

“Interview: Friedman on the Surplus”\*

Milton Friedman interviewed by Peter Robinson

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**ROBINSON:** *From 1962 all the way through 1997 the federal budget ran a deficit. Then in 1998 the federal budget went into surplus. This year, according to the latest budget forecasts, the surplus could top \$280 billion. What changed?*

**FRIEDMAN:** The circumstances were different. In the first place you had a tremendous economic boom going on in the 1990s, which was raising incomes. And we have a tax system under which a 10 percent rise in income yields more than a 10 percent increase in taxes. People are shifted into higher brackets, so that without passing a law the taxes go up more than proportionately to income. So receipts went up as a result of the very rapid economic expansion.

But second of all, we had gridlock. We had a Democratic president, a Republican House and Senate. If we had had an all-Democratic House and Senate we would not have a surplus now. It would have been spent. If we had had an all-Republican House, Senate, and White House, it would either have been spent or it would have been returned in lower taxes. But because we had the divided government—we had gridlock—the money was not spent. That’s the only reason we have a surplus.

**ROBINSON:** *So this is temporary? An anomaly that arises from a very good economy with money gushing in while the principal actors in Washington are unable to agree on what to do with it?*

**FRIEDMAN:** Exactly. And it will not last once we have—as we do now—a Republican president, a Republican House, and a Republican Senate.

**ROBINSON:** *Let’s cast the rest of this interview as advice to George W. Bush. You’ve got this surplus—what do you do with it? Three things can be done: (1) the surplus could be used to increase government spending programs, (2) it could be used to pay down the public debt, or (3) it could be sent back to the American people in the form of a tax cut.*

*Here’s the case, as I understand it, for spending the surplus: The country needs productive capital. Higher government spending on research and infrastructure, many argue, is a good way of increasing our stock of productive capital. So? Why don’t we just spend the surplus?*

**FRIEDMAN:** Well, carry that logic on and you’re saying that having the government take over the whole economy would be a good way of increasing productivity. That’s an argument for socialism. We have quasi-socialism now, where the economy is 50 percent socialist. If you take—

**ROBINSON:** *Fifty percent socialist? You don’t mean the government already owns the means of production?*

**FRIEDMAN:** Yes, of course I do. What does ownership of the means of production mean? It means you're entitled to the proceeds of the income that they generate.

Take a look at federal, state, and local spending. It amounts to 40 percent of the national income. Then add in all the mandates that government imposes on private spending—for instance, when the government insists that you have antipollution devices on your car—that might as well be on the budget. If you add those costs, plus all the regulations and restrictions on enterprises, that accounts for about another 10 percent. So about 50 percent of the output of the country is controlled by the government, which is equivalent to saying that the government owns 50 percent of the means of production.

I think that with all these issues you have to distinguish the economics of the subject from the politics of the subject. On truly economic grounds, government spending is adverse to productivity, not favorable to productivity.

**ROBINSON:** *All right, but let me quote economist Barry Bluestone. He makes an argument one hears a great deal. "It was the federal government investment that led to the Internet. The latest theoretical breakthroughs and computer miniaturization are going on in university and private labs, but almost all the funding has come from the Pentagon."*

**FRIEDMAN:** There's no doubt that the Pentagon funding has led to research, but you don't know what would have been done with that money if the government hadn't been spending it.

To judge the efficacy of government spending, we have to look at a much broader range. How is it that a place like Hong Kong can have nearly the same average income per person as the United States? Surely it's not because of Hong Kong's plethora of resources? No, it's because government spending in Hong Kong has been about 10 or 15 percent of the national income. Now, under the new regime in Hong Kong, it's starting to go up. And Hong Kong is going to lose its vaunted productivity. It's the disparity in government spending between the United States and Hong Kong that explains how little Hong Kong can match the big United States in standards of living and growth.

If you take it further, we've seen a society in which 100 percent of the spending was by the government. It was the Soviet Union, which was hardly an advertisement for government spending as a road to productivity.

