

“The Basic Principles of Liberalism”\*  
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**A. Liberalism Old and Liberalism New**

Liberalism, as it developed in the 17th, 18th and 19th Century, was a philosophy very different from that which has recently come to be designated by the same term. It put major emphasis on the individual as the basic unit in society, and on freedom as the central goal in the relations among individuals. In politics, it represented a reaction against authoritarian political regimes. It aimed at limiting the rights of rulers, establishing democratic parliamentary institutions, extending the franchise, and the like. It favored the substitution of the rule of law for the rule of men. In economics, it favored free competition at home and free trade abroad. Developing as it did in a period when governmental regulation was rife, it emphasized the need to reduce state intervention. “Laissez-faire” became a convenient motto. It was international in outlook and viewed free trade as a means of eliminating sources of conflict among nations and promoting a free world.

In the 20th century, liberalism has come to have a very different meaning. The 20th century liberal emphasizes welfare rather than or, as he would put it, in addition to freedom. His reliance is on the state, not the individual. In respect of concrete aims, the difference is perhaps least in the political sphere. Like the 19th century liberal, the 20th century liberal professes a belief in democratic parliamentary institutions, universal franchise and the other political aspects of democratic societies. Yet even here there is a difference: faced with the choice between doing something through government or not, the 19th century liberal will resolve any doubt by leaving the matter to the individual, the 20th century liberal by assigning it to the state. A particular expression of this difference is the attitude toward centralization of governmental functions. The 19th century liberal prefers decentralization even at the sacrifice of some material efficiency; the 20th century liberal has almost the reverse preference. There is a much sharper difference in the field of economic policy. The 20th century liberal distrusts the price system in all of its manifestations. He puts his confidence in collective action through political authorities. The welfare state comes close to being his ideal.

The contrast in views of men who profess the two positions is less sharp in fact than I have drawn it. We are all of us influenced by the intellectual climate we live in and that intellectual climate changes but slowly. The old and the new live side by side. In consequence, the position is one of uneasy compromise. We are all to some extent collectivists and all to some extent individualists. The Republicans generally favor free enterprise at home but oppose free trade abroad; the Democrats generally favor free trade abroad but oppose free enterprise at home.

The confusion of terminology is itself evidence of the continued strength of earlier ideas. As Schumpeter wrote, “As a supreme if unintended compliment, the enemies of the system of private enterprise have thought it wise to appropriate its label.” In this way liberalism has now come to mean in many respects almost the opposite of what it initially meant. Various terms have been suggested to carry the original meaning; I must confess that I like none of them.

Accordingly in the rest of these lectures I propose to use the term “liberalism” in its 19th century meaning.

### **B. Relationship between Political and Economic Liberalism**

Even a cursory survey of experience is enough to suggest that economic liberalism is closely related to political liberalism. I know of no example in history of a country that has been politically free that has not also had economic liberalism in the sense that the major part of its economic activities were organized through a free and private market. But while economic liberalism appears to have been a necessary condition for political liberalism, it alone has not been enough. There are obvious examples of societies that have used the market to organize a major part of their economic activities, that is, have been capitalist, yet have not been politically free. Japan, at least prior to World War II, and Russia, prior to World War I, were capitalist societies, yet essentially autocratic in political structure. Fascist Italy and contemporary Spain are additional examples, though somewhat less clear ones, since, in both, the state has played such a large role in controlling and conducting economic affairs that it is perhaps as accurate to term them socialist or collectivist economies as capitalist, and this is even more clearly the case for National Socialist Germany. Yet it is noteworthy that even in these countries — Nazi Germany alone excepted — suppression of individual freedom has gone nothing like so far as in the modern totalitarian countries like Russia and China, where economic collectivism has been added to political authoritarianism and where little more than vestiges of capitalism survive. The reason seems clear. Such capitalism as there was provided some sources of power partly independent of the overriding political authorities. In addition, of course, economic freedom has value in itself and capitalism meant some measure of economic freedom, so that even the subjects of Tsarist Russia could change some jobs without the permission of an instrumentality of the State. It is clear also from such an historical survey that one cannot specify with any fine precision the degree of economic freedom that is requisite for political freedom. We have observed in the modern era considerable interventions in the market as in post-World-War II England without the sacrifice of political freedom.

