returning our government to what it once was—a government by private citizens serving in Congress as a part-time matter. Part-time government was at one time

the case at the state and federal levels. One of the main reasons we have so much power centered in Washington is because of the invention of air-conditioning. If you look at the historical record, you'll find that before air-conditioning, the terms that Congress sat were very short. Since air-conditioning they've become almost 12-month terms, almost year-round government.

We need once again to convert our legislators into ordinary citizens who are doing a public service by spending some time in government. Many of our municipal officials are volunteers, and Proposition 140 would go a long way toward converting our state government. On the federal level, this would be much more difficult to do. Do we need a Constitutional amendment? That's an open question at the moment. Colorado last year passed a proposition requiring limited terms for representatives of the state to Congress. That proposition will be before the Supreme Court one of these days, and if the Supreme Court rules that as constitutional, which I doubt they will, that would offer one way of doing it. Short of that, the only other way is to get the states to call a constitutional convention, under Article Five of the Constitution, in which if three-quarters of the states request Congress to call a convention, Congress must do so. At any rate, I leave you with that small ray of hope. If we don't do something along those lines, if we continue on the path we have been going on for the past 60 years, we are headed in the direction from which Eastern European countries freed themselves two years ago.

Answers to Written Questions from the Floor:

Q. What are my chances of finding a job?

A. Generally, excellent; after all, the great bulk of people find jobs. Unemployment is not the kind of problem people think it is. Ordinarily, it's a problem of a temporary period between jobs.

Q. What is the real motive behind the principle that less government is better?

A. The statement that less government is better is, like most half truths—half true. Government has very real functions. Those are: 1) to provide for the defense of the nation; 2) to secure law and order; 3) to provide a means to specify the rules under which we play; and 4) to mediate disputes among individuals. When government gets much bigger, it does those things much less well. Why has crime been so much on the rise in the U.S.? Mostly because government is so busy doing other things. It's so busy trying to enforce bad laws—laws prohibiting the use of drugs—that we don't have enough law enforcement officers to do the things law enforcement agencies should do. My estimates are that government disposes of more than half the total resources of this country. Total government spending—federal, state, and local—amounts to 43 percent of the national income. In addition to that, government mandates many functions for private individuals. We don't always recognize that. Why? Because we don't distinguish between input and output. Government absorbs more than half of our resources, but it produces only a trivial amount of our product—maybe 5 percent or 10 percent of our living standard comes from government. The great miracle of our society is that private enterprise is able to take half the resources of our country and produce the kind of standard of living that is the envy of the rest of the world. That's a real miracle. But there's a limit beyond which private enterprise cannot go.

Q. How would decriminalization of drugs aid our economy or safety?

A. Decriminalization of drugs will not particularly aid our economy. But decriminalization of drugs is important to eliminate the spectacle of areas of our inner cities which are uninhabitable and to eliminate the spectacle of 10,000 extra homicides a year due to battles between drug dealers, and people who are accidentally shot on the streets in the course of drug battles. Decriminalization is also important on the international scene. What business do we have destroying the policy and economy of Colombia because we cannot enforce our own laws? I'm not arguing in favor of drugs, but our present program is doing more harm than good. The real problem with government is not what projects it initiates, but the fact that there are no mechanisms to eliminate unsuccessful experiments. If a private enterprise initiates a project, and it's unsuccessful, it loses money and has to close down—it has no choice. If a government enterprise is unsuccessful, it will expand. And it will expand for a very good reason: The people who initiated it, like all of us, know they can't make mistakes—know they were right—and the only reason it hasn't worked is they haven't had enough money to spend on it. And if we have a source of money, mainly taxpayer money, we're going to draw on it for that purpose. The war on drugs has failed. We ought to recognize that it has failed, and terminate it.

Q. Would term limits put more power in the hands of the lobbyists?

A. Who are the lobbyists? If the lobbyists are the government bureaucracies themselves, how would term limitations put more power in their hands? As to outside lobbyists, how would it put more power into the hands of outside lobbyists? There's a great misunderstanding about government. Why do we have changes in the tax laws every year or two? It's silly. Whether you have a good tax system or a bad one, at least you ought not change it every year. The only reason we have tax law changes every year or two is to raise campaign funds for the people who are running for office. Again, that's not a joke—just look at the facts. Members of the various committees concerned with taxation expenditure get their political funds from people who want to keep from being hurt in the process of revision. Therefore, if you have short-term legislators, that source of special interest and lobbying power will be completely eliminated. Why spend your money to bribe someone who will only be in office for a short term? Before I realized the extent to which the government itself was a special interest, I was concerned about the term limitation bill on the grounds that it might be a nice career for a young man to try to get elected for a brief term in order to be able to get some enterprise to promise him a cushy job when he retired if only he would vote for the right things. But I soon realized that the problem is not outside special interests, not the General Motors or the General Electrics, but the Department of Health and Human Services and the like.

