

“The Suicidal Impulse of the Business Community”

by Milton Friedman

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I thought that I would comment tonight on three different issues: First, where the American economy is today, where it is headed, and what are its problems. Second, an issue that has been very much in the news—namely, whether the federal government ought to provide additional equity for the International Monetary Fund (IMF). Third, the suicidal impulse of the American corporate community, a topic that derives directly from the other two.

In my opinion, the euphoria regarding the current economic situation is unjustified. There is no doubt that in 1983 we are having a very vigorous economic expansion. Output is increasing rapidly, inflation has been coming down and staying down, and is now relatively low. Interest rates, while high, are lower than they were a year or two ago. Although they moved up a little a few months ago, they’re pretty stable right now and if anything moving down a little. Everything seems fine. Unemployment is coming down, employment is going up—a very typical pattern in the first year of an expansion.

The great mistake that people make is to suppose that it is appropriate to extrapolate from the present to the future. There is a widespread feeling of confidence that nothing but good is going to come, that inflation has been licked, we are embarked on a long healthy expansion, 1984 will be a good year and so will 1985, so we can relax and stop worrying about the issues that have bedeviled us for so long. Unfortunately, that’s not true.

What’s going on right now is an overheated economy, an economy that is a consequence of the most expansive monetary policy that we have had in the whole postwar period. The rate of monetary growth from July 1982 to July 1983 was higher than in any other twelve-month period since the end of World War II. The rate of monetary growth over the two-year period from 1981 to 1983 is higher than in any two-year period in the whole postwar period. I should not have said the whole postwar period; my computer only had the data from 1947 on—I only checked that back to 1947. But I’m sure it’s true for the whole postwar period. That very rapid monetary expansion sparked our very rapid economic growth this year.

I want to call to your attention that in October, November, and December of 1982, only one group of economists was predicting a very vigorous expansion in 1983, namely, that small group known as monetarists—that is, those of us who emphasize monetary forces. Most economists were saying that at best there would be an anemic recovery in 1983. But given the monetary explosion from July 1982 on, it seemed to us—and experience supported that view—that the United States was headed for a vigorous expansion in 1983. Monetary growth first affects nominal income and economic activity. It influences inflation only much later. Inflation has been coming down not because of the rapid monetary growth after July 1982, but because of what preceded it. Between July 1980 and June 1982, monetary growth was on the average lower than it had been earlier—but equally important—it was highly erratic and unstable. It produced a

highly erratic and unstable economy with a sharp recession, one of the most severe of the postwar period, and that's what brought inflation down.

We now have built into the system a resurgence of inflation in 1984, but not necessarily or even likely to double-digit levels. Inflation today is somewhere around 3 or 4 percent. Almost all forecasts of inflation for 1984 are in the neighborhood of 5 percent. However, I believe a more likely prospect is that inflation will range somewhere between 6 and 9 percent by late 1984. Moreover, we do not even have an assurance of continued economic growth into 1984. Monetary growth (M1) went up 13.5 percent from July 1982 to July 1983. It rose 2.4 percent from July 1983 to September 1983. *If* monetary growth continues for another three to five months at a rate of anything like 2.0–2.5 percent, there will be a new recession in the first half of 1984. That prospect fills me with foreboding. If there is a recession in 1984, the situation at the time of the election would be one in which inflation, interest rates, and unemployment were rising—not exactly a situation conducive to re-election of an incumbent president. If that happened, there would be in 1985 and 1986 enormous upward inflationary pressure and a strong tendency for that pressure to be countered with something that hasn't been mentioned for a long time—namely, wage and price controls.

If a recession occurred and was met, as it surely would be, by expansive monetary and fiscal policy, then by 1985 there would be a tendency for inflation to rise sharply. The public at large is fed up with inflation and strongly opposed to it, but its memory is very short. There would thus be an enormous incentive for the powers that be to adopt a panacea to stop inflation that, as you all know now but did not know in 1971, is a disastrous way to meet the situation—namely, trying to suppress the inflation through wage and price controls. President Nixon's imposition of such controls was by all odds the worst mistake he made, a far more serious mistake than anything that happened under Watergate. By 1985 we shall be thirteen or fourteen years away from that, and public memories are short.