The relation between economic freedom and political freedom is complex and by no means unilateral. In early 19th century England, the philosophical radicals and their allies regarded political reform as primarily a means of achieving economic liberalism. Following Adam Smith, Ricardo and Bentham they believed that a reduction of state intervention in economic activity, a large measure of “laissez-faire,” was the main requisite for rapid economic progress and wide distribution of its fruits — and as an aside, later experiences under a largely “laissez-faire” regime gives no reason to doubt the correctness of their belief. They viewed the vested interests of the politically powerful, especially the landlords, as the chief obstacle to such a policy. Political reform would give the power to the people and the people would naturally legislate in their own interest, which is to say, would legislate “laissez-faire.”

From the end of the 19th century to the present the intellectual descendants of the philosophical radicals — Dicey, Mises, Hayek and Simons to mention only a few — have emphasized the reverse relation, that economic freedom is a means toward political freedom. The triumph of Benthamite liberalism in 19th century England was followed by a reaction toward increasing intervention of government in economic affairs, and this tendency toward collectivism was greatly accelerated both in England and elsewhere by the two World Wars. Welfare rather than

freedom became the dominant note in democratic countries. Recognizing the implicit threat to individualism, these writers 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.

In the past decade or so, the relation between political and economic liberalism has been manifested historically in a still different fashion. Increasing intervention by the state did indeed come into conflict with political liberties. But instead of leading, as so many of us feared it would, to a suppression of political liberties, it has in many cases led to a slowing down or reversal of the spread of intervention. Again Britain provides the prime example. Perhaps the turning point is the control of engagements order which the labor party reluctantly found it necessary to impose to carry out their economic plans. If carried into effect this law would have given political authorities complete control over the jobs men might take. This was so obvious a threat to liberties that the act was enforced in only a negligible number of cases and repealed not long after it had been enacted. The repeal of the act ushered in a decided shift in British economic policy. Ever since, there has been a more or less steady reduction in centralized control and expansion in the area assigned to the market. Of course the proximate reason for this shift in policy and the similar shifts in many other democratic countries was the limited success or outright failure of the central economic planning which had been attempted. But at least one reason for this lack of success was the unwillingness of democratic communities to carry through their plans when doing so would have required riding roughshod over cherished personal liberties. It may well be that this shift in policy is temporary; that we are witnessing not a turn of the tide but a minor lull in the collectivist trend of the century. Even so, it illustrates strikingly the close relation between economic liberalism and political liberalism.

Crude historical observation alone is never persuasive. It may be that the coincidence of economic and political liberalism in practice has been a common result of a more general influence. We turn therefore to an analysis of some of the reasons why economic liberalism might be expected to be favorable to political freedom.

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 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 power to coerce and enables economic strength to be a check to political power rather than a reinforcement. Economic strength is capable of being widely dispersed; there is no law of conservation of economic strength which forces the growth of new centers of strength to be at the expense of existing centers; there can simply be a larger number of millionaires, so to speak. Political power on the other hand is far more difficult to decentralize. Its personal character imposes something more nearly akin to a law of conservation of power. There can be numerous small independent governments; there cannot be numerous equi-potent small centers of political power in a single large government, as there can be numerous centers of economic strength in a single large economy. In consequence, if economic strength is joined to political power, concentration seems almost inevitable.