**ROBINSON:** *What is it that is less productive about government spending? When money is spent through the political mechanism, why is that inherently inferior?*

**FRIEDMAN:** Because nobody spends somebody else's money as carefully as he spends his own. That's a fundamental principle. All government spending is spending somebody else's money. It's Ms. A taking money from Mr. B to give to Mr. C.

Going back to the main question, that's why I do not think government spending is the answer. On the contrary, I think government spending is much too high now from an economic point of view. The argument for having the government spend the surplus is purely a political argument.

**ROBINSON:** *What about option two, using the surplus to pay off the national debt?*

**FRIEDMAN:** From a purely economic point of view that makes a great deal of sense. If it were feasible to take the whole surplus and use it to pay down the debt, I might well be in favor of it. The argument against doing that is political. Even if politicians say they are going to pay down the debt, the political pressures to spend it will be so strong that they will in fact spend it.

**ROBINSON:** *But let's pause for a moment on the economic arguments here. Purely as an economic matter, would you rather pay down the debt than return the money in the form of tax cuts? That's the distinction between investment and consumption, is it not?*

**FRIEDMAN:** Yes. But I personally would rather it go back in the form of lower taxes.

The argument that people will make for paying back the debt is that, if you pay it back, the money will go to people who will invest it. The sellers of government securities will want to replace them with other assets, which will mean investment.

**ROBINSON:** *Another quotation from a famous economist, in this case, Robert Solow. "Reduction of the public debt will make more capital available to private business. Most of the funds previously tied up in Treasuries [government bonds] will add to the demand for corporate securities. Interest rates will fall some, and equity prices may rise. Some potentially productive investments that had been held back by the old, slightly higher, level of interest rates will now be more valuable. Some businesses will take advantage of lower interest rates to finance productive investments that would not otherwise have been profitable." The business sector invests. The economy expands. That, according to Solow, is the thing to do. But even in principle you're not in favor of that, are you?*

**FRIEDMAN:** Solow's argument is a valid argument. But here's the question: Is it appropriate for the government to decide how much of the public's money should be devoted to investment and how much should be devoted to consumption? Isn't that something for you to decide and for me to decide? Is that a proper national objective? I think not. I think that the total amount of investment ought to be the amount that individuals—you, me, and everybody else—want to use for that purpose.

**ROBINSON:** *So you're making a moral argument that it's simply no business of the government's because it is no business of the government's.*

**FRIEDMAN:** Absolutely.

**ROBINSON:** *Now, the political argument that you are making—you say that you'd be open to paying down the debt if it were politically feasible.*

**FRIEDMAN:** But it's not politically feasible. The pressures on Congress mean that it will be spent. Look at what's been happening to the surplus so far. Congress has been getting rid of it as fast as it could—and under very difficult circumstances, because divided government up to now has meant that it's been hard to get agreement on what to do. Even so, it has been able to put through a lot of government spending. History shows that over a long period of time government will spend whatever the tax system raises plus as much more as it can get away with. That's why we've had universal deficits.

**ROBINSON:** *You've made the point that special interests, those lobbying Washington, will receive a specific and concrete benefit from government spending and that therefore it's worthwhile to them to spend resources to lobby to get it.*

**FRIEDMAN:** Yes, but I think it goes much more directly to the interest of the legislators themselves. They are trying to get reelected. They are trying to buy votes. And how can they buy votes? The most efficient and effective way of buying votes has always been to spend—that is, to buy votes with the voters' money.

**ROBINSON:** *In that case, let me ask you a historical question. Our form of government was set up over 200 years ago, and yet right up through the middle of the last century, the share of federal government spending remained small relative to the overall economy. What happened to change it? That is to say, the fundamental institutional structures and incentives were always there. What happened?*

**FRIEDMAN:** What happened was the Great Depression, which changed people's views. Before the Great Depression, the general public vision was that the government was a necessary evil and that you should rely on the private market. The Great Depression was wrongly attributed—in my opinion, it was produced by government mismanagement—to a failure of the capitalist system, and public attitudes changed drastically as a result. From regarding the government as a necessary evil the public came to regard the government as the answer to all problems, which set in motion, beginning with FDR's New Deal, a process under which government has been growing incrementally from then on.