Now you will say to me, "Oh, but the Federal Reserve isn't going to let that happen." But that assumes that what happens in the monetary area is what the Federal Reserve intends to happen. It isn't. The Federal Reserve did not intend to have a monetary explosion from 1982 to 1983. After all, in 1979 the Federal Reserve said it was going to have a period of gradual and slow monetary growth, yet there followed three years of the most erratic monetary growth in the whole history of the Federal Reserve.

The problem is that the Federal Reserve has adopted policies and procedures that keep it from controlling the one thing it really should control, namely, the quantity of money. It turns that over to the market because what the Fed insists on trying to do is to control interest rates. It's fascinating to read what is said in the papers. All during June and the earlier part of 1983, the papers were full of stories advocating that the Federal Reserve ease up at a time when monetary growth was hitting 13, 14, and 15 percent. What the Federal Reserve has done is to peg interest rates. The resulting monetary growth depends on things over which the Federal Reserve has no control—namely, the market demand for credit and the market supply of credit. If there is downward pressure in the market on interest rates over the next three, four, or five months, monetary growth will be very slow, and we shall have a recession in early 1984. If we're lucky and the market pressure is not for lower interest rates—if the market pressure is for relatively

stable interest rates or even somewhat higher interest rates than we have now—then we will have more rapid monetary growth. I'm not saying this is what will happen; I'm saying that it is a mistake to suppose that this scenario is beyond the bounds of possibility.

Unfortunately, there are some early signs that it may even be more than that. In September, leading indicators showed a slight decline for the first time in many months. The decline was trivial, not statistically significant, at best a straw, but a straw in the direction I've been talking about. Construction contracts peaked in June and came down in July and August. Construction and housing are one of the earliest moving series in the business cycle. They tend to peak early in an expansion and hit bottom early in a recession. Again, two swallows don't make a summer, but it's another straw.

Now we may be lucky; it may be that won't happen. If it doesn't happen, if we get a somewhat more rapid rate of monetary growth over the next few months, then we shall nonetheless have an acceleration of the rate of inflation in 1984, but we shall not have a recession. We shall have a slowdown, but not a serious one. In that case, economic circumstances in 1984 will be much more favorable to the incumbent president. A third possibility is that the Fed will resume the monetary explosion that temporarily ended in July 1983. If that happens, then inflation will be no higher in 1984 than I indicated—6 to 9 percent. But by 1985 we shall be heading into double digit inflation. I don't know which of those outcomes will occur. They are all possibilities. I have found over the years that I'm much better at predicting the consequences of what the Federal Reserve does than I am at predicting its actions. For the former you need to be an economic analyst, for the latter, a psychoanalyst.

One way this ties into my third topic—the suicidal impulse of the business community—is the business community's attitude toward the Fed. I want to ask the corporate executives in this room a question. Suppose you had asked one of the top people in your business to specify his goals for a year ahead. Suppose he specified his goals, with a wide range between top and bottom, and at the end of each year, readjusted these goals to match whatever actually happened that year, so that he started over fresh for the next year. Suppose that, over a three-year period, that executive was nonetheless outside his goals 77 percent of the time. Would you think he was a marvelous executive who ought to be promoted? Or would you think that there was something wrong with the way he ran his outfit? In the 59 months since 1978, the Federal Reserve has set its goals in exactly that way. It set a wide range and recalibrated it every year, and yet it was outside that range 77 percent of the time. Of the times it was outside that range, it was on the inflationary side 80 percent of the time. Is that a record that should lead to the belief—so common on Wall Street and in the boardrooms of the *Fortune* 500—that the Federal Reserve has been doing a tremendous, marvelous job over the past four years, that its chairman should be reappointed and lauded as having presided over an extraordinarily successful episode of monetary policy?

The Fed did manage to bring inflation down; there's no question that's a positive achievement, something that was very desirable. But it brought inflation down at an extraordinarily and unnecessarily high cost to all of us. The cost was high, and we by no means have any assurance that inflation has been brought down for the long run rather than simply as a temporary matter.

The cost was high because of the erratic and unstable way in which the Fed conducted monetary policy over that period of time.