The force of this abstract argument can perhaps be demonstrated best by example. One aspect of a free society is the freedom of individuals openly to advocate and propagandize 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 it is possible for men openly to advocate and work for socialism. Equally, political freedom in a socialist society would mean that men were 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 for a socialist society, since all jobs are under the direct control of political authorities. It would take an act of self-denial whose difficulty our own recent experience underlines to permit a government employee 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, 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 an act of self-denial that would permit a minor government official to retain his job although openly advocating capitalism; it stretches credulity to conceive of permitting high officials to finance “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 financed by a few wealthy individuals who have become persuaded — by a Frederick Vanderbilt Field, or an Anita Blaine McCormick, or a Corliss Lamont, to mention a few names recently prominent; or by a Friedrich Engels, to mention a more ancient case. 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 persuade 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 other venture will be profitable. The competitive publisher, for example, cannot afford to publish only those writings with which he agrees; his touchstone must be the likelihood that the market will be large enough to yield a satisfactory return on his investment. In this way, the market breaks the vicious circle and makes it possible ultimately to finance such ventures by small amounts from many people without first persuading them. There are no such possibilities in the socialist society; there is only the all-powerful state.

Let us stretch our imagination and suppose that the government is aware of this problem and composed of people anxious to preserve freedom. Could it provide the funds? Perhaps, but it is difficult to see how. It could establish a bureau for subsidizing subversive propaganda. But how

could it choose whom to support? If it gave to all who asked, it would shortly find itself strapped for funds, for socialism would hardly repeal the elementary economic law that a sufficiently high price will call forth a large supply. Make the advocacy of radical causes sufficiently profitable, and the supply of advocates will be unlimited.

Moreover, freedom to advocate unpopular causes does not require that such advocacy be without cost. On the contrary, no society could be stable if advocacy of radical change were costless, much less subsidized. It is entirely appropriate that men make sacrifices to advocate causes in which they deeply believe. Indeed, it is important to preserve freedom only for people who are willing to do so; otherwise freedom degenerates into license and irresponsibility. What is essential is that the cost of advocating unpopular causes be tolerable and not prohibitive.

But we are not yet through. In a free market society it is enough to have the funds. The suppliers of paper are as willing to sell it to the *Daily Worker* as to the Foundation for Economic Education. In a socialist society it would not be enough to have the funds. Our hypothetical capitalist organ would have to persuade the government factory making paper to sell some to them, the government printing plant to print the paper, and so on.

An example of the role of the market in preserving political freedom that is closer to home is our recent experience with McCarthyism. Entirely aside from the substantive issues involved and the merits of the charges made against individuals, what protection did individuals and in particular government employees, have against irresponsible accusations and probings into matters that it went against their consciences to reveal? The protection of the Fifth Amendment would have been a hollow mockery if relying on it made it impossible to earn a living. Their fundamental protection was the existence of a private market economy in which they could earn a living. Here again, the protection was not absolute; many potential private employers were, rightly or wrongly, adverse to hiring them; and it may well be that there was far less justification for the costs imposed on many of the people involved than the costs generally imposed on people who advocate unpopular causes. But the important point is that the costs were limited and not prohibitive, as they would have been if government employment had been the only possibility.

It is of interest to note that a disproportionately large fraction of the people involved apparently went into the most competitive sectors of the economy — small business, trade, farming — where the market approaches most closely the ideal free market. No one who buys bread knows whether the wheat from which it is made was grown by a communist or a Republican, by a pleader of the fifth amendment or a supporter of McCarhy, or for that matter, by a Negro or a White. This illustrates how an impersonal market separates economic activities from political views and protects men from being discriminated against in their economic activities for reasons that are irrelevant to their productivity, whether these reasons are associated with their views or their color.

As this example suggests, the groups in our society that have the most at stake in the preservation and strengthening of competitive capitalism are those minority groups which can most easily become the object of the distrust and enmity of the majority — the Negroes, the Jews, the foreign born, to mention only the most obvious.

Yet, paradoxically enough, the enemies of the free market — the socialists and communists — have been recruited in disproportionate measure from precisely these groups. Instead of recognizing that the existence of the market has protected them from the attitudes of their fellow countrymen, they attribute the residual discrimination to the market.