Q. If you could totally restructure the federal government based on the world of the 1990s, instead of 1776, what would you do?

A. I think the people of 1776 did a pretty good job. If I could totally reconstruct the federal government, I would reduce it roughly to the scale that would be consistent with the constitution as it has been interpreted for close to 200 years. Obviously there would be changes in detail; it was unnecessary in 1776 to legislate whether an airplane flying over your house was violating your property rights. But as for the basic, fundamental role of Congress and what the federal government ought to be doing, the past 200 years hasn't altered the extraordinary insight which the framers of the Constitution showed.

Q. Both Reagan and Bush have maintained that our country is currently in the midst of the greatest economic expansion in our history, yet our federal, state, and local governments are all broke or running huge deficits. Where is all the money from all that growth?

A. Mr. Reagan was correct that from 1982 to 1988, the U.S. economy was in a very rapid economic expansion. But I'd like to change the question a little and ask, "how is it, when the country has at least three times the per capita wealth and income that it had in real terms in the 1930s, that a city like San Francisco could build the Golden Gate Bridge and the Bay Bridge then, and can't afford projects like that now?" I gave the answer in my talk. The reason is that government now absorbs the resources needed for those types of projects, and spends that money on things it has no business doing. The infrastructure of the country is in many ways deteriorating. How is it that when I was a student at Columbia in the 1930s, I wasn't afraid to ride the subway system in New York City, and I wasn't afraid to go down to Harlem? Why is it that people are afraid to do these things now? It's because the New York City government and the state government have grown so large, and have performed their functions so badly. So, where's all the money from the growth? It's all being absorbed for governmental programs that ought not to exist.

Q. *The Wall Street Journal* reported that the failure of the Bank of New England could have resulted in a meltdown of the banking system. Please update us on this situation.

A. The failure of the Bank of New England wouldn't have caused a banking system meltdown. In fact, this isn't even an accurate quote of what the *Journal* said. What the *Journal* referred to was not the banking system, but the international currency system—to the fact that the Bank of New England was involved in non-banking activities, or associate banking activities, involving currency swaps and the like on an international level, which could have led to a meltdown. But I don't think it would have; I think that's just wrong.

Q. What in your view are the prospects for a successful resolution of the crisis in the savings and loan and insurance industries? Has the deterioration gone too far?

A. No, I don't believe the deterioration has gone too far. As far as the savings and loan industry is concerned, the problem now is another inefficient government agency, the Resolution Trust Corporation, which unfortunately has too many assets to sell and doesn't know how to sell them. But here we keep coming back to the same problem. Why did we get the savings and loan crisis in the first place? People say it's because we had deposit insurance. We had deposit insurance introduced in 1934, and until 1980, it worked fine. Very few banks or savings and loans failed. Suddenly we have trouble because the government produced inflation in the 1970s. It was the inflation of the 1970s that led interest rates to be driven up. Savings and loans had long-term assets at fixed, relatively low interest rates, had to borrow their money from the public on demand deposits, and had to pay competitive interest rates. The result was that the difference between the interest rates they had to pay and the ones they received caused losses and eroded the savings and loans' net worth. As long as the savings and loans had net worth, the people who owned or managed them had a strong incentive to behave responsibly, but once they no longer had a net worth to protect, and had government insurance for all their deposits, the savings and loans had a "heads I win, tails you lose" gamble—and they gambled, as one might expect. We never had the same problem with banks for one very simple reason. Bank assets were not held

for as long a time duration as savings and loans assets. Banks had relatively short-term loans on the whole, matched against short-term deposits. Nevertheless banks had a period of inflation in the 1970s, with rising interest rates and a false appearance of prosperity, which also induced them to make very unsafe loans and put them into difficulty. Needless to say, I favor major reforms in the banking industry; I have for 50 years or more.

Q. The savings and loan bailout was originally estimated to cost \$80 billion. Now Congress is asking for an additional \$80 billion. What is your estimate for the ultimate cost and its impact on our economy?