Let me turn to my second subject. There is a great to-do about the international debt crisis. Brazil, Argentina, Mexico—you can add a few more names—are, it is feared, going to default on their debts, and the only way we can save them is by shoring up the International Monetary Fund by having the U.S. government vote an additional \$8.4 billion to add to the equity of the IMF. Here again, I have not heard many executives of major corporations argue against that position. Is that an appropriate position? I ask you to contemplate for a moment the underdeveloped countries that are not in trouble. If you go down the list of big international debtors, is it an accident that on that list you do not find Hong Kong, you do not find Taiwan, you do not find Singapore, you do not find South Korea, you do not find Japan? Is that an accident? Or is it because those countries have developed by using market mechanisms to organize their resources? What countries are on the debtor list? Is there a single country on the list of big debtors that has not tried to develop through centralized government control of its economy? Poland is the extreme case. In Mexico, the government now owns 70 percent of the productive resources and has been moving for decades in the direction of complete socialism. For several decades, a military junta in Brazil has controlled the economy and determined what economic activities would be undertaken. The characteristic feature of the big debtor countries is that they have adopted the philosophy that development must be controlled and organized by a centralized government.

What is the International Monetary Fund? The International Monetary Fund was established at the time of Bretton Woods Agreement, under which the various countries were to have fixed exchange rates among their currencies. The specific function of the IMF is to preside over the agreement and to provide temporary financing to smooth over temporary balance of payments imbalances. That function disappeared completely in 1971 when the Bretton Woods system was terminated. In a world of floating exchange rates, there is no need for such an agency. But no government organization, national or international, is willing to go out of existence simply because there is no longer any reason for it to exist. Old generals may fade away, but bureaucrats never do. Government bureaucracies, international bureaus, if they can possibly find a reason for continuing to exist, never fade away. So, beginning in 1971, the IMF became an institution in search of a function, and it latched onto the function of becoming or trying to become an international central bank. You have already heard some of my views about the domestic central bank. I don't think our domestic central bank has done a particularly good job of running this country's monetary system, and I believe that an international central bank is unlikely to do a better job in running the world's monetary system. One of the last things we need is an international central bank.

Whom does the IMF deal with? Does the IMF deal with individual entrepreneurs or does it deal with the government? If the IMF makes a loan, to whom does it make a loan? What is the consequence of the IMF's operations in these various countries? The consequence is consistently to make the government sector stronger relative to the private sector. But that's just what's gotten these countries into trouble. Do we really want to encourage an institution that will stimulate Brazil to give its military junta still greater power over Brazilian industries? Isn't it in the self-interest of the United States and the self-interest of the majority of the citizens of Brazil,

Argentina, Mexico, and the other countries to encourage a policy of promoting private free markets and private enterprises opposed to government-directed economics? The way to do that is not to provide more funds to the IMF.

But you will say: “My God, look what would happen! Citibank might go broke. We’ve got American commercial banks that have made large loans to these countries. Those loans are in many cases larger than their total capital. We can’t possibly let them go broke, can we?” Why not? Why can’t we? Those commercial banks willingly made those loans because they got good interest rates and good fees for making them. They have made many questionable loans within the country. They should be responsible for organizing whatever rescue efforts are organized, for arranging whatever stretch-outs are desirable, just as they do with their domestic clients. I suspect that they would not lose any more money in the process than they are likely to as the IMF twists their arm to make still more loans, to throw still more good money after bad money.

For a moment, contemplate the dire possibility that Citibank or one of these other banks might go broke. That would not be a disaster. The amounts of money involved are no larger than those involved when New York Central went broke. Our economy is a profit and loss system, and you cannot get the profits if you’re not going to bear the losses. If the government is going to guarantee banks against losses when they make bad loans, the government will sooner or later take over the profits when they make good ones. Do we want a nationalized banking system? I do not believe that the government ought to be in the business of bailing out the commercial banks, whether directly or indirectly, through providing additional funds to the IMF.

I’m opposed to this on two levels. I don’t believe providing additional funds to the IMF is an effective way to improve the prospects of collecting those loans. All it’s going to do is to postpone the evil day. In the second place, even if I am wrong, and the IMF quota increase did bail out the commercial banks, I don’t believe the federal government ought to be in the business of bailing out the commercial banks.

But you will say to me, “Oh, but we couldn’t have any failures of the commercial banks because that would produce a financial collapse.” People have been saying either of two opposite things. On the one hand, they say: “If banks fail, the Federal Deposit Insurance Corporation would be involved and the Federal Reserve would have to pump so much money into the system that that would produce inflation.” On the other hand, the same people are saying in a different context, “Allowing major banks to fail would be terrible because it would produce deflation.”