### **C. Economic Liberalism, the Ideal Concept**

In discussing any viewpoint about policy, it is important to distinguish between the general principles on which it rests and the concrete policy proposals to which these principles lead. The principles can and should be abstract, ideal and uncompromising. Their application involves the weighing of alternative costs and returns and a judgment about their quantitative importance. These applications can never be stated once and for all.

Any set of principles about the appropriate organization of society rests on two pillars; on the one hand a set of ultimate values or goals, on the other a particular conception of the nature of man and the world. To the liberal the ultimate value in the relation of man to his fellow men is freedom of the individual or perhaps the family, where freedom includes economic freedom as a special case. This value is, it should be emphasized, a social one. Freedom has no meaning as a value to a Robinson Crusoe on his island. Similarly in a society freedom must be supplemented by individual goals. The possession of freedom does not tell a man what to do with his freedom.

The liberal's conception of the nature of man and the world recognizes that the full use of modern knowledge and technology requires the coordination of a large number of imperfect men lacking omniscience. It is trite to note that literally millions of people are involved in providing one another with their daily bread, let alone their yearly automobiles. The challenge to the liberal is how to reconcile this widespread interdependence with individual freedom.

Fundamentally there are only two ways of coordinating the economic activities of millions: central direction involving use of coercion – the technique of the Army and the modern totalitarian state; voluntary cooperation of individuals – the technique of the market place.

The possibility of coordination through voluntary cooperation rests on the elementary – yet frequently denied – proposition that both parties to an economic transaction benefit from it provided that the transaction is voluntary and informed. Voluntary exchange can therefore bring about coordination 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 solely 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 that other households ultimately use rather than directly by producing goods for its own immediate use. The incentive for adopting this indirect route is, of course, the increased “output” made possible by division of labor and specialization of function. In consequence, both parties can benefit from each exchange. Since the household always has the alternative of producing directly for itself, it need

not enter into any exchange unless it does benefit, so no exchange will take place unless both parties do benefit from it. Cooperation is thereby achieved without coercion.

Division of labor and specialization of function could not go far in a simple exchange economy in which a household is the largest productive unit and in which final products are exchanged against final products. To extend the scope of division of labor, the productive unit in existing market economies is largely separated from the consumption unit and takes the form of an enterprise that serves as an intermediary between the use of the resources owned by some households to produce products and the acquisition of the products by the same or other households. The introduction of such an intermediary permits cooperation in production over a far broader area and makes possible complex chains of exchanges and indirect means of utilizing resources. The elaboration of cooperative arrangements is further facilitated by the use of “money” or generalized purchasing power to effect transactions rather than the direct exchange of goods or services.

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 coordination is fully displayed in the simple exchange economy that contains neither enterprises nor money. As in that simple model so in the complex enterprise money exchange economy cooperation is strictly individual and voluntary provided (a) enterprises are private, so that the ultimate contracting parties are individuals and (b) individuals are effectively free to enter or not enter into any particular exchange, so that any transaction is strictly voluntary.

It is far easier to state these provisos in general terms than to spell them out in detail and much of the content of the succeeding lectures is devoted to this problem, which may therefore be neglected in this preliminary sketch of the ideal of the liberal.

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 to most of his activities. The consumer is protected from coercion by the seller because of the existence of other sellers with whom he can deal; the seller, from coercion by the consumer, because of other consumers to whom he can sell; the employee, 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 any centralized authority.

Indeed, a major source of objections 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. At bottom of most arguments against the market is a lack of belief in freedom itself.

The freedom provided by the market plays a dual role. On the one hand it is an end in itself. Economic freedom, as already emphasized, is a part of freedom in general and by no means an unimportant part. On the other hand, in the ways which we have already indicated, economic freedom promotes and supports political freedom.

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## Notes

\* One of several lectures delivered at Wabash College and elsewhere that formed the basis of *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).

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