A. I have no idea what the ultimate cost will be, but it will not have a major impact on the economy. One has to realize that these costs have already been borne. The harm from the savings and loan debacle is simply being recognized just now—it isn't occurring just now. The savings and loan problem occurred when money was wasted building apartment houses that should not have been built and shopping centers that should not have been built. It was those bad investments that were the real cost. All we're doing now is writing it on the books.

Q. Should taxpayers bail out the savings and loans?

A. The taxpayer is not bailing out the savings and loans; the taxpayer is bailing out the depositors in those savings and loans who were led to deposit because the government assured them that their deposits were insured. We have a moral obligation to live up to that guarantee. Given the other bad policies the government has followed, particularly with regard to the insurance industry, insufficient government regulation was responsible. But two wrongs don't make a right. Regulation is not in and of itself a good thing; we shouldn't have more regulation, we should have less regulation. In a good world, government would not regulate banks or savings and loans. But given that we have deposit insurance, given that we had inflation, given that net worth was eroded, then yes, limited regulation was a factor in the savings and loan scandal. But poor regulation wasn't the main factor. The main factor was that Congress prevented the regulators from doing their job.

Q. How much has inflation and government-paid health care contributed to the spiraling cost of health care?

A. Before 1950 total spending on health care in the U.S. was about four percent of the national income. Since then it has risen to 12 percent of the national income. Two-thirds of the increase is government spending. The involvement of government in health care has been a disaster—another failed program that we ought to terminate. The solution to the health care problem has only one defect—it's not politically feasible. That good solution is to eliminate all government health care programs, and introduce only one new one. That new one would be to provide every individual in the country with a major medical catastrophe insurance policy that has a very high deductible—\$10,000 to \$20,000—or 30 percent to 40 percent of their annual income, whichever amount is lower. If people had protection against major medical catastrophes, people could pay for their own health care. By doing this, we would reintroduce competition into the health care business. After all, when total spending on health care was four percent of the total income, it totaled less than spending on tobacco and alcohol. But this solution is politically not feasible because there are too many vested interests in the current Medicare and Medicaid programs.

Q. With regard to the current recession and state budget crisis, and the request for more tax revenue, which tax would have the least adverse effect on the economy—an increased sales tax, or an increased income tax on those with higher incomes?

A. Both would have bad effects, and neither one is necessary. We can't spend our time profitably by asking, "what's the best way for our opponents to destroy us?"

Q. What will be the effect on long-term interest rates and inflation of the huge demand for capital by Eastern Europe, Kuwait, and other countries?

A. That demand is grossly exaggerated. There is no great demand for capital by Eastern European countries and Kuwait. Kuwait is a tiny little country, economically equivalent to a small county in Texas. As far as Eastern European countries are concerned, if they really move toward a private enterprise economy, if they privatize, they will generate internal capital for their own needs. That has been the history everywhere. How much external capital did it take to build up Hong Kong? Almost none. There's never a shortage of capital if the incentives for using capital are the right incentives. That's the real challenge for Eastern European countries—to set up economic institutions under which the incentives are right.

Q. How do you explain the fact that the education system in the U.S. is so bad despite the U.S. government's spending more on education than most Western European countries?

A. It's not bad despite the spending, it's bad because of the spending. The U.S. education industry is the most socialized industry in this country other than the military. Total expenditures on education are nearly as large as total expenditures on the military. We don't recognize that because most of the spending is done by state and local governments. But the education industry is a typical socialized industry: excessively costly, extremely inefficient, and low quality—with some specially favored groups doing very well, and a very large group suffering. Our education system has no competition; it's a monopoly which determines what school our children should attend and what they will study. The only way we can solve the education problem is by introducing competition, which means privatization, privatization, privatization. Over thirty years ago, I proposed a voucher system for schooling. Under the voucher system, parents could send their children to the school of their choice. If they chose not to send their children to a government school, they would receive a voucher equal roughly to the cost the government school would save. The public at large has over and over again expressed itself in favor of the voucher, but every attempt to introduce the voucher system has been sabotaged by the educational bureaucracy. The most recent example was in Oregon, where there was a very good voucher initiative on the ballot in last fall's election. Two months before the election, a public opinion poll showed that two-thirds of voters were in favor of it, but the initiative was defeated after the educational bureaucracy, including teachers, sent propaganda home with children. If there ever was an example of a governmental agency deciding issues and sabotaging the public will, that was a very good one.

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