These contradictory comments reflect a confusion between capital or credit on the one hand and money on the other. What produced the Great Contraction from 1929 to 1933 was not the capital losses of failed banks, but the decline in the quantity of money. The losses to the stockholders and to the depositors in banks that closed their doors during the Great Depression—and a third of all banks closed their doors—were less than one-fifth as large as the total decline in the quantity of money. The Great Contraction occurred because the good banks were forced by bad Federal Reserve policy to contract their liabilities and their assets. The situation today is very different. Some banks might indeed suffer capital losses and even fail, but the FDIC would protect the depositors. Straightforward monetary policy could avoid any contraction in the total quantity of

money and therefore any widespread financial collapse. So I conclude that support for the IMF bailout is undesirable and should not be given.

This brings me to my third point—the suicidal impulse of American corporate executives. I have been impressed repeatedly over the years by the schizophrenic character of American business. When businessmen plan their own businesses, they look ahead five, ten, fifteen, twenty years and they take measures that are intended to preserve the long-run health of their companies. But when the corporate executives of this country get into the public policy area, they seem unable to look ahead more than one or two years. They are very shortsighted. They follow policies that in the long run are very adverse to business enterprises as a whole and even to their own enterprise.

Let me give you a few examples. A few weeks ago I gave a talk in Honolulu at the American Bankers Association's annual meeting. Prior to introducing me, the president of the association expressed great satisfaction that there had been great progress in eliminating remaining restrictions on the rates of interest that commercial banks could pay to their depositors under Regulation Q. He went on to stress the importance and desirability of eliminating the remaining restrictions. When I started my talk, I couldn't resist saying, "Where do you think those restrictions came from? Who do you suppose was responsible for putting them into effect?" The answer, of course, is the commercial banking industry. Regulation Q was adopted in the Banking Act of 1933 because the commercial banking industry had been lobbying for decades to get the government to prevent the payment of interest on demand deposits. In addition, they wanted limits on the interest rate that could be paid on time deposits.

Why did money market mutual funds develop? They were fine from the point of view of depositors, of savers, since these funds enabled individuals to get market interest rates, but for the country as a whole the development of money market mutuals was a complete waste. It would never have occurred if there had not been government-imposed limits on the interest rates that commercial banks could pay to depositors. That has always seemed to me a curious way to protect depositors. It's fascinating that, to the best of my knowledge, no consumer defense group, no Nader group, has ever opposed those limits. Those limits were responsible for the development of the money market mutuals and the development of the money market mutuals in turn finally forced the elimination of those restrictions. Yet, only during the past five or ten years have any considerable number of commercial bankers opposed those restrictions and favored their repeal. The first commercial banker to do so and the one who has consistently been in the forefront of recognizing the long-range implications was Walter Wriston of Citibank.

To continue, why do we have a large Eurodollar market in London? Why isn't the world's financial center in New York, where it belongs? The answer is simple: because the commercial banking industry among others was for so long opposed to the floating of exchange rates and favored the maintenance of fixed exchange rates. What drove the international financial business to foreign soil was a combination of Regulation Q, which limited the interest rate that could be paid; the interest equalization tax, which was introduced purportedly to defend the dollar from depreciation; and the restriction on foreign lending by American banks that was introduced by President Johnson in order to try to stem an outflow of gold from the United States. Again, Walter Wriston was the only major commercial banker who came out in favor of floating exchange rates at a time when it would have done some good. If we had not had a system of

fixed exchange rates, if we had not had a Regulation Q, the financial center of the world would be in New York instead of in London. Certainly there is ample evidence of a suicidal impulse on the part of the banking community.

The same phenomenon has been evident more recently in the area of international trade. Has the steel industry done itself any good by trying to get government protection from foreign competition, or has it done itself harm? One problem with the automobile industry has been the high price of steel because of the measures taken to shelter the American steel industry from foreign competition. In response, most of the automobile industry lobbied for import quotas on cars from Japan. Has that really benefited the automobile industry or hurt it? So far as the Japanese producers are concerned, it has been a blessing in disguise. In effect, we have encouraged the creation of a Japanese export cartel that enables Japanese manufacturers to charge higher prices and export higher-grade cars, yielding a larger profit margin. On the whole, their profits have gone up and not down as a result of the so-called voluntary restrictions on the export of cars.

With some notable exceptions, businessmen favor free enterprise in general but are opposed to it when it comes to themselves. As I've said many times, there's a fascinating difference between my fellow academics and businessmen, the two groups that I regard as the greatest threats to free markets.