**ROBINSON:** *Even under Ronald Reagan, government spending went up.*

**FRIEDMAN:** Government spending went up. But not as rapidly as under others. In the last few years of his tenure, I think from 1985 on, government spending as a fraction of national income went down.

**ROBINSON:** *So he managed that much. But that's a relatively modest accomplishment.*

**FRIEDMAN:** Right.

**ROBINSON:** *So let me ask you this, how do we claw our way back to a public view of government as a necessary evil? How can we reconstruct that public frame of mind?*

**FRIEDMAN:** Well, I think we're doing a good job of reconstructing that frame of mind because the public at large is getting fed up with the failures of government. You see that most clearly and explicitly in the field of education, where the failures and deficiencies of our government educational system have aroused the public a great deal. But you see it in other areas as well. All polls show the public at large used to think that government was a good thing. Now it doesn't.

**ROBINSON:** *There's a notion bandied about in the press that the public's anger with government is a response to negative campaign advertising or to divisiveness in Washington. You argue that what they're really reacting to is the way government behaves when it gets its hands on 50 percent of the economy?*

**FRIEDMAN:** That's right.

**ROBINSON:** *Now, the third option for handling the surplus: tax cuts. You favor that above all?*

**FRIEDMAN:** I favor it on economic grounds because it enables the ultimate consumer—the ultimate individual, you and me—to decide how the money should be used. You know, it makes no sense for me to send my money to Washington to have somebody in Washington decide how to use it. I'd rather decide how to use it myself—whether for charity or for welfare or for other purposes. So that's the first and most important argument. But the political argument for it is that it's the only way to keep Congress from spending it.

**ROBINSON:** *Only if Congress doesn't have the money can it be prevented from spending it?*

**FRIEDMAN:** Right. That's why for a long time now I have been in favor of any tax cut, under any circumstances, in any way, in any form whatsoever.

**ROBINSON:** *On any pretext.*

**FRIEDMAN:** On any pretext because that's the only way to keep down government spending.

**ROBINSON:** *Here's the argument some economists make against a tax cut. Again, quoting Robert Solow: "Tax reduction, especially income tax reduction, fattens the disposable income of households. Most of it flows into consumption; only a small fraction is saved. The choice between debt reduction and tax reduction as ways of disposing of a budget surplus is mainly a choice between adding to investment and adding to consumption, between provision for the future and enjoyment today." So, according to this argument, you cut taxes and all you're going to do is enable the American people to go on a brief, giddy spree.*

**FRIEDMAN:** It will enable the American people to do what the American people want to do, not what Bob Solow thinks they ought to do.

**ROBINSON:** *But you're making a moral argument, not an economic argument.*

**FRIEDMAN:** Yes, that's a moral argument, absolutely. Are there any other arguments? Fundamentally doesn't it all come down to moral arguments? What's an *amoral* argument?

**ROBINSON:** *President George W. Bush has just heard it from Milton Friedman: cut taxes any way you can. But here's what George Bush has proposed: 50 percent of the surplus will go to Social Security and Medicare, 25 percent will go to new spending programs, and only the remaining 25 percent will go to tax cuts. Is that enough tax cutting for you?*

**FRIEDMAN:** No. It ought to be at least 50 percent, with the 25 percent in there for new programs being cut. We don't need new programs. We need fewer programs. You know, I wish there were some way in which no law could be passed without repealing an old law.

**ROBINSON:** *You mean that Congress could only have, say, 400 laws—and if it wanted to pass a new one it would have to subtract an old one? Not a bad idea.*

**FRIEDMAN:** My other favorite position along that line is that no law should be allowed that is longer than the Constitution of the United States. So you wouldn't have these 900-page laws that have hidden items that nobody knows about and that make it impossible for a president to keep tabs on.

