Thank you, Chip [Mellor], and thank you, George [Gilder]. I appreciate those very nice words all of you have said, but I do want to point out one little paradox to you. As I speak to you, I am speaking from some notes that were produced by one of those chips that George was talking about. As he was speaking to you, he was speaking from notes handwritten. (Laughter) I believe that handwriting still has a role in the world and that the fact that they were handwritten did not in any way detract from the value of the ideas that they expressed.

More seriously, I want to talk to you tonight about a very basic problem that is both an opportunity and a challenge. Certainly the most dramatic event of recent years has been the collapse of communism and socialism around the world. There are very few people anywhere anymore in the world, whether in Russia or China or anywhere else, who believe that the efficient way to organize economic activity is through central direction and socialism. George [Gilder] has been pointing out the extent to which those ideas have been undermined by technological developments, but it is also true that those ideas are fundamentally undermined by the difficulty of anybody at the top, and this is part of what he was talking about, appreciating the complexity or taking hold of the complexity of the way in which a system needs to be organized. The most creative aspect of a system is the individuals who participate in it and who accept responsibility for what goes on. So we are seeing around the world a collapse of socialism. Yet, and this is where the challenge is, there has not yet been a case of any country that has successfully made the transition from a communist or socialist state to a free market state.

Somebody sent me just today a column from the Washington Times written by Max Lerner, and I want to quote one paragraph that is sort of the theme of what I am going to talk about tonight:

“The great vacuum in economic theory today,” he said, “is the absence of a theory of transition from a command economy with its centralized allocations, pricing, and controls to an autonomous economy with a free movement of prices, wages, interest rates, savings, and capital investment.”

What I want to talk to you tonight about are some radical ideas, which I hasten to add are by no means finished and complete, about how you can possibly succeed in converting a socialist society, a totalitarian society, into a free market society in a practical way within a relatively brief period of time. As I say, I do not believe I have fully worked out these ideas, and I hope you will try to think along with me about them and think about how we can achieve that objective — achieving it is a little too strong — how we can even conceive of a way of doing it.

The essential requirement is that we substitute private ownership for government ownership. The key to a successful economic system is private property, private ownership, private responsibility, so that a free market system has private people using their own resources in a way that satisfies their own values in voluntary cooperation with other similar individuals.
As you know, there has been a great deal of talk over recent years about privatization and there has been an enormous amount of privatization worldwide. However, almost all of it has taken place in countries that, while not necessarily 100 percent private enterprise, have very large private enterprise components. The question is whether those techniques which have been employed for that purpose can be used in converting an almost completely centralized society into a private enterprise society.

There are many examples in actual practice. Chile is a good example. Allende had expropriated many enterprises and under the Pinochet regime most of those have been privatized. But there it was pretty straightforward: the expropriation had been done only a few years earlier, the former owners were still around, and a large part of the privatization simply consisted in giving back to the former owners the property that they had lost. In addition, other state enterprises were sold, but that raised no great problem because there was a lot of wealth in the country, a lot of private property, and it was perfectly possible to sell them off either to people within Chile or to foreign investors.

A very different example is that of Yugoslavia. Way back when it broke with Russia and tried to shift away from Russian central direction, it went in the direction of creating worker cooperatives, of essentially taking a state enterprise and giving it to the workers who were then working there as a cooperative. That turned out to be a failure. It did not create the kind of system they thought they were going to create for one very simple reason, and that is because the workers did not receive transferable shares in their enterprises. They could not sell them or people could not buy in, and that turned out to be a fatal defect.

More recently, Britain has privatized a great many enterprises through a process of essentially market auction, of auctioning them off on the market, although in some cases in order to get political acceptability they have treated the employees specially favorably.

However, these methods are not really applicable to a completely socialist state. Take for an example our close neighbor Cuba or Poland. The Chilean solution is not possible. It is so many years since everything has been nationalized that it is meaningless to think about giving it back to the private [former?] owners. I had some Cuban-Americans who came to talk to me about what might happen to Cuba if Castro was overthrown. They mentioned the problem of individual homes of which the former owners were still around. But can you conceive of what would be involved if you tried to settle ownership claims of 30 years’ duration and which for 30 years have not been manifested, and of what the reaction would be of the people who now occupy those houses? It seems to me that it is impossible.

Similarly, worker cooperatives would be technically possible if they were combined with transferable rights. If you took each state enterprise, converted it into a corporation, gave every worker a pro rata share of the shares of that corporation, and allowed them to buy and sell them on the stock market, that would be technically possible, but I think it would be politically intolerable. The workers are only a fraction of the total population. What about the rest of the population? Whom do the factories belong to? Do they belong to the workers? Not at all. They belong to the country as a whole; to the people as a whole.
What about selling on the market? Whom are you going to sell the enterprises of Poland to? It is true that there is a very wealthy philanthropic American of Polish extraction who has spent something like $100 million I think to buy a share in the Gdansk shipyard. That’s charity; that’s not a commercial purchase. You have a property that almost surely has a negative value, not a positive one. But more generally, the only way in which you could sell off the Polish enterprises or, for that matter, if you think of Cuba going the same way, the Cuban enterprises would be primarily to foreigners. Again, in order to sell them off, you would have to sell them at bargain-basement prices. It would be again politically intolerable to dispose of the major productive enterprises of the country almost entirely to foreigners. 