My fellow intellectuals are all in favor of freedom for themselves. When they say, "We want free speech, we want free research," I say to them, "I don't understand you people. You talk about the waste of competition, about how terrible it is to have a gasoline station on each corner of an intersection. Don't you think it's a terrible waste of competition to have professors in four universities studying the same research project? Don't you think there ought to be a central governmental authority to establish priorities in research and prevent such wasteful competition and duplication?" They respond in great dudgeon: "You don't understand the intellectual process. We have to have variety and diversity, the freedom to guide our own work, in order to have productive competition." However, when it comes to the business community, my fellow intellectuals don't believe that at all. They all want a government planning body. I shouldn't say all; there are notable exceptions, many of whom are in this room. But many of my fellow intellectuals are inclined to say, "We ought to have a central planning agency that will eliminate wasteful competition and that will decide priorities." So most intellectuals are in favor of freedom for themselves and are opposed to freedom for everyone else.

The business community is very different. At the drop of a hat, almost every businessman can give a lecture on the virtues of free markets in general. But when it comes to their own business—if they are in steel, we've got to do something about those Japanese; if they're in automobiles, same story. In other areas, they will tell you, they need a special depreciation provision in the tax code, or an investment tax credit, or this or that special benefit.

I submit that this is precisely the long-run suicidal attitude that has brought the banking industry and the steel industry, not to mention the more ancient case of railroads, to their present state. I use the word *suicidal* in a very explicit sense. Forty or fifty years ago, the commercial banking industry was the financial industry. Today, Sears Roebuck, Merrill Lynch, or American Express

is a larger operation in the credit industry than any commercial bank. The commercial banking industry as it has traditionally been known currently accounts for only a bit over one-third—maybe it's 40 percent—of the total credit activities of the country. It has been committing suicide; it's going out of business.

The business community in general has been shortsighted in the same way in lobbying in Washington for special privileges. I can't blame corporation executives for lobbying for their individual companies; they have a responsibility to their clients. But that excuse does not hold for organizations supposedly representing the American business community such as the Business Council and the National Association of Manufacturers. More recently, the Chamber of Commerce has been something of an exception, but that has been a very recent phenomenon, and I am skeptical of its permanence. The only organization that has almost consistently been on the side of freer markets and freer trade has been the National Federation of Independent Business. That's because it felt it didn't have enough clout to get anything in Washington. The broader and more influential organizations of businessmen have acted to undermine the basic foundation of the free market system they purport to represent and defend. A free market system can exist in any country only if government is limited in scope. Every attempt to expand the scope of government, no matter how good the purpose, reduces the viability of a free market.

Questions and Answers

Question: We're trying to export a lot of agricultural products to Japan and other countries of the world, and right now we have a very strong dollar. How are we going to compensate for that with the import restrictions we have on steel, cars, and things?

Friedman: Let me ask you a question. Who has been harmed most by those import restrictions, by the so-called voluntary restrictions, on automobiles and on steel? The answer is the producers of agricultural products. For the moment, this may sound like a crazy statement, but it's correct. If you ask who has benefited and who has been harmed by keeping out Japanese automobiles, obviously the owners and employees of the American automobile industry have been temporarily benefited. The people who want to buy cars are harmed. They have a smaller choice, and they have to pay a higher price. Beyond that, if we buy fewer automobiles from Japan, the Japanese earn fewer dollars. If the Japanese earn fewer dollars, they have fewer dollars to spend for American agricultural products.

Why do we have a strong dollar? We have a strong dollar partly because of the restrictions that we have imposed on imports. That isn't the only or even the main reason. The main reason we have a so-called strong dollar is because we are a safe haven for funds. All over the world people would like to invest money in the United States. But that doesn't cost jobs; let's get that straight. There's no greater nonsense than the talk that the strong dollar is somehow costing us jobs. If you look at the balance of payments, statistically we have a so-called large deficit. When the Japanese construct an automobile plant in Tennessee, that's a capital import. It's not treated as an item on the current account, but it nonetheless hires American workers. It adds just as much to American employment as if the Japanese bought American exports. Similarly, if funds come in from abroad and are used to buy U.S. government bonds, a smaller amount of bonds has to be sold in the private market, and more funds are available for American investments. The foreign

funds help to finance the deficit of the federal government, which is also supposedly providing jobs.