**ROBINSON:** *Lately we have been hearing from Washington, D.C., that because the economy is slowing the Bush administration may accelerate its tax cut as a way of getting the economy pumped up and rolling along again. The economist Paul Krugman wrote an article in the New York Times in which he called this suggestion "a crude, Keynesian view of economic policy." And he continued, "If Milton Friedman weren't still alive, he'd be spinning in his grave." What do you make of that?*

**FRIEDMAN:** He's right.

**ROBINSON:** *He's right?*

**FRIEDMAN:** Absolutely.

**ROBINSON:** *But you just told us you'd cut taxes at any time, under any pretext.*

**FRIEDMAN:** Of course, I know, but the reason for cutting taxes is not to stimulate the economy. I was just as much in favor of cutting taxes a year or two years ago when the economy was booming. I don't believe that the Keynesian remedies are valid. Now it's an interesting thing, Bob Solow is a Keynesian, but he was against reducing taxes before. I wonder whether he would now be in favor of reducing taxes with the economy slowing. I doubt it.

**ROBINSON:** *So Bush is wrong? Cutting taxes would not stimulate the economy?*

**FRIEDMAN:** No, it would not stimulate the economy. Look, if you want—I can give you a long theoretical argument as to the problem—but let me just turn to one dominant fact: you have Japan, which has been in a kind of rolling recession for 10 years. In that period it's had either 4 or 5 major fiscal stimuli programs.

**ROBINSON:** *That is to say, increases in government spending?*

**FRIEDMAN:** Increases in government spending and reductions in government taxes. They've been an utter failure, they haven't had any affect on the economy whatsoever.

**ROBINSON:** *But why?*

**FRIEDMAN:** Because if the government spends more or less, somebody else has less or more to spend. There's an offsetting element unless the government spending is financed by printing money. What really matters is what happens to monetary policy. Monetary policy goes one way and fiscal policy goes the other way. If you look at all such examples, monetary policy has always dominated—not fiscal policy. If you reduce taxes then people have more to spend, but on the other hand, government has less to spend. Why is there any net increase in total spending?

**ROBINSON:** *So there's no net change in total spending, but, on the contrary, as you've just instructed us, the people's money will be spent more wisely, more productively, and everybody's better off?*

**FRIEDMAN:** Right. I'm in favor of the tax cut but not because we could be in a recession.

**ROBINSON:** *Your argument for accelerating the tax cut would be simply that the surplus is coming faster than originally forecast?*

**FRIEDMAN:** That's right, exactly.

**ROBINSON:** *Now that you've disposed of the surplus, let's spend the remaining few moments tidying up the economy of the United States. You've just said that the old notion of a Keynesian fiscal stimulus—cutting taxes to stimulate the economy, or boosting government spending to stimulate the economy—doesn't work. What does work? What should George W. Bush do?*

**FRIEDMAN:** Sit there. Let me give you a comparable case. In 1980–81 we were in a situation where inflation was running in the double digits. In the five months before the election the Federal Reserve was very stimulative. It was pumping money in like mad. There was a more rapid increase in the quantity of money in that five-month period than at any other comparable five-month period since the end of World War II.

Then, the month after the election, the money growth slowed and went down very sharply and the economy went into a recession. What did Ronald Reagan do? In my opinion no other president in the postwar period would have stood by or sat there, but Ronald Reagan sat there and supported Paul Volcker in his measures. It brought an end to the inflation. It started us on our path of lower and lower inflation—of disinflation. The advice that everybody was giving to Reagan at that time was that he should step in and stop that recession from growing. If he had done that we would now still be having inflation in double digits.

As for today, if the president just sits still—if he just waits a while—it's not going to be a major recession. It'll be a minor recession, if there is a recession. And we still don't know whether we're even going to have a recession. And I might tell you that economists have a very poor track record in predicting recessions. So we may not have a recession, but if we do it will be like most postwar recessions, relatively mild. It will last less than a year or a little more than a year—and then the economy will turn around and start going up again.

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## Notes

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