China did better in the agricultural area than any of these by essentially converting one form of organization into another, converting cooperatives into individual plots. That worked pretty well in agriculture but they have not succeeded anywhere else in the society.

I do not believe that those techniques are appropriate or usable or feasible. What other method is there? This is where I want you to go along with me and go back to first principles. Who owns the state enterprises? That’s the first question to ask. If you ask that to people as I have in various places, they will say, “Oh, the government owns them.” But who is the government? What do you mean the government owns them? Of course, when you drive people to that point, they will come out with the right answer: “Why the people own them.” Of course, the people own them. Well then, the right solution is to give them to the people. If the people own the property, if they own the enterprises, why not give it to them? Why not have the ownership individual and separate rather than collective?

I first suggested this idea of giving the property in a Newsweek column that I wrote in 1976, which was really directed to how Britain might privatize or denationalize its enterprises. Much to my surprise it was adopted, not in Britain, but there is one example in which the technique was adopted. That is in British Columbia, Canada, where the province owned a great many natural resources. They grouped them all together and established something called the British Columbia Resources Investment Corporation, BCRIC for short. They established this large corporation, BCRIC, and they gave every citizen of British Columbia a certain number of shares in the corporate enterprise, in addition to which they raised additional capital by floating a stock issue, which turned out to be the largest and most successful stock issue that had ever been floated in Canada. However, that is the only example I know of in which that principle was actually followed, and yet it seems to be fundamentally the right principle.

Then you will come back properly and say, “But how are you going to do it? A government like the Polish government owns absolutely thousands of enterprises. Are you going to give every citizen of Poland a thousand pieces of paper, one share of stock in each of a thousand enterprises?” That is obviously not a very sensible or feasible policy, but there are ways in which you could surmount that readily. [SOMETHING MISSING HERE BETWEEN THE END OF SIDE 1 AND THE BEGINNING OF SIDE 2] … he said is that what you would do would be to take those thousand or so or many thousands — probably five, ten or twenty thousand — and organize them into conglomerates, mutual funds if you want or their equivalent. In each conglomerate, you try to mix together enterprises that were profitable and enterprises that were losing money so that the whole would be somehow a mixture of these. Then let’s say you established eight or ten of these conglomerates, perhaps in different industries and in different
ways — I won’t try to specify in detail the method — and you gave every citizen of Poland one share or 100 shares — it doesn’t matter; that’s just a question of units — in each of these eight or ten mutual funds conglomerates. These are now private enterprises, ownership is widely distributed, everybody in Poland or in Cuba is a capitalist, there are stock markets established on which the shares can be purchased or sold, and each individual one of these funds has some initial board of directors but thereafter they are going to behave like any corporation. They are going to be free to sell off or consolidate or put out of business any of the enterprises they own.

However, you do have a very serious transition problem. It seems to me what you ought to do for the transition is to make it a gradual one and say those enterprises that have been losing money and have been being subsidized by the state will be given a three-year period to turn around by giving a sliding scale of subsidy for three years — two-thirds next year, one-third the year after, and nothing thereafter. Obviously, I am just trying to outline the broad ideas and not the details.

It is also true that there is another problem, getting political support. That might require, as it did in Britain, giving specially favorable treatment to the employees but not simply turning over the enterprises to the employees.

That is as far as I had gotten more or less years ago, and I had stopped thinking about the problem until the issue arose in a concrete form more recently. Particularly, it arose in my personal case when I had some people from the Cuban-American community come to me and ask my advice about how they might plan for privatizing Cuba when and if it ever became possible. That led me to some further thinking. There is one fundamental defect with what I have just proposed: you seem to be giving people something for nothing. You are handing over to them shares of the enterprises and that is not right. It is against all the principles we believe in: we do not believe there is a free lunch and we do not believe we ought to be giving people something for free. Moreover, it is a general principle of human beings that what you get for nothing you value at nothing. You only value things that you pay for and that have imposed a cost on you. Moreover, if you do what I have suggested, while you give the people the property, you leave the government saddled with the national debt, including the need to spend money on the transitional problems that I have mentioned.

So the question arises: Why shouldn’t you privatize the debt, too? Who owes the debt? If the people own the enterprises, don’t the people owe the debt? Clearly, that is not really feasible with respect to the whole debt. You cannot saddle individuals with obligations that may exceed their ability or willingness to pay. It is okay to give everybody in the community an equal pro rata share of the people’s enterprises, but you cannot really make them responsible for pro rata shares of the people’s debt because you would put them in a position that would simply be intolerable.