As for agricultural products, insofar as people from abroad want to invest funds in the United States because we are a safe haven, the only way they can do so is by selling us more than they buy from us in a form that enters the current account. That's the only way capital funds can come to this country. If one of Mitterrand's countrymen would like to have money in the United States, how can he get it to the United States? If he's got a factory in France, he can't pick up the factory and send it to the United States. If he's got a house in France, he can't pick it up and send it to the United States. He can get capital to the United States only by inducing somebody to give him dollars in return for francs. How does he induce somebody to give him dollars for those francs? By offering a lot of francs per dollar. That's the only way he can do it. But whoever is providing him those dollars is in turn getting the francs he can use abroad, and the only thing he wants them for is to buy French goods. So ultimately the only way in which people from abroad can get capital into the United States is by the United States' importing more from abroad than it exports. If we impose restrictions on imports, we say, "Oh, that will improve our balance of payments." It may or may not. If the reason funds are coming over here is simply because people want to have funds in the United States as a safe haven, it won't improve our balance of payments in the slightest. So to get down to your case, so far as the strong dollar is concerned, there may be nothing you can do about it. The measures that are in fact being taken to do something about it are on the whole counterproductive and are doing more harm than good. If we were simply to abolish all tariffs and avoid all this nonsense about restrictions, the dollar would not be as strong as it is now. And foreign countries would be earning more dollars, part of which they would spend on your product.

Question: Why are you concerned, if you are, about Sears Roebuck or American Express taking the place of the banks?

Friedman: I have stressed it mostly as evidence of the suicidal activities of the commercial banking industry. However, I am concerned about it for a different reason, the same reason that I am concerned about the money market mutuals. It's a highly inefficient way of resolving these problems; it's a waste. If we hadn't had Regulation Q, there would have been no reason for money market mutuals to arise. A lot of resources, a lot of entrepreneurial capacity, was devoted to developing money market mutuals. We've got a lot of entrepreneurial ability and intelligence in this country. The more of it that is devoted to finding ways around governmental regulations and controls, the less of it is available for the really effective purpose of promoting the well-being of the country, of improving our standard of life. Of course, given those government regulations, it's desirable that you have money market mutuals; it's desirable that Sears Roebuck and so on go into financial activities. But that's only desirable because we did some foolish things that wasted our resources, and it's the waste of resources I'm worried about, not the competition.

Question: Are you rejecting the argument that the Japanese government with its different economic system is in any way influencing the dollar/yen relationship?

Friedman: Not at all. Of course it is, but two wrongs don't make a right. If the Japanese have all sorts of restrictions on imports from us, that's wrong and against the interests of most Japanese. When I went to Japan a year or two ago, I saw the most wonderful phenomenon when I got off the airplane. Getting off the first-class section along with me were high-powered Japanese executives and government officials. What do you suppose they were carrying off the plane with them? Little packages of frozen meat. That's an incredible way to export meat from the United States to Japan, on first-class passage. It's absurd, and there's no doubt that the Japanese by their restrictions on imports harm themselves and harm us. But if we in return impose restrictions on them, we are just making the harm to them greater and the harm to us greater. President Reagan has been using a marvelous image. If you are in a boat with a group of people and one of them shoots a hole in the boat, is the way to help yourself to shoot another hole? That's what we do when we impose restrictions in response to Japan's restrictions. If we believe that by imposing retaliatory restrictions, we're going to induce Japan to get rid of its restrictions, we're flying in the face of all experience that I know about. All such attempts have ended with both sides' increasing their restrictions.

Question: Can you make us feel a little better about the federal deficit?

Friedman: Sure, I'll be glad to do that. The federal deficit is not a problem. The problem is government spending. If federal government spending today were the same fraction of the national income as in 1979, the deficit would be only one-third its present size. The deficit has been produced primarily by an increase in federal spending. I'm not in favor of deficits. Deficits are bad things for political, not economic reasons.

From an economic point of view, a deficit is a form of taxation. The real cost to the American people of the federal government is what the federal government spends. If the federal government spends \$800 billion dollars and takes in \$600 billion, who do you suppose pays the other \$200 billion? Is there some kind of a Santa Claus that is going to pay for it? We pay for it. The only difference between that \$200 billion and the \$600 billion is that the taxes are hidden either in the form of inflation or in the form of wealth tax that is implicit in borrowing. From an economic point of view, there is little to choose between a deficit and other forms of taxation.

From a political point of view, deficits are terrible because they encourage the irresponsible growth of government. They make it possible for legislators to vote for spending, which their constituents regard as a good thing, without having to vote for the taxes to pay for them. That's why deficits are bad in my opinion.

The crucial problem, however, is government spending. Federal spending is now something like 25 percent of national income. At that level it is absorbing a fraction of our resources larger than I think the people want. How can we stop that increase in spending? You are not going to stop it by electing the right people to congress. When the right people get to congress, they're going to do the wrong things. And they're going to do the wrong things because you and I tell them to do the wrong things. Let's not blame them. You think you don't tell them to do the wrong things, but when a program comes up that you have a special interest in, you sure do. I've gone around with a lantern for many years looking for a person without a special interest. I never have found him. We all are special interests, you and me and all of us.

Question: Could you elaborate on President Reagan's insistence on the \$8.4 billion dollars for the IMF? I had always interpreted him as a free market economist, if not a supply-side economist. Now is that a political decision, or is it an economic decision? It seems to go in the face of what his monetary philosophy has been in the past.

Friedman: You are quite right on the \$8.4 billion. My interpretation of it is that it is primarily because of his concern about international political relationships rather than because of domestic monetary considerations. To begin with, some years back, before the international debt had risen as much as it has now, the U.S. Treasury was strongly opposed to any increase in the quota for the IMF. Other countries around the world were trying to pressure us into a substantial increase. You may recall at the meetings in Ottawa a couple years ago that that was the position President Reagan took at the time. I think what's happened now is that one way or the other the initial increase proposed by some of the other countries was very much larger. You get yourself into a situation where a group of people sit around a table and it's very hard to be a loner who keeps on saying zero, zero, zero. So you finally end up compromising, and you feel you ended up with a pretty good deal because it's only 8.4 instead of 21.4. Once you have made an agreement with other countries, you get yourself locked into a commitment, so you feel that if now the United States backs off and doesn't go through with that 8.4, we're going to be regarded as welshing on our commitments to other countries. At the moment I can sympathize with this, because in view of the problem about the deployment of the missiles in Europe, which is very high on everybody's agenda, there is great unwillingness on the part of the administration to appear in any way to be anything but wholly cooperative with respect to other countries. I believe it's that consideration more than any other that is playing a role here.

Question: But the 8.4 is mainly for Third World countries that have nothing to do with the deployment of missiles.

Friedman: The purpose of the \$8.4 billion is supposedly to prevent various countries from defaulting on loans, many of which are to banks outside the United States. So you have two forces impinging on the administration: one is the force of international politics and the other is the pressure of the American banking community. I say the American banking community, but I should qualify that. At the American Bankers Association's annual meeting, every speaker who preceded me came out strongly in favor of the \$8.4 billion. When I got up, I thought I was going to be booed when I came out against it. I was surprised to get a very warm reception. The explanation is very simple: there are 13,000 American banks but perhaps only 400 or 500 or 600 of them are involved in any way in foreign lending. The small banks would like nothing better than for the big banks to get into trouble. So I was cheered by all the small bankers, and the other people were cheered by all the big bankers. I believe that it was political pressure from the banking community that was the internal pressure and the pressure from our allies abroad that was the external pressure.

Question: You said that the answer to the problem of federal spending probably was not electing the right people to congress. Would you elaborate on that?

Friedman: I think there is only one answer, and that is a constitutional amendment to balance the budget and limit spending. That amendment passed by a two-thirds vote in the Senate last year, but only by a majority vote in the House. Thirty-two states now—Missouri was the last one just a few months ago—have passed legislation asking Congress to call a constitutional convention to propose such an amendment. When and if a thirty-third state passes such a request, I think Congress will vote out the amendment because it doesn't want to take a chance on having a constitutional convention. California, I may say, has a possibility of being that thirty-third state. The National Tax Limitation Committee, with which I'm associated, has started an initiative drive in the state of California to try to get an initiative on the ballot instructing the legislature to pass a call for such a convention. There are two or three other states around the country in which one house or the other has passed such a measure. So I am very optimistic that sometime within the next couple of years we will get a constitutional amendment. It's not a panacea, you can't solve everything by a constitutional amendment, but I think it would be the most effective single measure we could take. A second measure would be another constitutional amendment to give the president a line-item veto. Those two amendments together would go a long way toward enabling us to get spending under control. Without them I don't think we will.

10/4/12