However, I believe you can do it with respect to part of the debt, and this is sort of the present stage of my thinking about a combination proposal. Suppose you consider one of these conglomerates I have talked about, or all of them, and ask yourself what is a reasonable part of the debt to regard as a counterpart of that collection of assets. It is very easy to answer that question for some enterprises. Consider an enterprise that is making money even under state ownership. You can set a value on that enterprise by capitalizing the value of the income stream. That provides you with the capital value for that enterprise. Now consider an enterprise that is
losing money. That enterprise may be losing money but in most cases it will have assets. Even
the Gdansk shipyard undoubtedly has trucks, tools, and other assets, and you can at least say that
it is valued at least as much as its breakup value or its liquidation value or salvage value — I
don’t know what the technical term is. Now suppose you added that up for all these enterprises
that you are going to turn over to the people. You get a certain total. Now suppose you are going
to give every individual these ten shares of stock, and with that you combine a piece of the debt
corresponding to the estimated value of those ten shares of stock when those enterprises are run
by the government. I do not want to try to estimate the value of these enterprises in private hands
because the whole purpose of this exercise is to give private people an incentive to make those
enterprises worth a good deal more in private hands than they are in government hands, but what
I want to do is to turn over to each individual a package whose net value is zero as long as it is in
government hands but which I am sure will have a very high positive value when it is in
individual hands. Moreover, I would specify if I did that, with respect to the bid of a bond that I
am turning over to each individual as the debt part corresponding to the asset, that the principal
and interest are to be paid only from the dividends from the stock he receives or from the
proceeds of selling the stock. I will let individuals be free to sell it but, when they sell it, they
have to sell the bond obligation along with it.

That seems to me to be about as far as I have gone in my thinking about the general framework
of how you could convert a socialist state into a private enterprise state in a way that was both
feasible and politically acceptable, ethically equitable. Obviously, all I have done is to sketch the
broad outlines of a very radical approach and there is a great deal to be done to fill in the details.
Obviously, I have left out and oversimplified. There are some parts of what the state owns that
should be treated in a very different way. For example, if you go to Poland, insofar as people are
in apartments or houses that are government owned, it is really much more sensible to turn the
property rights in those over to individuals connected with the debt obligation corresponding to
the rent that they are now paying, or something like that, than it is to have a reshuffling of those
apartments or those houses by putting ownership of those in a mutual fund. So there are
problems of that kind and I do not want to pretend that my solution is a solution for all those
problems. However, I believe it would solve the problem of a very large core of the problems
that are to be faced by a socialist state.

It is not the whole problem because the other major problem that such a socialist state would face
if you were trying to convert it into a private enterprise state is the problem of currency, of
money, and that raises a whole different series of problems.

All I am trying to do here is to suggest that, when people talk about how to privatize a country
like China or Poland or Cuba, I believe they are in general not facing up to the real magnitude of
the problem because the typical approach is along the lines that have worked in capitalist
societies, along the lines of selling things off, trying to find buyers for them, or of proceeding as
China did in the industrial area by trying to go along with joint ventures. I do not believe that is
the way at all. Moreover, I believe that when you try to privatize in a society like China or
Poland on a piecemeal basis, a little bit at a time, you create many problems for yourself. You
know there are two opposing aphorisms. One is, “You should not cut a dog’s tail off by inches”
— cut it off all at once. The other aphorism is, “Look before you leap” — do things gradually
and not wholly. There are some cases in which it is desirable to do things gradually, but in the
area we are now talking about I believe there is a great deal to be said for doing things globally,
for trying to convert a whole mass of enterprises into private property overnight, and establishing a private market in that way instead of trying to establish it bit by bit.

Let me emphasize again that as a political matter there are special groups that have to be mollified. You have a whole bureaucracy in a country like Russia or in a country like Poland that has a very strong vested interest against any change. One of the virtues of the kind of proposal I am describing is that it may offer a way to buy them off in a rather easy and innocuous fashion, just as Margaret Thatcher was able to buy off the employees of Telecom when she privatized it by giving them specially favorable treatment with respect to the shares. In the same way, I do not mind if you say that the present ruling bureaucracy in Poland will get an extra 10 percent quota of these shares as a way of buying them off.

Let me repeat and close by saying that any actual application of the kind of thing I am talking about would have to be tailored to the circumstances of the particular country. I am sure it would be quite different in Cuba than it would be in Poland, than it would be in Russia, than it would be in China. But the broad basic idea which has fundamentally the two components — first, that the enterprises belong to the people and should be given to the people in one way or another on an individual basis and, second, that the gift should be accompanied by an obligation so that it is not a something-for-nothing — I believe those two principles are broadly applicable. Thank you.

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